Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

Stock Update

Result Update

Petronet LNG

Subdued Q3; lower LNG price to support volume recovery

Oil & Gas	Sharekhan code: PETRONET
Reco/View: Buy ↔	CMP: Rs. 223	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 31.12

Updated Dec 08, 2022

Medium Risk

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

Source: Morningstar

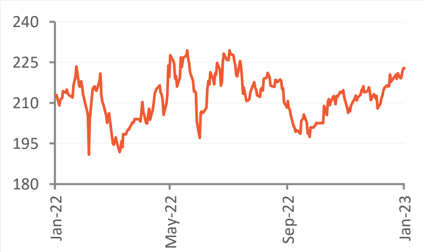
Company details

Market cap:	Rs. 33,420 cr
52-week high/low:	Rs. 232/190
NSE volume: (No of shares)	16.1 lakh
BSE code:	532522
NSE code:	PETRONET
Free float: (No of shares)	75.0 cr

Shareholding (%)

Promoters	50.0
FII	34.9
DII	4.1
Others	11.0

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	5.3	10.0	-2.9	4.6
Relative to Sensex	6.0	7.8	-11.8	1.9

Sharekhan Research, Bloomberg

Summary

- Q3FY23 adjusted PAT of Rs. 489 crore, down 34% q-o-q was 15% below our estimate due to weaker-than-expected re-gas volume of 167 tbtu (down 13% q-o-q), a decline in trading margin to just Rs. 25 crore and a forex loss of Rs. 60 crore. Reported PAT of Rs. 1,181 crore includes use or pay charge of Rs. 849 crore.
- Dahej terminal utilisation was weak at 69% (versus 82% in Q2FY23; 15% q-o-q fall in re-gas volume to 154 tbtu) due to lower tolling volume of 47 tbtu amid elevated spot LNG prices, demand shift to alternate fuels and procurement of HP-HT gas through gas exchange.
- Dahej utilization recovered to 81% currently as spot LNG price has fallen to $16-20/mmBtu and the management is hopeful to improve utilization if spot LNG price remains below $20/mmBtu . PLNG is negotiation with clients to receive use or pay charge of Rs. 415 crore (for CY21) in Q4FY23. The company assured that there will be no impact on dividend payout as it has cash of Rs. 6,900 crore on the books.
- We maintain our Buy rating on Petronet LNG with an unchanged PT of Rs. 248, as valuation of 9.4x/8x its FY24E/FY25E EPS is attractive, given resilient earnings model and stock offers a 5-6% dividend yield.

Petronet LNG's (PLNG's) Q3FY2023 standalone adjusted operating profit of Rs. 826 crore (down 40.3% y-o-y; down 29.5% q-o-q) was 14% lower than our of Rs. 956 crore on the account of 7% miss in total re-gas volume at 167 tbtu (down 19.7% y-o-y; down 13% q-o-q), lower trading margin/inventory gain of Rs. 25 crore/Rs. 95 crore (versus Rs. 273 crore/Rs. 118 crore in Q2FY23) and forex loss of Rs. 60 crore. We have adjusted reported operating profit of Rs. 1,675 crore (down 3.3% y-o-y; up 42.8% q-o-q) for Rs. 849 crore related to "Use or Pay charges" booked by P-LNG for lower than committed annual volume offtake (155 tbtu) by the customers. Dahej terminal's utilisation declined to 69% (versus 82% in Q2FY23 and estimate of 75%) as tolling re-gas volume was weak at 47 tbtu due to lower gas demand amid elevated spot LNG prices, a demand shift to alternate fuels (propane) given favourable prices and procurement of HP-HT gas through gas exchange. PAT (adjusted for "Use or Pay charges" of Rs. 849 crore and favourable arbitration award of Rs. 79 crore) of Rs. 489 crores, down 45%/34% y-o-y/q-o-q, was also 15% below our estimate of Rs. 576 crore due to weaker-than-anticipated re-gas volumes and lower trading margins, partially offset by higher other income.

Key positives

- The company hiked Dahej re-gas tariff by 5% to Rs. 59.9/mmBtu.

Key negatives

- Lower-than-expected Dahej terminal's re-gas volume at 154 tbtu, down 15% q-o-q.
- Sharply lower trading margin of only Rs. 25 crore versus Rs. 273 crore in Q2FY23.
- Outstanding receivables of Rs. 3513 crore as on December 2022.

Management Commentary

- Booked use or pay charges of Rs. 849 crore in Q3FY23 due to lower volume off-take by customers. Use or pay receivable is at ~Rs. 1264 crore and the company is negotiating with client to receive at least Rs. 415 crore related to CY21 in Q4FY23.
- The management indicated that there would be no impact on dividend payout despite take or pay receivables as PLNG has strong cash of Rs. 6900 crore on its books.
- Dahej terminal's utilisation improved to 81% (versus 69% in Q2FY23) as spot LNG price has cooled off to $16-20/mmBtu.
- Dahej capacity expansion is on track with phase-1 (2.5mtpa) expected to get completed by end-CY24 and phase-2 (another 2.5mtpa) by March 2025.
- PDHPP plant – In process to select a licensor and expect board approval for the petchem plan by March 2023. PDHPP plant (16%+ IIR threshold) capex estimated at Rs. 13000-14000 crore but would be in a staggered manner till FY26.

Revision in estimates – We have lowered our FY23 earnings estimate to factor lower Dahej re-gas volume and have fine-tuned our FY24-25 earnings estimates.

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 the Dahej terminal, and the stock offers a decent dividend yield of 5-6%. Moreover, the stock trades at an attractive valuation of 9.4x/8x FY24E/FY25E EPS given earnings visibility and 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	60,793	53,843	58,825
OPM (%)	12.2	7.8	10.4	10.8
Adjusted PAT	3,352	2,937	3,570	4,170
% YoY growth	*14.1*	*-12.4*	*21.6*	*16.8*
Adjusted EPS (Rs.)	22.3	19.6	23.8	27.8
P/E (x)	10.0	11.4	9.4	8.0
P/B (x)	2.5	2.2	1.9	1.6
EV/EBITDA (x)	5.4	5.2	4.2	3.3
RoNW (%)	26.7	20.4	21.7	21.9
RoCE (%)	27.2	20.9	21.9	25.2

Source: Company; Sharekhan estimates

Q3 PAT missed estimate on lower re-gas volume and trading margin

Q3FY2023 standalone adjusted operating profit of Rs. 826 crore (down 40.3% y-o-y; down 29.5% q-o-q) was 14% lower than our of Rs. 956 crore on the account of 7% miss in total re-gas volume at 167 tbtu (down 19.7% y-o-y; down 13% q-o-q), lower trading margin/inventory gain of Rs. 25 crore/Rs. 95 crore (versus Rs. 273 crore/ Rs. 118 crore in Q2FY23) and forex loss of Rs. 60 crore. We have adjusted reported operating profit of Rs. 1,675 crore (down 3.3% y-o-y; up 42.8% q-o-q) for Rs. 849 crore related to "Use or Pay charges" booked by P-LNG for lower than committed annual volume offtake (155 tbtu) by the customers. Dahej terminal's utilisation to 69% (versus 82% in Q2FY23 and estimate of 75%) as tolling re-gas volume was weak at 47 tbtu due to lower demand amid elevated spot LNG prices, a demand shift to alternate fuels (propane) given favourable prices and procurement of HP-HT gas through gas exchange. PAT (adjusted for "Use or Pay charges" of Rs. 849 crore and favourable arbitration award of Rs. 79 crore) of Rs. 489 crores, down 45%/34% y-o-y/q-o-q, was also 15% below our estimate of Rs. 576 crores due to weaker-than-anticipated re-gas volumes and lower trading margins, partially offset by higher other income.

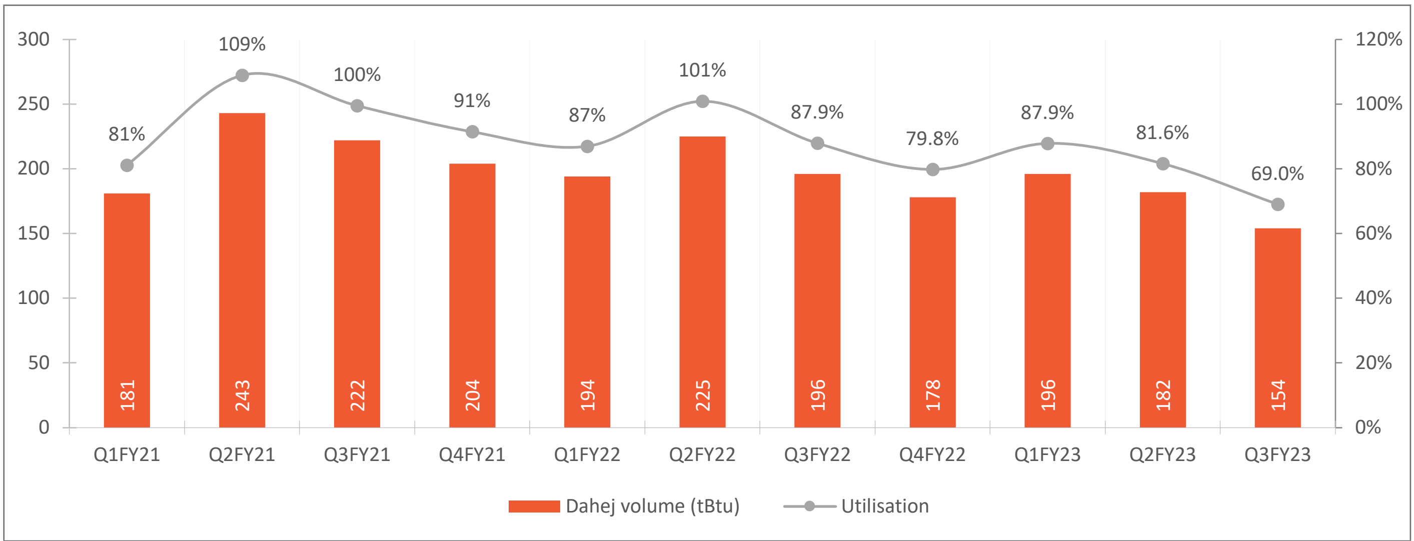
Dahej terminal's re-gas volume stood at 154 tbtu (down 15.4% q-o-q) with a utilisation rate of 69% (versus 88%/82% in Q3FY22/Q2FY23) and Kochi re-gas volume was at 13 tbtu (up 30% q-o-q) with utilisation rate of 20% (versus 19%/16% in Q3FY22/Q2FY23). Dahej long-term/tolling/spot re-gas volume stood at 104 tbtu/47 tbtu/3 tbtu as compared to 103 tbtu/77 tbtu/2 tbtu in Q2FY23. The sharply lower utilization at Dahej terminal is attributable to elevated spot LNG prices, demand shift to alternate fuels (propane) given favourable prices and procurement of HP-HT gas through gas exchange.

Q3FY23 earnings call highlights

- **Use or Pay charge:** The company has booked Rs. 849 crore in Q3FY23 (versus Rs. 430 crore in Q3FY22) of "Use or Pay charges" as part of contractual agreements for lower than committed volume offtake (volume default of 155 tbtu in Q3FY23 versus 80 tbtu in Q3FY22) by customers. Outstanding balance of use or pay charges stood at Rs. 1264 crore as on December 31, 2022 and PNG is in discussion with its client to get last years due of Rs. 415 crore in Q4FY23. Management indicated that there would not be any impact on dividend payout due to outstanding receivable (total of Rs. 3513 crore including use or pay charge) as PLNG has cash of ~Rs. 6900 crore on its books.
- **Dahej terminal's utilization and re-gas tariff hike:** The current utilization at Dahej terminal has improved to 81% versus 69% in Q3FY22 led by fall in the recent spot LNG price to $16-20/mmBtu. If spot LNG price remains below $20/mmBtu than the management expects LNG demand to increase in India and expect better utilization (80-90%) for Dahej terminal in the coming quarters. P-LNG has taken the contractual annual tariff hike of 5% and current tariff stands at ~Rs. 59.9/mmBtu .
- **Dahej 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. The Dahej capex break-up – Rs. 1,250 crore for two storage tanks, Rs. 1,700 crore for jetty and Rs. 570 crore for capacity expansion to 22.5 mtpa.
- **Capex guidance –** PLNG plans to spend Rs. 1,250 crores in FY23 and Rs. 1,800 crore in FY24 on capital expenditure.
- **Gopalpur FSRU update:** The east coast Gopalpur FSRU project (Rs. 2300 crore capex estimated) is expected to get completed in 2 years time post awarding contracts. Currently, the company is seeking environment clearance and agreement with the Gopalpur Port Trust.

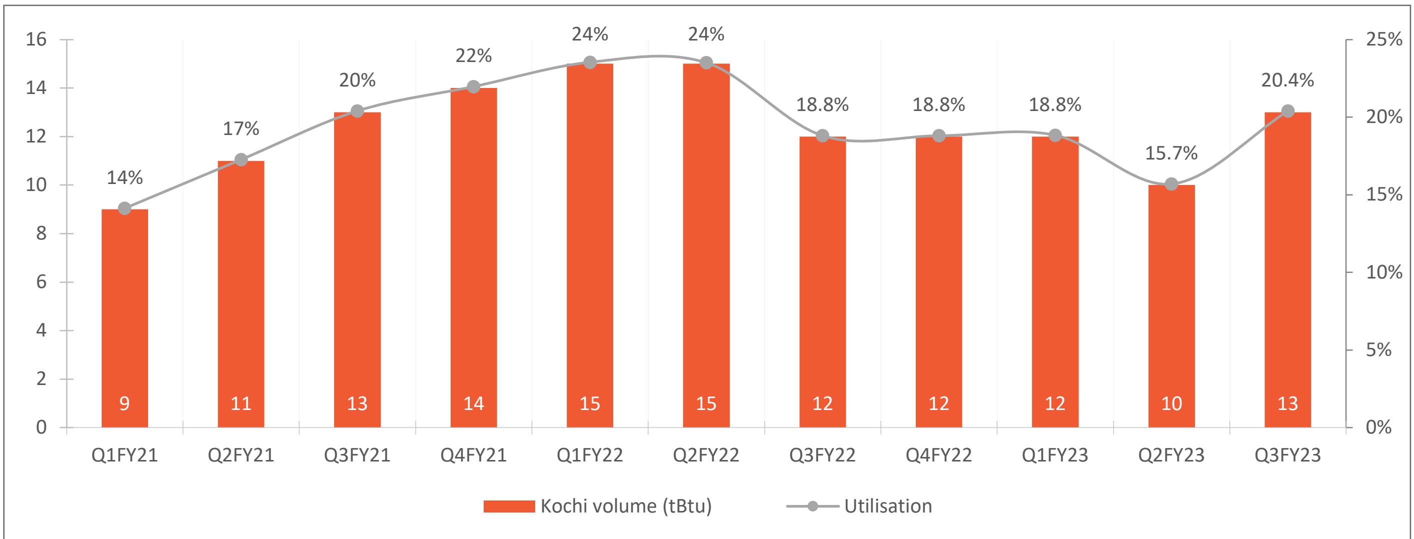
- **Petchem/Biogas plant update -** PLNG is going ahead with the PDHPP plant and it is in the licensor selection stage. After this, the project capex would be determined, and Board approval is expected by March 2023. The project will be completed in 4 years post project tender award at an estimated capex cost of Rs. 13000-14000 crore. The project IRR is 16%+ with a staggered capex plan and low capex in FY24. The biogas plant is facing land issue at Haryana.
- **Others:** 1) During Q3FY23, inventory and trading gains were lower q-o-q and came at Rs. 95/Rs. 25 crore respectively. 2) Re-gas service revenue (incl. take or pay) was recorded at Rs. 1,112 crore in Q3FY23, 3) Notional forex loss of Rs. 60 crore due to rupee depreciation was recorded in other expenses and 4) Gorgon volume at Dahej terminal stood at 5.44 tbtu in Q3FY23.

Dahej terminal volume and utilisation



Source: Company, Sharekhan Research

Kochi terminal volume and utilisation trend



Source: Company, Sharekhan Research

Results (Standalone) Rs cr

Particulars	Q3FY23	Q3FY22	YoY (%)	Q2FY23	QoQ (%)
Revenues	15,776	12,597	25.2	15,986	-1.3
Total Expenditure	14,101	10,865	29.8	14,813	-4.8
Reported operating profit	**1,675**	**1,732**	**-3.3**	**1,173**	**42.8**
Adjusted operating profit	**826**	**1,384**	**-40.3**	**1,173**	**-29.5**
Other Income	184	72	155.9	94	95.1
Interest	81	78	4.9	81	0.3
Depreciation	192	194	-0.7	192	0.1
Reported PBT	**1,586**	**1,533**	**3.4**	**994**	**59.5**
Exceptional income/(expense)	928	348	166.9	0	NA
Adjusted PBT	**657**	**1,185**	**-44.5**	**994**	**-33.9**
Tax	405	389	4.0	250	62.2
Reported PAT	1,181	1,144	3.2	744	58.6
Adjusted PAT	**489**	**884**	**-44.6**	**744**	**-34.2**
Equity Cap (cr)	150	150		150	
Reported EPS (Rs.)	7.9	7.6	3.2	5.0	58.6
Adjusted EPS	3.3	5.9	-44.6	5.0	-34.2
Margins (%)			**BPS**		**BPS**
Adjusted OPM	5.2	11.0	-575	7.3	-210
Effective tax rate	25.5	25.4	15	25.1	43
NPM	3.1	7.0	-392	4.7	-155

Source: Company; Sharekhan Research

Operating performance

Particulars	Q3FY23	Q3FY22	YoY (%)	Q2FY23	QoQ (%)
Capacity utilisation – Dahej (%)	69.0	87.9	-1883	81.6	-1255
Capacity utilisation – Kochi (%)	20.4	18.8	157	15.7	471
Total volume (tbtu)	**167.0**	**208.0**	**-19.7**	**192.0**	**-13.0**
Long term volume – Dahej	104.0	117.0	-11.1	103.0	1.0
Tolling volume – Dahej	47.0	76.0	-38.2	77.0	-39.0
Spot volume – Dahej	3.0	3.0	0.0	2.0	50.0
Total Dahej volume (tbtu)	**154.0**	**196.0**	**-21.4**	**182.0**	**-15.4**
Long term volume - Kochi	13.0	12.0	8.3	10.0	30.0
Tolling volume – Dahej	0.0	0.0	NA	0.0	NA
Spot volume – Dahej	0.0	0.0	NA	0.0	NA
Total Kochi volume (tbtu)	**13.0**	**12.0**	**8.3**	**10.0**	**30.0**

Source: Company; Sharekhan Research

Outlook and Valuation

■ Sector View – Recent moderation in spot LNG price to improve volume visibility for gas utilities

Recently spot LNG price has declined to $16-20/mmBtu in January 2023 post a full year of volatile and continued high spot LNG price in CY22 due to Russia-Ukraine crisis. The elevated spot LNG price has impacted LNG demand in India and that is also reflected to lower utilization at LNG terminals in the country. However, recent steep fall in spot LNG price if sustained and long-term domestic gas demand drivers (higher demand from CGD and fertiliser sectors and the government's aim to increase the share of gas in India's overall energy mix to 15% by 2030) would drive strong volume growth for over FY24-25 for gas utilities like PLNG.

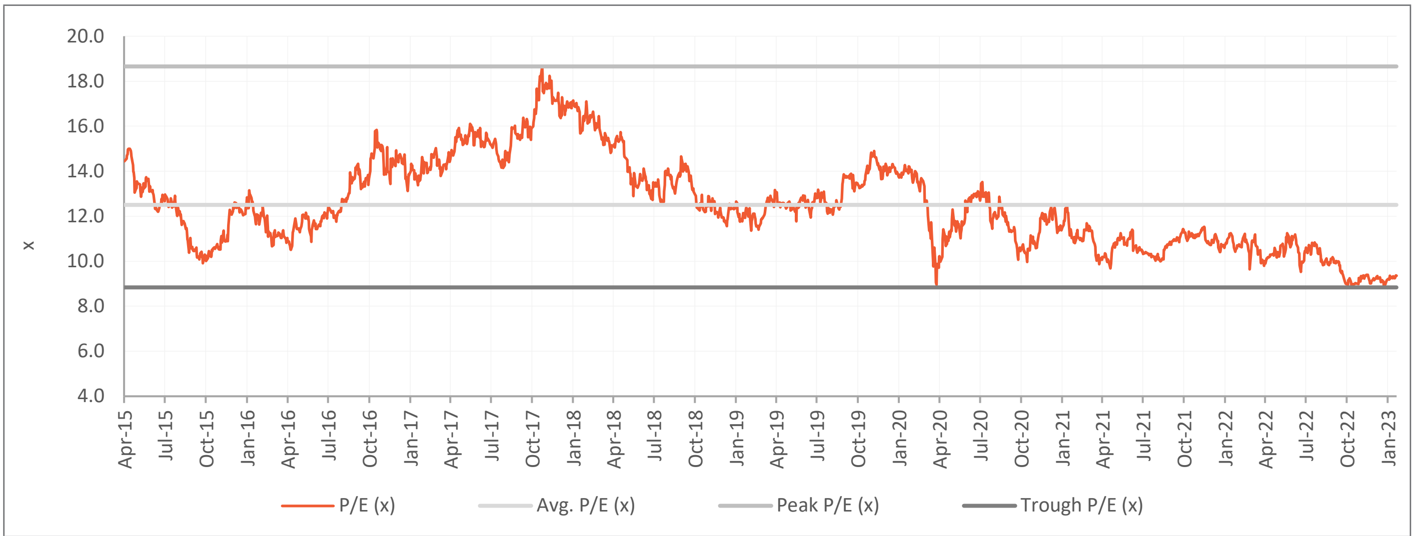
■ Company Outlook – Decent earnings growth visibility

The 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 an 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 the Dahej terminal, and the stock offers a decent dividend yield of 5-6%. Moreover, the stock trades at an attractive valuation of 9.4x/8x FY24E/FY25E EPS given earnings visibility and 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 fall in spot LNG price would drive volume recovery at Dahej terminal, which provides earnings visibility. 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 22%, FCF yield of 8-9%, and a dividend yield of 5-6%.

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 & 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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