Stock Update

Sharekhan by BNP PARIBAS

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Petronet LNG

Volume visibility in volatile gas price environment

Oil & Gas	Sharekhan code: PETRONET	Company Update

Summary

- PLNG's Dahej terminal utilisation likely to recover to near full utilisation in Q2FY22 as demand for contracted LNG (available at half of spot LNG price) is believed to have picked up and shift of volume from Dabhol LNG during the monsoon.
- Capex would be focused on Dahej capacity expansion to 22.5 mtpa by FY25E and spends on LNG retailing/CBG plants would in calibrated manner. FY21 annual report indicates plans to set-up ethane/propane import facility and petrochemical complex at Dahej.
- No major concern on PLNG's volume (although there may be volatility on quarterly basis) from ramp-up in domestic gas production as 16.5 mtpa of its Dahej capacity is booked under contracts. Volume visibility and 5% annual re-gas tariff hike to drive a 9% PAT CAGR over FY2021-FY2024E.
- We maintain Buy on PLNG with an unchanged PT of Rs. 285 as valuation seems attractive at 9.8x its FY23E EPS, considering decent earnings growth visibility, best RoE among gas utilities and FCF/Dividend yield of ~9%/~6%.

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. 232**	
Price Target: **Rs. 285**	↔

↑ Upgrade ↔ Maintain ↓ Downgrade

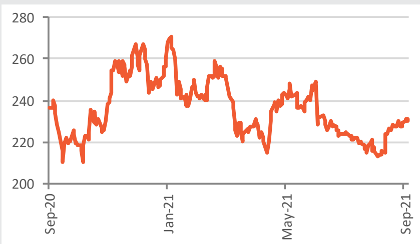
Company details

Market cap:	Rs. 34,733 cr
52-week high/low:	Rs. 275 / 207
NSE volume: (No of shares)	39.8 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	8	0	-6	-2
Relative to Sensex	2	-12	-20	-52

Sharekhan Research, Bloomberg

Petronet LNG's (PLNG) Dahej terminal is expected to benefit from recent high spot LNG price of ~$16/mmbtu as customers will switch over to contracted LNG (half the price of spot LNG price) and seasonal shutdown of Dabhol LNG terminal. This would result in strong volume recovery in Q2FY22. Moreover, expansion of Dahej LNG terminal to 22.5 mtpa by FY25E and calibrated capex to diversify into LNG fuel retailing CBG to drive long-term growth.

- **Dahej utilisation estimated to be >100% in August 2021:** PLNG's Dahej terminal utilisation is believed to have improved to 95%/>100% in July/August as contracted LNG price remains nearly half of the spot LNG price and shutdown of Dabhol LNG terminal during monsoon. Contracted LNG price is linked to three months' average Brent oil price and works out to be $8-9/mmbtu (excluding import and transportation cost) versus Asian spot LNG price of $16.2/mmbtu.
- **Dahej LNG capacity expansion and diversification to drive long-term growth:** PLNG plans to expand its Dahej LNG terminal capacity to 22.5 mtpa (to 20 mtpa in phase I by FY2023E and to 22.5 mtpa in phase II by FY2024E-FY2025E) from 17.5 mtpa currently. Capacity expansion and government's focus to increase share of gas in overall energy basket to drive long-term volume growth for PLNG. Moreover, PLNG is focused on diversifying into new business streams with calibrated capex in LNG fuel stations (initial plan to set up five stations and has approval to set up 24 LNG stations) and compressed biogas (CBG - 5 plants initially) depending upon profitability. The company in its FY21 annual report also indicated plans to set-up ethane/propane import facility and petrochemical complex at Dahej.
- **Robust balance sheet and high FCF could result in higher dividend:** PLNG has a strong balance sheet with net cash position of Rs. 5,705 crore (or ~16% of current market capitalisation) as on March 31, 2021, and we expect it to generate free cash flow (FCF) of ~Rs. 3,000 crore (yield of ~9%) annually. In the absence of any significant capex (cumulative capex of Rs. 1,500 crore-1,700 crore over FY2022E-FY2023E), PLNG may reward shareholders with higher dividend (FY2021 DPS of Rs. 11.5/share).

Our Call

Valuation - Maintain Buy with an unchanged PT of Rs. 285: PLNG 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 ~9%. Valuation of 9.8x its FY2023E EPS is attractive (as it is at a steep 25% 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 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. Likely aggressive capex in long gestation projects could raise cash utilization concern.

Valuation (Standalone) Rs cr

Particulars	FY21	FY22E	FY23E	FY24E
Revenue	26,023	41,827	42,506	46,722
OPM (%)	18.1	12.0	12.9	12.5
Adjusted PAT	2,938	3,231	3,561	3,839
% YoY growth	*3.0*	*10.0*	*10.2*	*7.8*
Adjusted EPS (Rs)	19.6	21.5	23.7	25.6
P/E (x)	11.8	10.8	9.8	9.0
P/B (x)	3.0	2.8	2.4	2.0
EV/EBITDA (x)	6.2	5.7	4.8	4.5
RoNW (%)	26.0	27.1	26.6	24.3
RoCE (%)	26.0	26.9	27.2	28.1

Source: Company; Sharekhan estimates

Dahej expansion – Plans to expand capacity to 22.5 mtpa by FY2025 in a phased manner

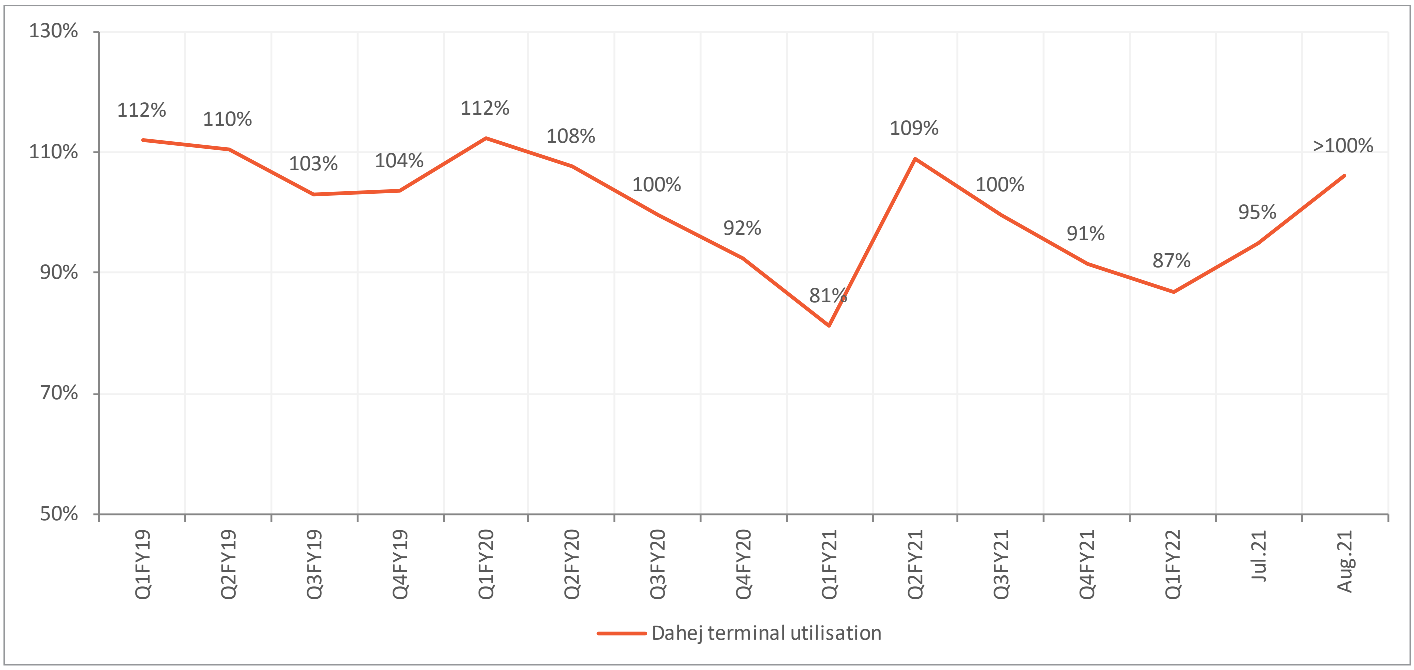
The company is planning to invest ~Rs. 4,540 crore at Dahej terminal, which includes Rs. 1,240 crore for storage tanks, Rs. 1,700 crore for jetty, and Rs. 1,200 crore for expansion of Dahej re-gas capacity to 22.5 mtpa from 17.5 mtpa, currently. Capacity expansion would be done in two phases, wherein in 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, capacity would be further expanded to 22.5 MTPA for a total capital outlay of Rs. 1,000 crore and would be completed by FY2024-FY2025.

Dahej expansion plan

Particulars	Capex (Rs crore)	Project completion timeline
Two storage tanks	1240	FY24
Third jetty	1700	FY25
Phase 1 expansion to 20 mtpa from 17.5 mtpa	200	FY23
Phase 2 expansion to 22.5 mtpa from 20 mtpa	1000	FY25
Tanker capacity enhancement	400	
Total Dahej expansion capex	**4540**	

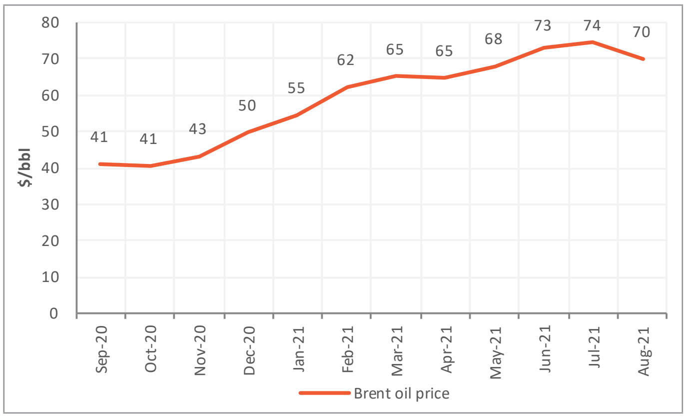
Source: Company; Sharekhan Research

Dahej terminal utilization recovers to >100% in August 2021



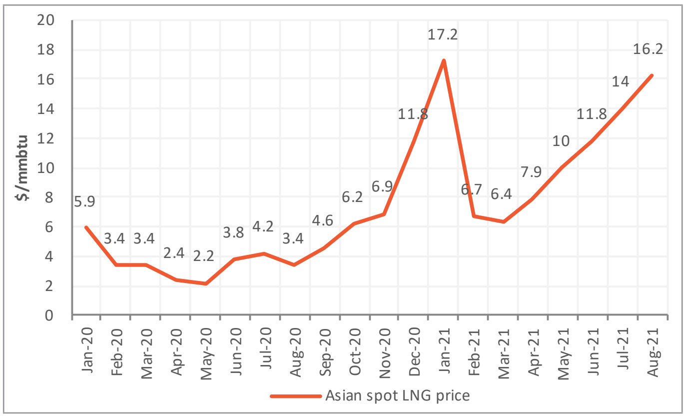
Source: Company; Industry reports, Sharekhan Research

Contracted LNG price at 12.7% to 3-m avg. Brent price



Source: Bloomberg

Spot LNG price increased sharply to $16.2/mmbtu



Source: Industry reports

East coast terminal at Gopalpur – Completed pre-project studies and in process to obtain FID

PLNG plans to set up a Floating LNG terminal at Gopalpur port in Odisha to meet the increasing gas demand of the eastern and central parts of India. PLNG has already completed pre-project studies and is in the process of preparing the Detailed Feasibility Report (DFR) for a 4 MTPA floating storage and regasification (FSRU) terminal, followed by a pre-feasibility report (PFR) for 5 MMTPA land-based terminal in future. PLNG has signed MOU with Gopalpur ports limited and is in discussion with them to finalise the key technical and commercial terms of the agreements and is in the process to obtain final investment decision for the project.

Diversification in new areas – LNG fuel station, CBG and petrochemical complex

- **LNG fuel station –** Management has indicated that it will gradually ramp up its LNG fuel stations, depending upon conversion rates to LNG trucks and buses. Management has 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, implementation would depend upon profitability. Moreover, 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 crore-10 crore.
- **Compressed bio gas (CBG) –** The company is looking for land for the setting up of the compressed bio gas (CBG) plants. Initially, it is planning to set up only 4-5 plants depending upon the feasibility, availability of feedstock and pipeline for evacuation facility. PLNG has a price assurance of Rs. 46/kg ($11-12/mmBtu) from the Government of India, which increases confidence for a better margin on CBG. Overall, PLNG has signed MoU with Ministry of Petroleum and Natural Gas (MoPNG) for setting up and commissioning of 100 CBG plants across India.
- **Formed new subsidiary PEL to offer services in the Asian gas bunkering market –** PLNG has incorporated a wholly owned subsidiary company, Petronet Energy Limited (PEL) with an authorised share capital of Rs. 500 crore to take new business activities in the area of Asian gas bunkering market. In line with this strategy, PEL plans to offer LNG bunkering services, allied services such as Gassing Up and Cooling Down operations and other value-added services in LNG and marine sector in a phased manner. PEL is in the process to take necessary regulatory approval and unit formation at Puthuvypeen Special Economic Zone, Kochi.
- **Petrochemical complex plans –** PLNG is embarking upon a major diversification drive and is exploring to have an ethane/propane import facility at Dahej LNG terminal and set-up a petrochemical complex based on imported propane at Dahej LNG terminal.

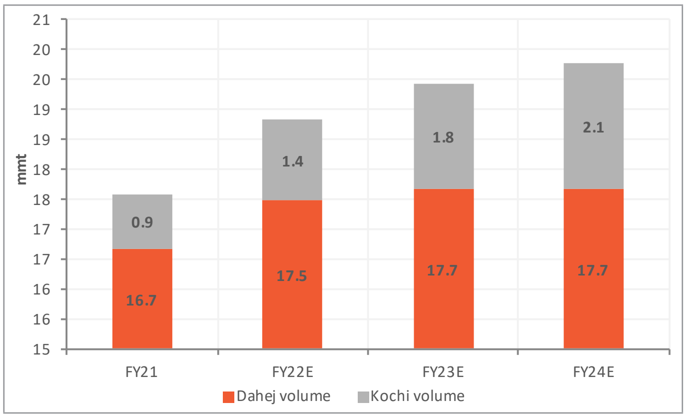
Initial capex plan on LNG retailing and CBG plants

Particulars	Capex (Rs crore)
LNG fuel station (target of 4-5 stations)	40-50
CBG plants (plan to set to 5 plants)	250
Total capex for LNG retailing and CBG	**290-300**

Source: Company; Sharekhan Research

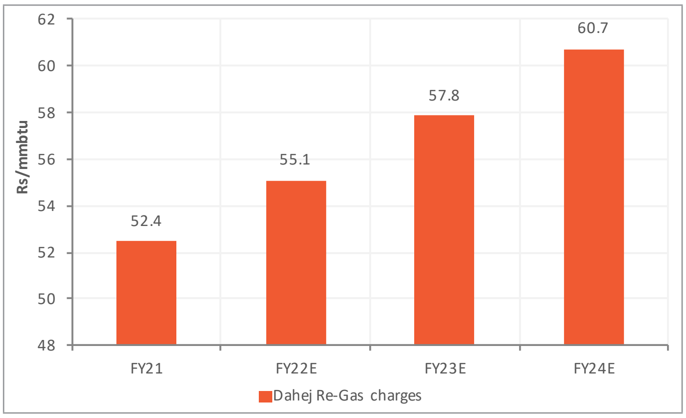
Financials in charts

Volumes to clock 4% CAGR over FY21-24E



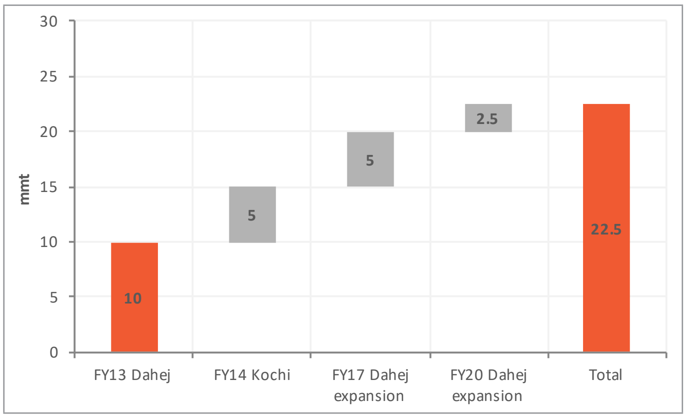
Source: Company, Sharekhan Research

Consistent hike in Dahej Re-gas charges



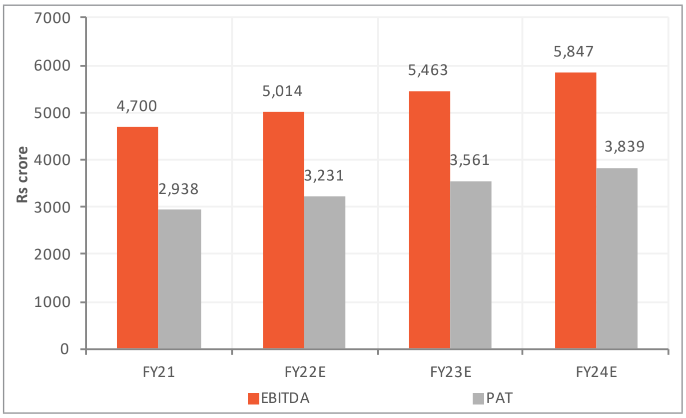
Source: Company, Sharekhan Research

PLNG capacity expansion



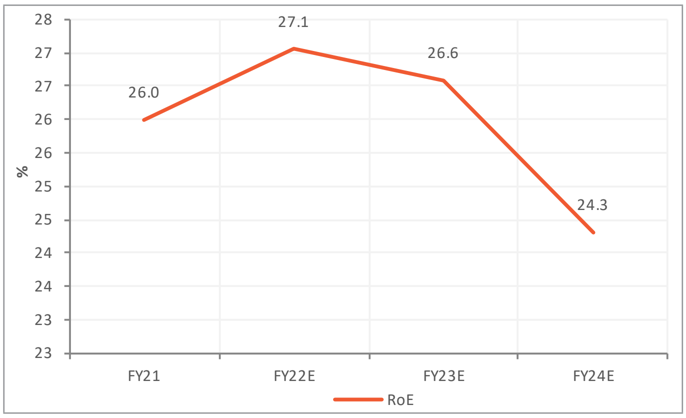
Source: Company, Sharekhan Research

EBITDA/PAT to clock 8%/9% CAGR over FY21-FY24E



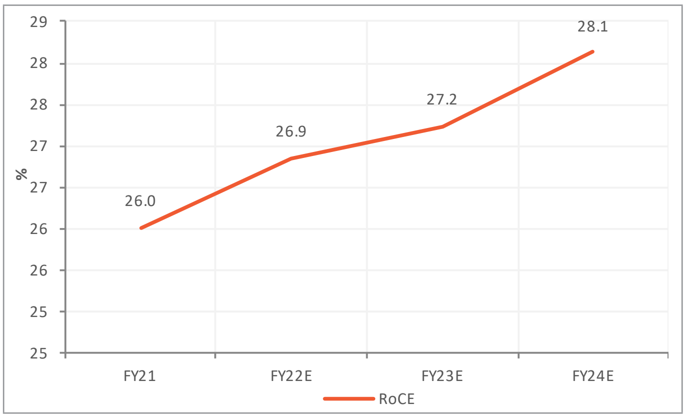
Source: Company, Sharekhan Research

Strong RoEs trend



Source: Company, Sharekhan Research

Consistent improvement in RoCE



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%/>100% in July/August 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 post at 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. Thus, we expect a 9% PAT CAGR over FY2021-FY2023E.

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

PLNG has earnings growth visibility (expect a 9% PAT CAGR over FY2021-FY2024E), superior RoE/RoCE of ~27% among gas utilities, and high FCF yield of ~9%. Valuation of 9.8x its FY2023E EPS seems attractive (as it is at a steep 25% discount to its historical average one-year forward PE multiple of 13x), considering earnings visibility and de-risked business model. Hence, we maintain our 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 6%.

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 and CEO
VK Mishra	Director - Finance

Source: Company Website

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	FMR LLC	4.5
2	Republic of Singapore	3.9
3	Kotak Mahindra Asset Management Co. Ltd/India	2.6
4	BlackRock Inc	2.5
5	Capital Group Cos. Inc/The	2.3
6	Fidelity Investment Trust	1.9
7	Vanguard Group Inc/The	1.5
8	BNP Paribas SA	0.9
9	Dimensional Fund Advisors LP	0.8
10	JP Morgan Chase & Company	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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