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Stock Update

Result Update

Petronet LNG

Strong Q2 despite challenges; attractive valuation

Oil & Gas	Sharekhan code: PETRONET

Reco/View: Buy	↔	CMP: **Rs. 213**	Price Target: **Rs. 248**	↔

↑ 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 Jul 08, 2022

Medium Risk

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

Source: Morningstar

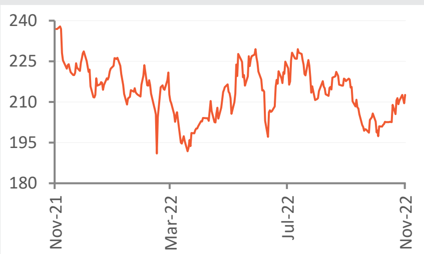
Company details

Market cap:	Rs. 31,883 cr
52-week high/low:	Rs. 240/190
NSE volume: (No of shares)	18.2 lakh
BSE code:	532522
NSE code:	PETRONET
Free float: (No of shares)	96.3 cr

Shareholding (%)

Promoters	35.8
FII	4.2
DII	14.2
Others	45.8

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	6.9	0.5	-0.3	-10.3
Relative to Sensex	0.9	-1.6	-12.4	-11.4

Sharekhan Research, Bloomberg

Summary

- Q2FY22 adjusted PAT of Rs. 818 crore, up 9% q-o-q was 25% above our estimate led by benefit of trading margin (Rs. 276 crore), inventory gain (Rs. 118 crore) which offsets forex loss (Rs. 98 crore), 8% miss in re-gas volume and lower other income.
- Dahej/Kochi re-gas volume declined by 7%/16.7% q-o-q to 182 tbtu/10 tbtu due to high spot LNG price. Dahej re-gas volume decline is attributed to lower tolling volume at 77 tbtu versus 94 tbtu in Q1FY23.
- Spot LNG declined to \$24/mmbtu and a further decline is expected in Q4FY23, which remains key to recovery in Dahej/Kochi terminal utilisatiion level. Board approved capex of Rs 2,305 crore for FSRU Gopalpur terminal; the Dahej expansion on track to get completed over CY24-25.
- We maintain our Buy rating on Petronet LNG with an unchanged PT of Rs248 as valuation of 8.8x/7.6x its FY24E/FY25E EPS is attractive given resilient earnings model despite volatile LNG price and stock offers ~5-6% dividend yield.

Petronet LNG's (PLNG) Q2FY2023 standalone operating profit of Rs. 1,173 crore, up 10% q-o-q, was 15% above our estimate of Rs1,023 crore due to trading margin of Rs. 273 crore (versus Rs103 crore in Q1FY23) and inventory gain of Rs118 crore (versus Rs. 110 crores in Q1FY23) partially offset by a forex loss of Rs98 crore partially and 8% miss in overall re-gas volume at 192 tbtu (down 7.7% q-o-q). Dahej re-gas volume stood at 182 tbtu (down 7.1% q-o-q) with a utilization rate of 82% (versus 101%/88% in Q2FY22/Q1FY23) and Kochi re-gas volume was at 10 tbtu (down 16.7% q-o-q) with utilization rate of 16% (versus 23.5%/18.8% in Q2FY22/Q1FY23). Dahej long-term/tolling/spot re-gas volume stood at 103 tbtu/77 tbtu/2 tbtu as compared to 101 tbtu/94 tbtu/1 tbtu in Q1FY23. Reported PAT at Rs744 crore (down 9.6% y-o-y; up 6.2% q-o-q). PAT (adjusted for forex loss impact of Rs98 crore) of Rs. 818 crores, up 8.8% q-o-q, was also 25% above our estimate of Rs. 654 crores led by the benefit of trading/inventory gain partially offset by lower-than-expected other income (down 33.5% q-o-q).

Key positives

- Improved trading margin on spot volume to Rs. 273 crore in Q2FY23 versus Rs. 103 crore in Q1FY23.
- Declared special dividend of Rs7/share, which implies a dividend yield of 3% on CMP.

Key negatives

- Lower-than-expected Dahej/Kochi terminal re-gas volume at 182 tbtu/10 tbtu, down 7%/17% q-o-q.

Management Commentary

- Board of directors has approved an investment of Rs2,305 crore to set up FSRU terminal at Gopalpur (East coast).
- Dahej expansion on track with phase-1 (2.5mtpa) expected to get completed by end-CY24 and phase-2 (another 2.5mtpa) by March 2025.
- Capex guidance of Rs1250 crore/Rs2500-3000 crore for FY23/FY24.
- PLNG is going ahead with PDHPP plant and is in the process to select a licensor post which would get more clarity on capex. Board approval for the petchem plan expected by March 2023. Biogas plant is facing land issue in Haryana.
- 16.5mmt of Dahej capacity is under a use-or-pay contract and off-takers would be liable to pay charges for capacity not utilized by December 2022.

Revision in estimates – We have fine-tuned our FY23-24 earnings estimates to factor in H1FY23 performance and have introduced our FY25 earnings estimate in this report.

Our Call

Valuation - Maintain Buy with an unchanged PT of Rs. 248: P-LNG earnings model is resilient to volatility in LNG price given contracted LNG volume for Dahej terminal, and the stock offers a decent dividend yield of ~5-6%. Moreover, the stock trades at an attractive valuation of 8.8x/7.6x FY24E/FY25E EPS given earnings visibility and high RoE of 22%. Hence, we maintain our Buy rating on Petronet LNG with an unchanged PT of Rs. 248.

Key Risks

Lower-than-expected re-gas volumes at Dahej terminal in case of any weakness in LNG demand amid elevated spot 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	FY22	FY23E	FY24E	FY25E
Revenue	43,169	51,452	50,610	55,327
OPM (%)	12.2	10.1	11.2	11.6
Adjusted PAT	3,352	3,291	3,610	4,211
% YoY growth	*14.1*	*-1.8*	*9.7*	*16.7*
Adjusted EPS (Rs)	22.3	21.9	24.1	28.1
P/E (x)	9.5	9.7	8.8	7.6
P/B (x)	2.4	2.0	1.8	1.5
EV/EBITDA (x)	5.1	4.4	3.8	3.0
RoNW (%)	26.7	22.7	21.6	21.9
RoCE (%)	27.2	23.1	21.9	25.2

Source: Company; Sharekhan estimates

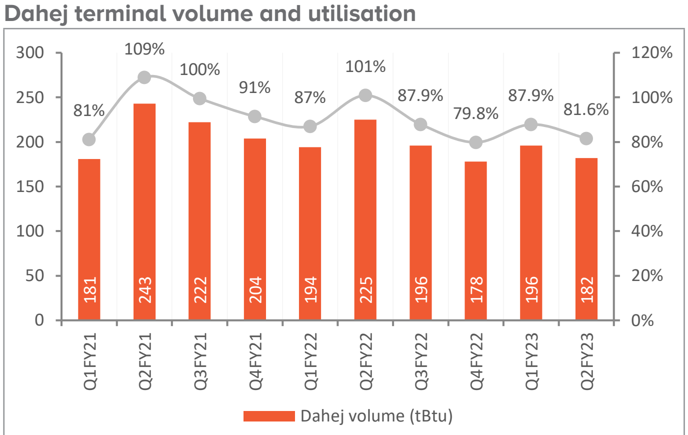
Q2 PAT beat estimate on trading margin and inventory gain; re-gas volume disappoints

Standalone operating profit of Rs. 1,173 crores, up 10% q-o-q was 15% above our estimate of Rs1,023 crore due to trading margin of Rs. 273 crore (versus Rs103 crore in Q1FY23) and inventory gain of Rs118 crore (versus Rs. 110 crore in Q1FY23) partially offset by a forex loss of Rs98 crore partially and 8% miss in overall re-gas volume at 192 tbtu (down 7.7% q-o-q). Dahej re-gas volume stood at 182 tbtu (down 7.1% q-o-q) with an utilisation rate of 82% (versus 101%/88% in Q2FY22/Q1FY23) and Kochi re-gas volume was at 10 tbtu (down 16.7% q-o-q) with utilization rate of 16% (versus 23.5%/18.8% in Q2FY22/Q1FY23). Dahej long-term/tolling/spot re-gas volume stood at 103 tbtu/77 tbtu/2 tbtu as compared to 101 tbtu/94 tbtu/1 tbtu in Q1FY23. Reported PAT at Rs744 crore (down 9.6% y-o-y; up 6.2% q-o-q). PAT (adjusted for forex loss impact of Rs98 crore) of Rs. 818 crore, up 8.8% q-o-q, was also 25% above our estimate of Rs. 654 crores led by the benefit of trading/ inventory gain partially offset by lower-than-expected other income (down 33.5% q-o-q).

Q2FY23 earnings call highlights

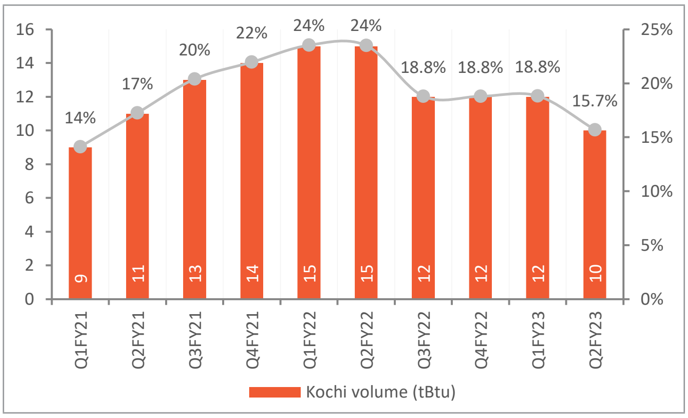
- **New LNG terminal at Gopalpur -** Board of directors has approved the investment of Rs2,305 crore to set-up FSRU terminal in Gopalpur (East coast). Environment clearance is yet to be obtained, and plans to place an order in the next 3-4 months. Target to book 40% capacity and expect utilisation of 50-60% with aim to take to 70-80% in five years post commissioning of the terminal. Provision to convert to land-based plant after 4-5 years.
- **Expansion plan on track -** Dahej expansion is going as per schedule with phase-1 (2.5mtpa) expected to get completed by end-CY24 and phase-2 (another 2.5mtpa) by March 2025. Dahje capex – Rs1246 crore for two storage tanks, Rs1700 crore for jetty and Rs570 crore for capacity expansion to 22.5mtpa.
- **Capex guidance –** PLNG plans to spend Rs. 1,250 crores in FY23 and Rs. 2,500-3,000 crore in FY24 on capital expenditure.
- **Petchem/Biogas plant update -** PLNG is going ahead with the PDHPP plant and is in the process to select a licensor post which would get more clarity on capex. Board approval for the petchem plan expected by March 2023. The biogas plant is facing land issue at Haryana.
- **Pay-or-use clause to trigger as per contract terms -** 16.5mmt of Dahej capacity is under the use-or-pay contract and off-takers would be liable to pay charges for capacity not utilised for them by December 2022.
- Spot LNG is corrected to $24/mmbtu and is expected to fall below $20/mmbtu in Q4FY23 and same bodes for higher utilization at Dahej/Kochi terminal.
- Saving of Rs15 crore month from power optimisation (grid consumption); lower internal LNG consumption provides volume for trading purposes.

Dahej terminal volume and utilisation



Source: Company, Sharekhan Research

Kochi terminal volume and utilisation trend



Source: Company, Sharekhan Research

Results (Standalone) Rs cr

Particulars	Q2FY23	Q2FY22	YoY (%)	Q1FY23	QoQ (%)
Revenue	15,986	10,813	47.8	14,264	12.1
Total Expenditure	14,813	9,516	55.7	13,199	12.2
Operating profit	**1,173**	**1,297**	**-9.6**	**1,064**	**10.2**
Other Income	**94**	**82**	**15.4**	**142**	**-33.5**
Interest	81	79	2.1	78	4.2
Depreciation	192	194	-0.7	191	0.5
Reported PBT	994	1,105	-10.1	937	6.1
Exceptional income/(expense)	**-98**	**0**	**NA**	**-68**	**NA**
Adjusted PBT	1,092	1,105	-1.2	1,005	8.6
Tax	**250**	**282**	**-11.6**	**236**	**5.7**
Reported PAT	744	823	-9.6	701	6.2
Adjusted PAT	818	823	-0.7	752	8.8
Equity Cap (cr)	**150**	**150**		**150**	
Reported EPS (Rs)	5.0	5.5	-9.6	4.7	6.2
Adjusted EPS	5.5	5.5	-0.7	5.0	8.8
Margins (%)			BPS		BPS
OPM	**7.3**	**12.0**	**-466**	**7.5**	**-12**
Tax rate	25.1	25.6	-43	25.2	-9
NPM	5.1	7.6	-250	5.3	-16

Source: Company; Sharekhan Research

Operating performance

Particulars	Q2FY23	Q2FY22	YoY (%)	Q1FY23	QoQ (%)
Capacity utilisation – Dahej (%)	81.6	100.9	-1928	87.9	-628
Capacity utilisation – Kochi (%)	15.7	23.5	-785	18.83	-314
Total volume (TBTU)	**192**	**240**	**-20**	**208**	**-7.7**
Long term volume – Dahej	103	102	1	101	2
Tolling volume – Dahej	77	117	-34.2	94	-18.1
Spot volume – Dahej	2	6	-66.7	1	100
Total Dahej volume (TBTU)	**182**	**225**	**-19.1**	**196**	**-7.1**
Long term volume - Kochi	10	14	-28.6	12	-16.7
Tolling volume – Dahej	0	0	NA	0	NA
Spot volume – Dahej	0	1	NA	0	NA
Total Kochi volume (TBTU)	**10**	**15**	**-33.3**	**12**	**-16.7**

Source: Company; Sharekhan Research

Outlook and Valuation

Sector View – High spot LNG price a near-term volume concern but long-term growth in intact

The spot LNG is at an elevated level of $24-25/mmbtu due to geopolitical tensions and is near-term concern for gas demand from price-sensitive sectors like power and Industrial PNG. We thus expect muted volume growth in the near term and recovery would hinge upon normalisation of spot LNG price. We expect strong long-term volume growth opportunities for gas utilities (such as P-LNG) supported by robust gas demand outlook given: 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.

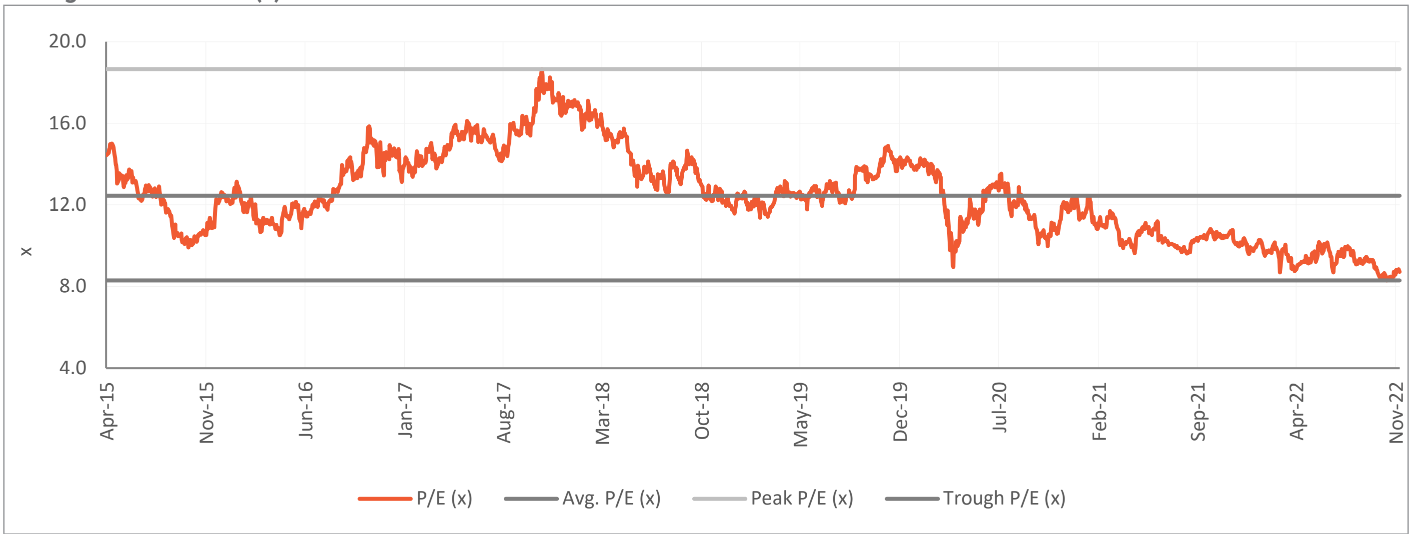
Company Outlook – Decent earnings growth visibility

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. However, the lower Kochi terminal's utilisation is a concern until the spot LNG price normalises. We expect 8% PAT CAGR over FY22-25E led by Dahej re-gas tariff hike and volume growth supported by capacity expansion.

Valuation – Maintain Buy with an unchanged PT of Rs. 248

P-LNG earnings model is resilient to volatility in LNG price given contracted LNG volume for Dahej terminal, and the stock offers a decent dividend yield of ~5-6%. Moreover, stock trades at an attractive valuation of 8.8x/7.6x FY24E/FY25E EPS, given earnings visibility and high RoE of 22%. Hence, we maintain our Buy rating on Petronet LNG with an unchanged PT of Rs. 248.

One-year forward P/E (x) band



Source: Sharekhan Research

About 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 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 off-take 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 regularly 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 a 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	FRM LLC	4.49
2	Republic of Singapore	3.56
3	Kotak Mahindra Asset Management Co Ltd	2.27
4	T Rowe Price Group	2.25
5	BlackRock Inc	2.15
6	Vanguard Group Inc	1.66
7	Fidelity Investment Trust	1.51
8	Lazard Ltd	1.03
9	JPMorgan Chase & Co	1.01
10	Dimensional Fund Advisors LP	0.98

Source: Bloomberg (Old data)

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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