Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

Stock Update

Petronet LNG

Robust Q3 re-enforces confidence on earnings visibility

Oil & Gas	Sharekhan code: PETRONET
Reco/View: Buy ↔	CMP: Rs. 220
	Price Target: Rs. 285 ↔

↑ Upgrade ↔ Maintain ↓ Downgrade

3R MATRIX

	+	=	-
Right Sector (RS)	✓		
Right Quality (RQ)	✓		
Right Valuation (RV)	✓		

\+ Positive = Neutral – Negative

What has changed in 3R MATRIX

	Old		New
RS		↔	
RQ		↔	
RV		↔	

ESG Disclosure Score NEW

ESG RISK RATING 25.15

Updated Jan 08, 2022

Medium Risk

NEGL	LOW	MED	HIGH	SEVERE
0-10	10-20	20-30	30-40	40+

Source: Morningstar

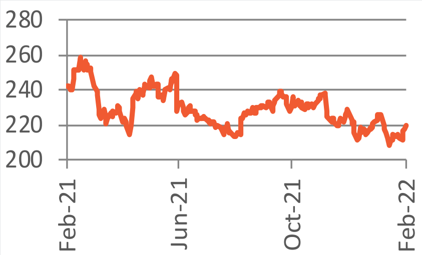
Company details

Market cap:	Rs. 32,940 cr
52-week high/low:	Rs. 261 / 207
NSE volume: (No of shares)	29.5lakh
BSE code:	532522
NSE code:	PETRONET
Free float: (No of shares)	75.0 cr

Shareholding (%)

Promoters	50.0
FII	34.1
DII	3.2
Others	12.7

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	-3	-7	3	-10
Relative to Sensex	0	-6	-6	-24

Sharekhan Research, Bloomberg

Summary

- Q3FY22 adjusted PAT of Rs. 892 crore (up 10% y-o-y) was 25% above our estimate led by higher trading margin and inventory gain which offsets weak re-gas volume of 208 tbtu (down 11% y-o-y). Reported PAT of Rs. 1,144 crore (up 30% y-o-y) has a benefit of Rs. 348 crore related to "Use or Pay charges".
- Dahej re-gas volumes declined by 11.7% y-o-y to 196 tbtu (utilization of 87.9%) and Kochi re-gas volume declined by 20% q-o-q to 12 tbtu (utilisation of 18.8%). Weak volumes were a result of elevated spot LNG prices ($25-26/mmBtu currently).
- "Use or Pay charges" of Rs. 348 crore reflect P-LNG's ability to protect earnings if customers offtake volume below contractual agreement and the same re-enforces confidence on earnings visibility for P-LNG. Dahej expansion projects on track and to be completed in next three years.
- Valuation is attractive at 9.3x/8.5x its FY23E/FY24E EPS, given earnings visibility, high RoE, and FCF/dividend yield of 9%/6%. Hence, we maintain a Buy on Petronet LNG with an unchanged PT of Rs. 285.

Petronet LNG's (P-LNG) Q3FY2022 standalone adjusted operating profit/PAT of Rs. 1,384 crore/Rs. 892 crore, up 8.1%/10% y-o-y was significantly above ours and the street estimate reflecting higher trading margin on spot volume and inventory gain of Rs. 66 crore, which offsets weak re-gas volume of 208 tbtu (down 11% y-o-y). We have adjusted reported operating profit/PAT of Rs. 1,732 crore/Rs. 1,144 crore for Rs. 348 crore related to "Use or Pay charges" booked by P-LNG on lower capacity utilisation by the customers and Rs. 11 crore on negative impact of the IND-AS. Although earnings beat our estimate, but operational performance was weak with decline in Dahej re-gas volumes by 11.7% y-o-y to 196 tbtu (utilization of 87.9% missed our estimate of 94.1%) and 20% q-o-q decline in Kochi re-gas volumes was to 12 tbtu (utilization of 18.8% missed our estimate of 29.8%).

Key positives

- "Use or Pay charges" of Rs. 348 crore reflects P-LNG's ability to protect earnings if customers offtake volume below contractual agreement.
- Dahej re-gas tariff increased by 5% from January 2022.

Key negatives

- Lower-than-expected re-gas volume of 208 tbtu, down 11% y-o-y.

Management Commentary

- **Use or Pay charges:** Out of the "Use or Pay charges" of Rs. 348 crore, P-LNG has received only Rs. 15 crore and Rs. 332 crore is yet to received. "Use or Pay charges" are part of contractual agreements and in case of request by offtakers P-LNG could look into giving concessions for only Q1, amid the pandemic.
- **Re-gas tariff hike:** Increased Dahej tariff by 5% from Jan'22 and Kochi tariff revision in due on 1st April'22. Decision on lower Kochi tariff expected in Q4FY22 and P-LNG does not expect much reductionin Kochi tariff. .
- **Dahej terminal project updates:** Two storage tanks (at a capex of Rs. 1245 crore), a jetty (capex of Rs. 1650 crore) and capacity expansion to 22.5mtpa in two phases (phase-1 capex of Rs. 250 crore and phase 2 capex of Rs. 700-800 crore). All project to be completed in next three years.
- **Petchem project** evaluation undergoing for setting-up polymer plant (capacity of 1250kt) and would take a decision only if the returns are good.
- **Other updates:** 1) In discussion with RasGas to extend long-term LNG supply contract beyond 2028, 2) Appointed consultant for feasibility study on East coast FSRU terminal (estimated of Rs. 1,600 crore for a 4-mtpa capacity) and 3) FY23 capex plan of Rs. 1400-1500 crore.

Revision in estimates – We maintain our FY22-24 earnings estimates.

Our Call

Valuation – Maintain Buy with an unchanged PT of Rs. 285: P-LNG has earnings growth visibility (expect a 9% PAT CAGR over FY21-FY24E), superior RoE/RoCE of ~27% among gas utilities, and high FCF yield of ~8-9%. Valuation of 9.3x/8.5x its FY23E/FY24E EPS is attractive (as it is at a steep 29% discount to its historical average one-year forward PE multiple of 13x), considering earnings visibility and de-risked business model. Hence, we maintain Buy on P-LNG with an unchanged PT of Rs. 285.

Key Risks

Lower-than-expected re-gas volumes at Dahej terminal in case of any weakness in LNG demand amid COVID-19, spike in LNG price, and any further delay in the ramp-up of utilisation rate at Kochi terminal due to pipeline connectivity issues.

Valuation (Standalone)

Rs cr

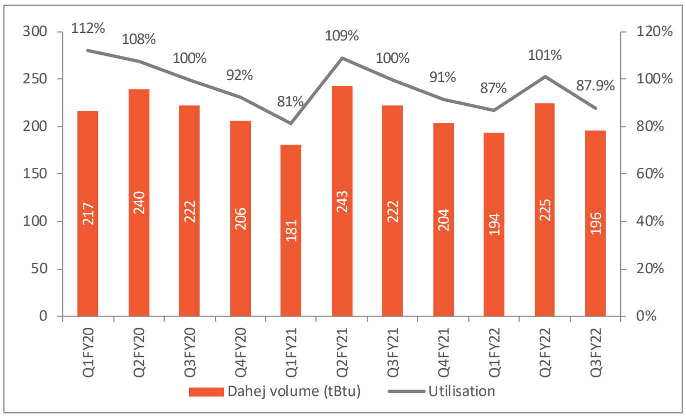
Particulars	FY21	FY22E	FY23E	FY24E
Revenue	26,023	40,855	44,550	46,627
OPM (%)	18.1	11.6	12.2	12.5
Adjusted PAT	2,938	3,048	3,555	3,853
% YoY growth	3.0	3.7	16.6	8.4
Adjusted EPS (Rs.)	19.6	20.3	23.7	25.7
P/E (x)	11.2	10.8	9.3	8.5
P/B (x)	2.8	2.7	2.3	1.9
EV/EBITDA (x)	5.8	5.6	4.5	4.0
RoNW (%)	26.0	25.6	26.6	24.5
RoCE (%)	26.0	25.4	27.1	25.9

Source: Company; Sharekhan estimates

Q3FY22 PAT above estimate on higher trading margin and inventory gain

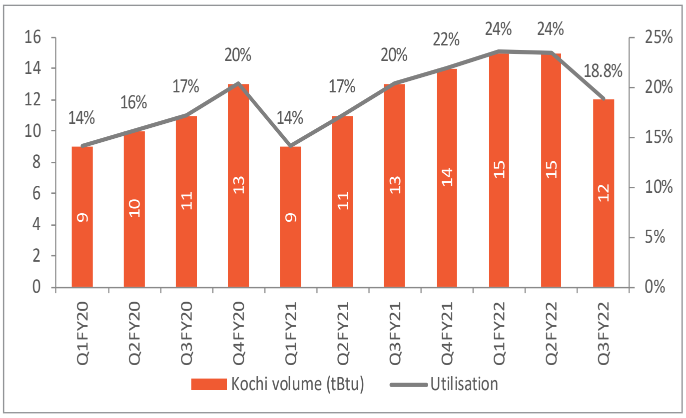
Q3FY2022 standalone adjusted operating profit/PAT of Rs. 1,384 crore/Rs. 892 crore, up 8.1%/10% y-o-y was significantly above ours and the street estimate reflecting higher trading margin on spot volume and inventory gain of Rs. 66 crore, which offsets weak re-gas volume of 208 tbtu (down 11% y-o-y). We have adjusted reported operating profit/PAT of Rs. 1,732 crore/Rs. 1,144 crore for Rs. 348 crore related to “Use or Pay charges” booked my P-LNG on lower capacity utilisation by the customers and Rs. 11 crore on negative impact of the IND-AS adjustment at PBT level. Although earnings beat our estimate, but operational performance was weak with decline in Dahej re-gas volumes by 11.7% y-o-y to 196 tbtu (utilization of 87.9% missed our estimate of 94.1%) and 20% q-o-q decline in Kochi re-gas volumes was to 12 tbtu (utilization of 18.8% missed our estimate of 29.8%).

Dahej terminal volume and utilisation



Source: Company, Sharekhan Research

Kochi terminal volume and utilisation trend



Source: Company, Sharekhan Research

Results (standalone) Rs cr

Particulars	Q3FY22	Q3FY21	YoY (%)	Q2FY22	QoQ (%)
Revenue	**12,597**	**7,328**	**71.9**	**10,813**	**16.5**
Total Expenditure	10,865	5,993	81.3	9,516	14.2
Reported operating profit	**1,732**	**1,335**	**29.7**	**1,297**	**33.6**
Adjusted operating profit	**1,384**	**1,280**	**8.1**	**1,362**	**1.7**
Other Income	72	111	-35.3	82	-12.0
Interest	78	82	-4.8	79	-2.4
Depreciation	194	192	0.6	194	0.0
Reported PBT	**1,533**	**1,172**	**30.7**	**1,105**	**38.7**
Exceptional income/(expense)	337	90	NA	-79	NA
Adjusted PBT	**1,196**	**1,082**	**10.5**	**1,184**	**1.0**
Tax	389	294	32.5	282	37.8
Reported PAT	**1,144**	**878**	**30.2**	**823**	**38.9**
Adjusted PAT	**892**	**811**	**10.0**	**882**	**1.2**
Equity Cap (cr)	150	150		150	
Reported EPS (Rs.)	7.6	5.9	30.2	5.5	38.9
Adjusted EPS	5.9	5.4	10.0	5.9	1.2
Margins (%)			**BPS**		**BPS**
Adjusted OPM	11.0	17.5	-648	12.6	-160
Effective tax rate	25.4	25.1	33	25.6	-15
NPM	7.1	11.1	-398	8.2	-107

Source: Company; Sharekhan Research

Operating performance

Particulars	Q3FY22	Q3FY21	YoY (%)	Q2FY22	QoQ (%)
Capacity utilisation – Dahej (%)	87.9	99.5	-1166	100.9	-1300
Capacity utilisation – Kochi (%)	18.8	17.3	157	23.5	-471
Total volume (TBTU)	**208.0**	**233.0**	**-10.7**	**240.0**	**-13.3**
Long term volume – Dahej	117.0	113.0	3.5	102.0	14.7
Tolling volume – Dahej	76.0	104.0	-26.9	117.0	-35.0
Spot volume – Dahej	3.0	5.0	-40.0	6.0	-50.0
Total Dahej volume (TBTU)	**196.0**	**222.0**	**-11.7**	**225.0**	**-12.9**
Long term volume - Kochi	12.0	8.0	50.0	14.0	-14.3
Tolling volume – Kochi	0.0	0.0	NA	0.0	NA
Spot volume – Kochi	0.0	3.0	NA	1.0	NA
Total Kochi volume (TBTU)	**12.0**	**11.0**	**9.1**	**15.0**	**-20.0**

Source: Company; Sharekhan Research

Outlook and Valuation

■ Sector outlook – Regulatory push to drive India's gas consumption

We expect strong long-term volume growth opportunity for gas utilities (such as P-LNG) supported by robust gas demand outlook led by: 1) higher demand from CGD, and fertiliser sectors, 2) regulatory push to switch to gas from polluting industrial/auto fuels and 3) the government's aim to increase the share of gas in India's overall energy mix to 15% by 2030. Hence, we believe that the long-term LNG demand outlook for India remains intact.

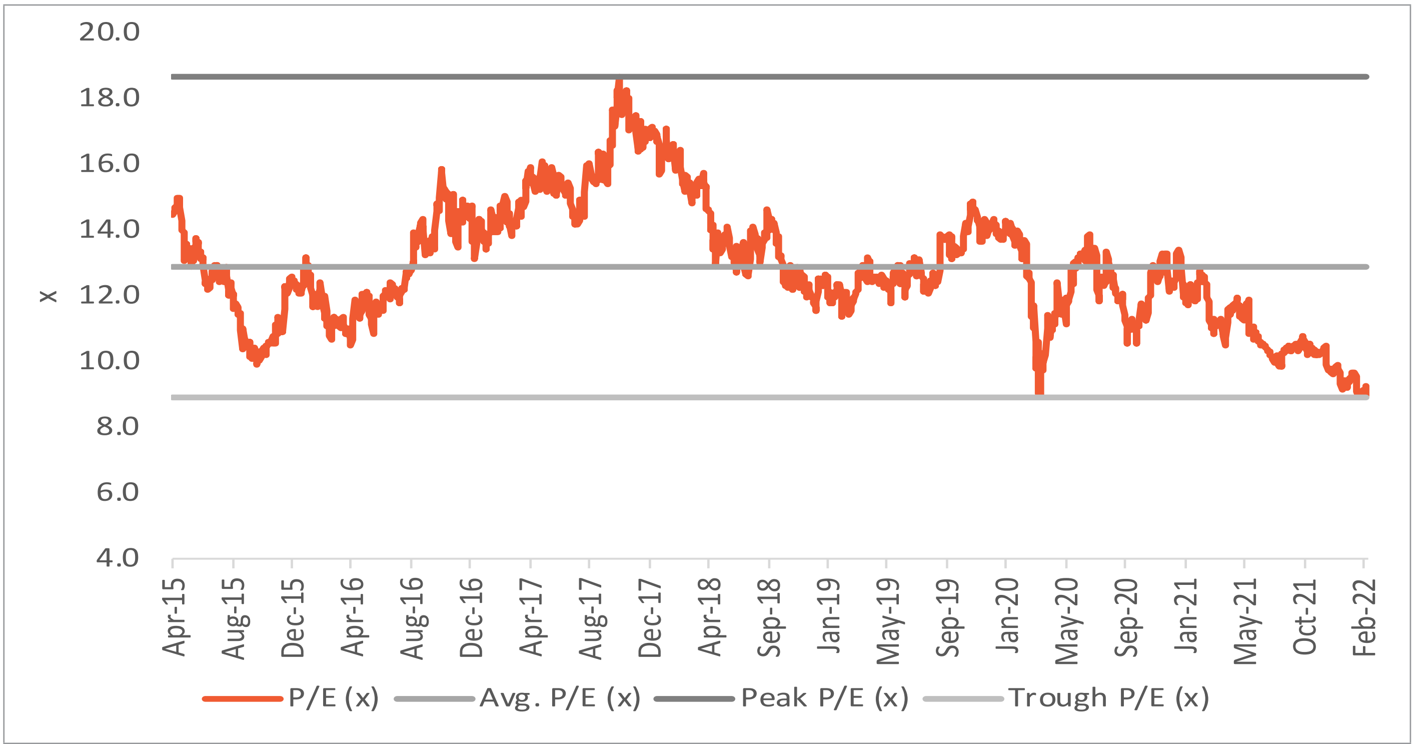
■ Company outlook – Volume recovery and re-gas tariff hike to drive earnings growth

Long term LNG demand story remains intact, and P-LNG would benefit from further capacity expansions at the Dahej terminal to 22.5 mtpa in the next 3-4 years. This coupled with a gradual ramp-up in Kochi terminal utilisation would aid volume growth. We expect P-LNG's re-gas volume to clock a 4% CAGR over FY2021-FY2024E and the company would be able to undertake a 5% annual re-gas tariff hike for its Dahej terminal. We thus expect 9% PAT CAGR over FY2021-FY2024E.

■ Valuation – Maintain Buy on P-LNG with an unchanged PT of Rs. 285

P-LNG has earnings growth visibility (expect a 9% PAT CAGR over FY21-FY24E), superior RoE/RoCE of ~27% among gas utilities, and high FCF yield of ~8-9%. Valuation of 9.3x/8.5x its FY23E/FY24E EPS is attractive (as it is at a steep 29% discount to its historical average one-year forward PE multiple of 13x), considering earnings visibility and de-risked business model. Hence, we maintain Buy on P-LNG with an unchanged PT of Rs. 285.

One-year forward P/E (x) band



Source: Sharekhan Research

About the company

P-LNG was incorporated in April 1998. P-LNG imports, re-gasifies, and markets liquefied natural gas (LNG) in India. The company owns and operates India's largest LNG terminal with a capacity of 17.5 mmt at Dahej (Gujarat) and 5 mmt at Kochi (Kerala). The company plans to further increase Dahej LNG terminal capacity to 22.5 mmt in the next 3-4 years. The company operates on a simple business model of charging re-gas margins on LNG volumes imported (both long-term and spot) through its terminals. The company earns additional marketing margins on spot volumes. The company's business is de-risked through back-to-back offtake contracts with customers.

Investment theme

The sharp recovery in re-gas volume at Dahej terminal provides earnings visibility in the current uncertain times. The company's plan to expand Dahej terminal's capacity to 22.5 mmt over the next 3-4 year and ramp-up of utilisation rate for Kochi terminal would drive volume growth. Moreover, P-LNG would be able to take 5% re-gas tariff escalation for its Dahej terminal on a regular basis as it enjoys a competitive edge as compared to other LNG import terminals given its low re-gas tariff and long-term contracted volume with a 'use or pay' clause. P-LNG's valuation is also attractive with strong RoE of 27%, FCF yield of 9%, and dividend yield of 5%.

Key Risks

- Lower-than-expected re-gas volumes at the Dahej terminal in case of weak LNG demand amid COVID-19.
- Any further delay in the ramp-up of utilisation rate at the Kochi terminal due to pipeline connectivity issues.
- Non-revision of re-gas tariffs on a yearly basis.

Additional Data

Key management personnel

Tarun Kapoor	Chairman
Akshay Kumar Singh	Managing Director & CEO
VK Mishra	Director - Finance

Source: Company Website

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	FMR LLC	5.7
2	Republic of Singapore	3.8
3	BlackRock Inc	2.3
4	Kotak Mahindra Asset Management Co. Ltd/India	2.2
5	Fidelity Investment Trust	2.2
6	T Rowe Price Group	2.0
7	Vanguard Group Inc/The	1.9
8	Capital Group Cos. Inc/The	1.4
9	BNP Paribas SA	0.9
10	Dimensional Fund Advisors LP	0.9

Source: Bloomberg

Understanding the Sharekhan 3R Matrix

Right Sector	
Positive	Strong industry fundamentals (favorable demand-supply scenario, consistent industry growth), increasing investments, higher entry barrier, and favorable government policies
Neutral	Stagnancy in the industry growth due to macro factors and lower incremental investments by Government/private companies
Negative	Unable to recover from low in the stable economic environment, adverse government policies affecting the business fundamentals and global challenges (currency headwinds and unfavorable policies implemented by global industrial institutions) and any significant increase in commodity prices affecting profitability.
Right Quality	
Positive	Sector leader, Strong management bandwidth, Strong financial track-record, Healthy Balance sheet/cash flows, differentiated product/service portfolio and Good corporate governance.
Neutral	Macro slowdown affecting near term growth profile, Untoward events such as natural calamities resulting in near term uncertainty, Company specific events such as factory shutdown, lack of positive triggers/events in near term, raw material price movement turning unfavourable
Negative	Weakening growth trend led by led by external/internal factors, reshuffling of key management personal, questionable corporate governance, high commodity prices/weak realisation environment resulting in margin pressure and detoriating balance sheet
Right Valuation	
Positive	Strong earnings growth expectation and improving return ratios but valuations are trading at discount to industry leaders/historical average multiples, Expansion in valuation multiple due to expected outperformance amongst its peers and Industry up-cycle with conducive business environment.
Neutral	Trading at par to historical valuations and having limited scope of expansion in valuation multiples.
Negative	Trading at premium valuations but earnings outlook are weak; Emergence of roadblocks such as corporate governance issue, adverse government policies and bleak global macro environment etc warranting for lower than historical valuation multiple.

Source: Sharekhan Research

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