COMPANY UPDATE

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PETRONET LNG LTD (PLNG)

PRICE: RS. 253 RECOMMENDATION: BUY
TARGET PRICE: RS. 285 FY20E PE: 14.3X

- We believe Petronet's earnings will continue to rise over the next 2-3 years, driven by higher volumes from Dahej LNG regasification terminal and a higher operating rate of the currently stranded Kochi terminal. Construction of the pipeline to evacuate gas from Kochi is progressing well.
- The company is further in the process of expanding capacity of the Dahej LNG terminal from 15 MMTPA to 17.5MMTPA. The expansion is likely to be commissioned in 1QFY19. This will help in meeting the rising domestic gas demand. Recently, it has expanded Dahej capacity by 50% to 15 MMTPA and the same is contracted more than 90% of its capacity giving decent revenue visibility.
- We have introduced FY20E earnings in this note. We expect PLNG's earnings to grow at a CAGR of 15% over the next three 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, an EPS of Rs.15 for FY19E and an EPS of Rs.17.5 for FY20E. We expect FY18E to be driven by acceleration in volume growth, supported by expansion. At CMP, we believe that the stock is reasonably valued at 14.3x FY20E earnings. We maintain 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.
- 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.

Summary table - Standalone

(Rs mn)	FY18E	FY19E	FY20E
Net Sales (Rs. Mn)	298,089	323,075	349,262
Growth (%)	19.4	8.4	8.1
EBIDTA	34,292	38,420	44,106
EBIDTA margin (%)	11.5	11.9	12.6
PBT	31,716	33,944	39,473
Net profit	21,091	22,573	26,250
EPS (Rs)	14.1	15.0	17.5
Growth (%)	23.7	7.0	16.3
CEPS (Rs)	16.8	18.0	20.6
Book value (Rs/share)	69	80.1	92.7
DPS (Rs)	3.1	3.5	4.0
ROE (%)	22.1	19.6	19.7
ROCE (%)	20.9	20.2	20.2
Net Cash (Debt)	34,599	49,038	66,037
NW Capital (Days)	12.4	13.4	14.6
EV/Sales (x)	0.6	0.5	0.4
EV/EBIDTA (x)	5.3	4.3	3.4
P/E (x)	17.9	16.7	14.3
P/BV (x)	3.62	3.13	2.71
P/CEPS (X)	14.9	14.0	12.2

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 a 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 and 965 TBTUs in FY20E 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 maintain BUY on Petronet LNG with a price target of Rs.285

We have introduced FY20E earnings in this note. We expect PLNG's earnings to grow at a CAGR of 15% over the next three 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, an EPS of Rs.15 for FY19E and an EPS of Rs.17.5 for FY19E. We expect FY18E to be driven by acceleration in volume growth, supported by expansion. At CMP, we believe that the stock is reasonably valued at 14.5x FY20E earnings. We maintain **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.

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 15 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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