Sharekhan
by BNP PARIBAS

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Stock Update

Petronet LNG

Strong Q1; volume recovery on track

Oil & Gas	Sharekhan code: PETRONET	Result Update

Summary

- Q1FY22 adjusted PAT of Rs. 675 crore (flat q-o-q) was 18% above our estimate led by better-than-expected re-gas volume of 209 tbtu (down 4.1% q-o-q and 4.5% above our estimate) and lower-than-anticipated depreciation.
- Dahej/Kochi re-gas volume of 194tbtu/15tbtu with utilisation of 87%/23.5% (better than our estimate). Dahej utilization has improved to 95% in July. Management has guided for recovery of Q1FY22 volume loss in coming quarters. Volume offtake visibility is strong as a 16.5-mtpa capacity is contracted for Dahej terminal.
- The management has changed its stance from an aggressive capex to gradual spends on LNG retailing/CBG plants. Focus remains on Dahej capacity expansion by 5 mtpa (in two phases), storage tanks and jetty with capex of Rs. 4,100 crore.
- Valuation is attractive at 9x its FY2023E EPS, given earnings visibility, high RoE, and FCF/dividend yield of 9%/7%. Hence, we maintain a Buy rating on Petronet LNG with an unchanged PT of Rs. 285.

Petronet LNG's (PLNG) Q1FY2022 operating profit of Rs. 1,054 crore (down only 3.4% q-o-q) was 8% above our estimate of Rs. 976 crore on account of 4.5% beat in re-gas sales volume at 209 tbtu (down only 4.1% q-o-q) and likely higher margin on spot LNG volumes. Dahej re-gas volume stood at 194 tbtu (down 4.9% q-o-q) with a utilisation rate of 87% (better than our estimate of 83.8%) and Kochi re-gas volume was at 15 tbtu (up 7.1% q-o-q) with a utilisation rate of 23.5% (higher than our estimate of 20.4%). PAT (adjusted for IND AS impact of Rs. 39 crore) at Rs. 675 crore (flat q-o-q) was 18% above our estimate of Rs. 573 crore led by a beat in volumes and lower-than-anticipated depreciation cost. Management indicated that utilization rate of Dahej terminal has recovered to 95% level as demand for contracted LNG remains strong given it is available at half the spot LNG price ($16/mmbtu). Focus would remain on expansion of Dahej terminal capacity to 22.5 mtpa (to 20 mtpa in Phase-I by FY2023 and to 22.5 mtpa in Phase-II by FY2024E-FY2025E) from 17.5 mtpa currently, while capex on LNG fuel stations (initial plan to set up 5 stations and has approval to set-up 24 LNG stations) and compressed bio-gas (CBG - 5 plants initially) would be gradual depending upon profitability of the same. In the absence of any significant capex (cumulative capex of Rs. 1,500-1,700 crore over FY2022E-FY2023E), PLNG may reward shareholders with higher dividend. Valuation of 9x its FY2023E EPS seems attractive (31% discount to its historical average one-year forward PE multiple of 13x), given a strong earnings visibility and FCF/dividend yield of 9%/7%. Hence, we maintain our Buy rating on PLNG with an unchanged PT of Rs. 285.

Key positives

- Better-than-expected overall re-gas volume of 209 tbtu (4.5% above our estimate) with Dahej/Kochi utilization of 87%/23.5%.

Key negatives

- Sharp 13% q-o-q decline in long term contracted volume to 89 tbtu in Q1FY2022.

Our Call

Valuation - Maintain Buy with an unchanged PT of Rs. 285: We have fine-tuned our FY2022-FY2023 earnings estimate and have also introduced our FY2024 earnings estimates in this report. A sharp volume recovery at the Dahej terminal and a gradual improvement in Kochi utilisation provides strong earnings visibility (expect a 10% earnings CAGR over FY2021-FY2023E) and a high RoE/RoCE at ~26.6%/27.2% (superior among gas utilities). Moreover, PLNG's valuation of 9x its FY2023E EPS seems attractive (as it is at a steep 31% discount to its historical average one-year forward PE multiple of 13x). The stock offers a healthy dividend yield of 7%. Hence, we maintain a Buy rating on PLNG 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	FY20	FY21	FY22E	FY23E	FY24E
Revenue	35,452	26,023	41,827	42,506	46,722
OPM (%)	11.3	18.1	12.0	12.9	12.5
Adjusted PAT	2,852	2,938	3,231	3,561	3,839
% YoY growth	24.5	3.0	10.0	10.2	7.8
Adjusted EPS (Rs.)	19.0	19.6	21.5	23.7	25.6
P/E (x)	11.3	11.0	10.0	9.0	8.4
P/B (x)	2.9	2.8	2.6	2.2	1.9
EV/EBITDA (x)	6.9	5.6	5.2	4.3	4.1
RoNW (%)	27.1	26.0	27.1	26.6	24.3
RoCE (%)	24.9	26.0	26.9	27.2	28.1

Source: Company; Sharekhan estimates

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		↔	

Reco/View	Change
Reco: **Buy**	↔
CMP: **Rs. 215**	
Price Target: **Rs. 285**	↔

↑ Upgrade ↔ Maintain ↓ Downgrade

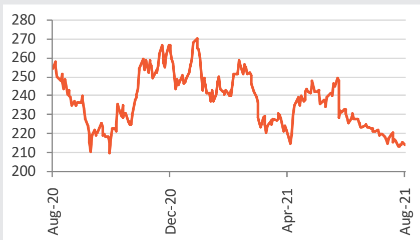
Company details

Market cap:	Rs. 32,190 cr
52-week high/low:	Rs. 275/207
NSE volume: (No of shares)	41.3 lakh
BSE code:	532522
NSE code:	PETRONET
Free float: (No of shares)	75.0 cr

Shareholding (%)

Promoters	50.0
FII	31.1
DII	5.1
Others	13.8

Price chart



Price performance

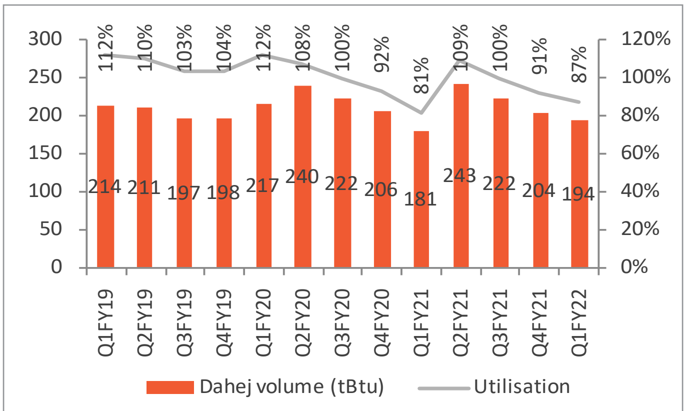
(%)	1m	3m	6m	12m
Absolute	-3	-12	-11	-16
Relative to Sensex	-9	-24	-18	-62

Sharekhan Research, Bloomberg

Q1FY22 PAT above estimate on higher volume and lower depreciation

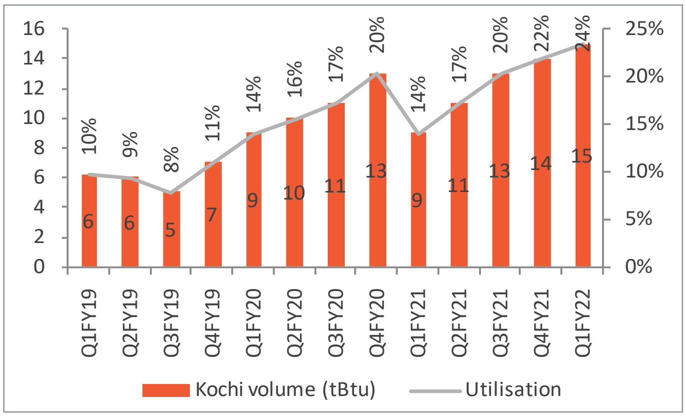
Standalone operating profit of Rs. 1,054 crore (down only 3.4% q-o-q) was 8% above our estimate of Rs. 976 crore on account of 4.5% beat in re-gas sales volume at 209 tbtu (down only 4.1% q-o-q) and likely higher margin on spot LNG volumes. Dahej re-gas volume stood at 194 tbtu (down 4.9% q-o-q) with a utilisation rate of 87% (better than our estimate of 83.8%). Kochi re-gas volume was at 15 tbtu (up 7.1% q-o-q) with a utilisation rate of 23.5% (higher than our estimate of 20.4%). PAT (adjusted for IND AS impact of Rs. 39 crore) at Rs. 675 crore (flat q-o-q) was 18% above our estimate of Rs. 573 crore led by a beat in volumes and lower-than-anticipated depreciation cost.

Dahej terminal volume and utilisation



Source: Company, Sharekhan Research

Kochi terminal volume and utilisation trend



Source: Company, Sharekhan Research

Q1FY2022 results conference call highlights

- **Dahej expansion plan –** The company is planning to invest ~Rs. 4,100 crore at Dahej terminal which includes Rs. 1240 crore for storage tanks, Rs. 1,700 crore for jetty and Rs. 1,200 crore for expansion of Dahej re-gas capacity to 22.5 mtpa from 17.5 mtpa, currently. Capacity expansion would be done in two phases, wherein in the Phase-I expansion, capacity would be expanded from 17.5 MT to 20 MT with a total investment of Rs. 200 crore and is expected to be completed by FY2023. In Phase-II, the capacity would be further expanded to 22.5MTPA for a total capital outlay of Rs. 1,000 crore and would be completed by FY2024-25.
- **LNG fuel station –** The management has indicated that they will gradually ramp up their LNG fuel stations depending upon the conversion rates to LNG trucks and buses. They have an initial plan of setting up 5 stations (out of which 4 would be with an OMC) and is targeting an IRR of 16%. Overall, the implementation would depend upon profitability. Also, the company is in talks with OMCs for collaboration and already has approvals for 24 fuel stations. The cost of setting up one LNG station is Rs. 8-10 crore.
- **Compressed bio gas (CBG) –** The company is still looking for land for the setting up of the compressed bio gas (CBG) plants. Initially, they are planning to set up only 4-5 plants depending upon the feasibility, availability of feedstock and pipeline for evacuation facility. They have a price assurance of Rs.46/kg ($11-12/mmBtu) from government of India which increases confidence for a better margin on CBG.
- **Dahej terminal volume outlook –** LNG volume has been improving with Dahej utilization level of 95% in July. Demand for long-term LNG is better given that it is available at half the price of spot LNG (at $16/mmBtu). Demand from all sectors has now bounced back to previous levels, except for power sector which is price sensitive. The company is confident that the volumes lost in Q1FY2022 would be recovered fully in the coming quarters.
- **Kochi re-gas tariff update –** Kochi re-gas tariff is at Rs. 87.2/mmBtu in Q1FY2022 versus Rs. 83.1/mmBtu in Q4FY2021 as the company has taken 5% tariff hike from April 2021. Revision in Kochi tariff would be possible only post significant ramp-up in the utilisation rate.
- **Capex plan –** The company plans to spend Rs. 500-700 crore in FY2022E and Rs. 1,000 crore in FY2023E on capital expenditure.

- **LNG terminal at East coast –** The company is assessing the gas demand potential and more clarity on capex plan would be provided at latter stage.
- Long term contract for LNG with Qatar is expiring in 2028 and by 2023 P-LNG plans extend it for another 10-15 years with a revised price terms and contractual agreement.
- The company diverted 6 tbtu of Gorgon volumes to the Dahej terminal. Re-gas income stood at ~Rs. 552 crore in Q1FY2022.

Result (standalone) Rs cr

Particulars	Q1FY22	Q1FY21	YoY (%)	Q4FY21	QoQ (%)
Revenue	**8,598**	**4,884**	**76.1**	**7,575**	**13.5**
Total Expenditure	7,544	3,974	89.8	6,484	16.3
Operating profit	**1,054**	**910**	**15.9**	**1,091**	**-3.4**
Other Income	69	68	0.2	49	39.4
Interest	80	88	-9.2	81	-1.6
Depreciation	192	194	-1.0	203	-5.5
PBT	**851**	**697**	**22.2**	**856**	**-0.6**
Exceptional income/(expense)	-53	-68	-22.1	-70	-24.3
Adjusted PBT	**904**	**765**	**18.3**	**926**	**-2.4**
Tax	216	176	22.2	233	-7.4
Reported PAT	636	520	22.2	623	2.0
Adjusted PAT	**675**	**571**	**18.3**	**674**	**0.1**
Equity Cap (cr)	150	150		150	
Reported EPS (Rs.)	4.2	3.5	22.2	4.2	2.0
Adjusted EPS	4.5	3.8	18.3	4.5	0.1
Margins (%)			**BPS**		**BPS**
OPM	12.3	18.6	-637	14.4	-214
Effective tax rate	25.3	25.3	0	27.2	-187
Adjusted NPM	7.9	11.7	-384	8.9	-105

Source: Company, Sharekhan Research

Operating performance

Particulars	Q1FY22	Q1FY21	YoY (%)	Q4FY21	QoQ (%)
Capacity utilisation – Dahej (%)	87.0	81.1	583	91.5	-448
Capacity utilisation – Kochi (%)	23.5	14.1	941	22.0	157
Total volume (TBTU)	**209.0**	**190.0**	**10.0**	**218.0**	**-4.1**
Long term volume – Dahej	89.0	78.0	14.1	102.0	-12.7
Tolling volume – Dahej	99.0	100.0	-1.0	97.0	2.1
Spot volume – Dahej	6.0	3.0	100.0	5.0	20.0
Total Dahej volume (TBTU)	**194.0**	**181.0**	**7.2**	**204.0**	**-4.9**
Long term volume - Kochi	11.0	8.0	37.5	11.0	0.0
Tolling volume – Dahej	2.0	0.0	NA	1.0	100.0
Spot volume – Dahej	2.0	1.0	100.0	2.0	0.0
Total Kochi volume (TBTU)	**15.0**	**9.0**	**66.7**	**14.0**	**7.1**

Source: Company, Sharekhan Research

Outlook and Valuation

■ Sector view - Regulatory push to drive India's gas consumption

We expect a 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 power, 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 long-term LNG demand outlook for India remains intact.

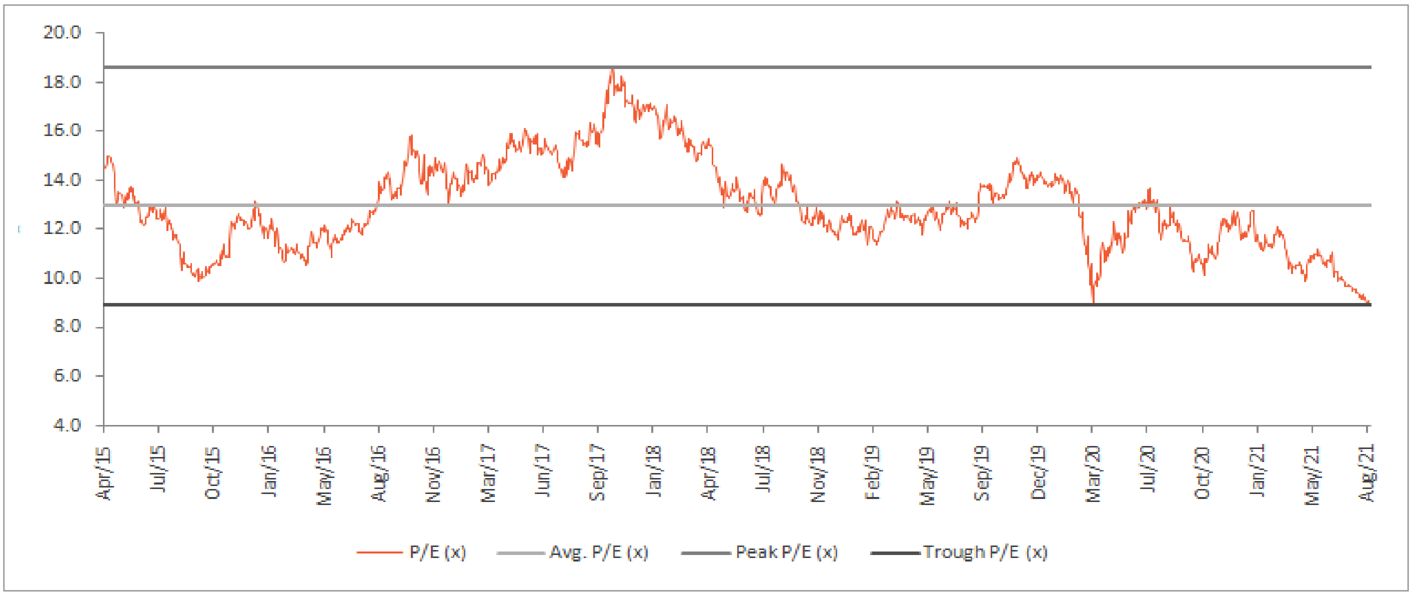
■ Company outlook - Volume recovery and re-gas tariff hike to drive earnings growth

PLNG's Dahej terminal utilisation rate has improved to 95% in July 2021 as compared to 87% in Q1FY2022 as demand for long term LNG remain strong given its steep discount to spot LNG price and thus management is confident to make up for volume loss in Q1FY2022. Moreover, long term LNG demand story remains intact and PLNG could benefit from further capacity expansion at its Dahej terminal to 22.5mtpa in the next 3-4 years. This coupled with gradual ramp-up in Kochi terminal utilisation would aid volume growth. We expect P-LNG's re-gas volume to grow at 5% CAGR over FY2021-FY2023E and the company would be able to undertake a 5% annual re-gas tariff hike for its Dahej terminal. We thus expect 10% PAT CAGR over FY2021-FY2023E.

■ Valuation - Maintain Buy on PLNG with an unchanged PT of Rs. 285

We have fine-tuned our FY2022-FY2023 earnings estimate and have also introduced our FY2024 earnings estimates in this report. A sharp volume recovery at the Dahej terminal and a gradual improvement in Kochi utilisation provides strong earnings visibility (expect a 10% earnings CAGR over FY2021-FY2023E) and a high RoE/RoCE at ~26.6%/27.2% (superior among gas utilities). Moreover, PLNG's valuation of 9x its FY2023E EPS seems attractive (as it is at a steep 31% discount to its historical average one-year forward PE multiple of 13x). The stock offers a healthy dividend yield of 7%. Hence, we maintain a Buy rating on PLNG with an unchanged PT of Rs. 285.

One-year forward P/E (x) band



Source: Sharekhan Research

About company

PLNG was incorporated in April 1998. PLNG 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, PLNG 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. PLNG's valuation is also attractive with strong RoE of 27%, FCF yield of 9%, and dividend yield of 7%.

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: Bloomberg

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	FMR LLC	4.2
2	Republic of Singapore	3.9
3	BlackRock Inc	2.8
4	Kotak Mahindra Asset Management Co. Ltd/India	2.6
5	Fidelity Investment Trust	1.9
6	Vanguard Group Inc/The	1.7
7	Capital Group Cos. Inc/The	1.7
8	BNP Paribas SA	0.9
9	Dimensional Fund Advisors LP	0.8
10	Robeco Luxembourg SA	0.7

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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