COMPANY UPDATE

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PETRONET LNG LTD (PLNG)

PRICE: RS.251 RECOMMENDATION: BUY
TARGET PRICE: RS.285 FY19E PE: 16.7X

- With a ban on the usage of petcoke (petroleum coke)/furnace oil, improving gas demand from power/fertilizer sector and no major ramp-up in domestic gas production in the near-term, LNG demand in India is expected to rise meaningfully, we opine. The key beneficiary of the same is expected to be PLNG.
- In Order to meet the rising domestic gas demand, PLNG is adding RLNG capacity of 2.5 MMTPA in Dahej to 17.5 MMTPA by FY19E. Recently, it has expanded Dahej capacity by 50% to 15 MMTPA 90% of its capacity is contracted, giving decent revenue visibility.
- On the other hand, Kochi terminal is operating at sub-optimal utilization given lack of pipeline infrastructure. Management expects quarterly uptick (marginal) in volumes till the Mangalore Kochi pipeline is commissioned and the same is expected by Dec'18. We believe this will significantly ramp-up RLNG volume. GAIL is working on getting approvals for the pipeline and clarity on the pipeline can potentially add to valuations of PLNG.
- We expect PLNG's earnings to grow at a CAGR of 15% over the next two years driven by volume growth, benefiting from contractual commitments of 17.2 mn tons and commissioning of Kochi-Mangalore pipeline. We expect PLNG to report an EPS of Rs.14.1 for FY18E and an EPS of Rs.15 for FY19E. We expect FY18E to be better driven by acceleration in volume growth, supported by expansion. At CMP, we believe that the stock is reasonably valued at 16.7x FY19E earnings. We recommend BUY on the stock with a price target of Rs.285/- including equity value of 26% stake in Dahej Port. Given that most of the capacity at Dahej is tied-up, there is strong visibility on the free cash flow yield.

Summary table

Rs mn	FY17	FY18E	FY19E
Net Sales (Rs. Mn)	249,627	298,089	323,075
Growth (%)	-8.0	19.4	8.4
EBIDTA	29,389	34,292	38,420
EBIDTA margin (%)	11.8	11.5	11.9
PBT	23,602	31,716	33,944
Net profit	17,057	21,091	22,573
EPS (Rs)	11.4	14.1	15.0
Growth (%)	4.0	23.7	7.0
CEPS (Rs)	13.8	16.8	18.0
Book value (Rs/share)	54	69	80.1
DPS (Rs)	2.5	3.1	3.5
ROE (%)	22.9	22.1	19.6
ROCE (%)	17.5	20.9	20.2
Net Cash (Debt)	7,635	34,599	49,038
NW Capital (Days)	11.8	12.4	13.4
EV/Sales (x)	0.8	0.6	0.5
EV/EBIDTA (x)	7.1	5.3	4.3
P/E (x)	22.1	17.9	16.7
P/BV (x)	4.65	3.62	3.13
P/CEPS (X)	18.1	14.9	14.0

Source: Company, Kotak Securities – Private Client Research

Key Risks and Concerns

We believe the key risk to our valuation are as follows:

- **Geo-political risk:** Any gas supply disruption from Qatar can have meaningful impact on the earnings. Though current situation is under control.
- Availability of LNG at reasonable prices on a long term basis has remained a key worry.
- **Regulatory risk:** Any capping of margins by PNGRB will negatively impact its earnings and growth. However, management has indicated that imported LNG does not fall under the preview of PNGRB.
- Project execution risk.

Key developments

- **New revenue streams for optimum utilization of resources:** PLNG is eyeing to invest in the overseas LNG market and in this regard it has signed a MoU with national oil company of Bangladesh to set-up land based 7.5 mtpa LNG terminal (pre-project studies has already started) at Kutubdia Island and is also in discussion with the Sri Lankan government for collaboration in development of LNG infrastructure.
- The company has plans to venture into retail LNG business and in this regard it will test run LNG-fueled buses in Gujarat and Kerala. It is in discussion with oil marketing companies (OMCs) to develop LNG dispensing infrastructure in India as Ministry of Road Transport and Highways has approved the usage of LNG as an automotive fuel. Although the above initiatives are at a nascent stage, they are important for PLNG from the perspective of FCF utilization and long term growth.

Petronet Gas Purchase, Sales Agreements

Petronet Gas Purchase, Sales Agreements	MMTPA
A). Petronet' s LNG procurement	
Ras Laffan (RasGas), Qatar	7.50
Gorgon LNG project, Exxon -mobil Australia	1.44
Balance: Spot/Short-term contract	6.70
B). Gas sale agreements - Take or pay agreement	6.0-7.0
Ras Laffan 7.5 mmtpa contract	
a). Gail	4.50
b). Indian oil	2.25
c). BPCL	0.75
Other contract	
d). Gujarat state petroleum corporation	1.25
e). Torrent Power	0.50
Dahej 5 mmtpa expansion	
f). Gujarat state petroleum corporation	1.00
g). Gail	2.50
h). Indian oil	1.50
i). BPCL	1.00
Total Gas sales agreements	15.75

Source: Company and Bloomberg

Key assumptions

RLNG volumes: We expect meaningful ramp-up in Petronet's RLNG volumes to 848 TBTUs in FY18E, 910 TBTUs in FY19E versus 714 TBTUs in FY17 led by (1) completion of ongoing expansion project at Dahej terminal, and (2) gradual increase in utilization of Kochi terminal.

Valuation & Recommendation

We recommend BUY on Petronet LNG Ltd with a price target of Rs.285

We expect PLNG's earnings to grow at a CAGR of 15% over the next two years driven by a volume growth, benefiting from contractual commitments of 17.2 mn tons and commissioning of Kochi-Mangalore pipeline. We expect PLNG to report an EPS of Rs.14.1 for FY18E and an EPS of Rs.15 for FY19E. We expect FY18E to be better driven by acceleration in volume growth, supported by expansion. At CMP, we believe that the stock is reasonably valued at 16.7x FY19E earnings. We recommend **BUY** rating on the stock with a price target of Rs.285/- including equity value of 26% stake in Dahej Port. Given that most of the capacity at Dahej is tied-up, there is strong visibility on the free cash flow yield.

Company back ground:

Petronet LNG is India's largest importer of liquefied natural gas (LNG) at its Dahej plant. It has expanded the Dahej capacity to 10 MMTPA.

PLNG has a firm supply contract with Qatar's RasGas for 7.5 MTPA for which it has a back-to-back sales contract. It also imports LNG on a spot basis depending on its ability to market the same in domestic market.

Similarly, it also imports cargos on behalf of other importers for a fee. The company currently charges Rs 35.85 per MMBTU as regasification charges, which are set to go up 5% every year in January.

Notes: LNG is natural gas in its highly compact liquid form. When natural gas is cooled to minus 260 degrees Fahrenheit (or minus 162 degrees Celcius), it is reduced to one six-hundredth of its original volume and becomes a clear, non-toxic liquid. LNG offers a safe and economical means for transporting natural gas over long distances to locations beyond the reach of pipelines. LNG is loaded on specialized ships and delivered to a regasification terminal where it is reheated, turned into gas and distributed to customers through a pipeline network.

RATING SCALE

Definitions of ratings

BUY	–	We expect the stock to deliver more than 12% returns over the next 9 months
ACCUMULATE	–	We expect the stock to deliver 5% - 12% returns over the next 9 months
REDUCE	–	We expect the stock to deliver 0% - 5% returns over the next 9 months
SELL	–	We expect the stock to deliver negative returns over the next 9 months
NR	–	Not Rated. Kotak Securities is not assigning any rating or price target to the stock. The report has been prepared for information purposes only.
RS	–	Rating Suspended. Kotak Securities has suspended the investment rating and price target for this stock, either because there is not a Sufficient fundamental basis for determining, or there are legal, regulatory or policy constraints around publishing, an investment rating or target. The previous investment rating and price target, if any, are no longer in effect for this stock and should not be relied upon.
NA	–	Not Available or Not Applicable. The information is not available for display or is not applicable
NM	–	Not Meaningful. The information is not meaningful and is therefore excluded.
NOTE	–	Our target prices are with a 9-month perspective. Returns stated in the rating scale are our internal benchmark.

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