COMPANY UPDATE

Sumit Pokharna
sumit.pokharna@kotak.com
+91 22 6218 6438

PETRONET LNG LTD (PLNG)

PRICE: RS.235 — **RECOMMENDATION: BUY**
TARGET PRICE: RS.276 — **FY20E PE: 14.2X**

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. PLNG is eyeing to invest in the overseas LNG market which will help him in geographical diversification and further expansion.

The company's management has highlighted that Dahej LNG terminal expansion from 15 MMTPA to 17.5MMTPA is expected to completed by June'19 and it will buy 3-4 LNG cargoes in FY19. 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 for more than 90% of its capacity giving decent revenue visibility.

We expect its earnings to grow at a CAGR of 14% over the next 3 years driven by (1) completion of Kochi- Mangalore pipeline, (2) Dahej expansion, and (3) tariff escalation as per contract. To begin with, it is also launching around 20 LNG fuel stations to boost LNG consumption in India.

We expect PLNG to report an EPS of Rs.14.0 for FY18E, an EPS of Rs.14.8 for FY19E and an EPS of Rs.16.5 for FY20E. At CMP, we believe that the stock is attractively valued at 14.2x FY20E earnings. We maintain BUY on the stock with a revised price target of Rs.276/- (earlier 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.

Summary table

(Rs mn)	FY18E	FY19E	FY20E
Net Sales (Rs. Mn)	298,554	322,354	344,976
Growth (%)	19.6	8.0	7.0
EBIDTA	33,341	36,675	41,958
EBIDTA margin (%)	11.2	11.4	12.2
PBT	30,944	33,199	37,325
Net profit	21,042	22,144	24,821
EPS (Rs)	14.0	14.8	16.5
Growth (%)	23.4	5.2	12.1
CEPS (Rs)	16.8	17.7	19.6
Book value (Rs/share)	69	79.8	91.8
DPS (Rs)	3.1	3.5	3.8
ROE (%)	22.1	19.3	18.8
ROCE (%)	20.7	19.9	19.3
Net Cash (Debt)	34,543	48,566	64,214
NW Capital (Days)	12.4	13.4	14.6
EV/Sales (x)	0.6	0.5	0.4
EV/EBIDTA (x)	5.1	4.2	3.3
P/E (x)	16.8	15.9	14.2
P/BV (x)	3.4	2.9	2.6
P/CEPS (X)	14.0	13.3	12.0

Source: Company, Kotak Securities – Private Client Research

Other developments:

- In order to boost domestic LNG consumption, PLNG and other stake holders are setting up an eco-structure with a total investment of Rs.150 bn in next decade.
- **LNG terminal in Sri Lanka:** PLNG will invest US$ 300 mn to set up a ~2-2.5 mmtpa floating LNG terminal in Sri Lanka. However, capex will be incurred in FY20E. PLNG will be the biggest shareholder in Sri Lanka LNG terminal with a 47.5 percent stake. Japan's Sijitz Corporation, Mitsubishi Company of Japan, the Sri Lankan government and Sri Lanka Gas Terminal Ltd have also shown interest in this project.
- **Kochi update:** 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. 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.

Key Risks and Concerns

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

1. **Geo-political risk:** Any gas supply disruption from Qatar can have meaningful impact on the earnings. Though current situation is under control.
2. Availability of LNG at reasonable prices on a long term basis has remained a key worry.
3. **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.
4. 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.
- Liquefied natural gas eco-structure: In order to boost domestic LNG consumption, PLNG and other stake holders are setting up an eco-structure with a total investment of Rs.150 bn in next decade. However, PLNG's investment will be Rs15 bn out of that.
- The company is launching around 20 LNG fuel stations on a 4,000-km route running from Delhi to Thiruvananthapuram as part of its larger scheme in association with oil marketing companies and state roadways of Rajasthan, Gujarat and Kerala. It is expected that around 2 lacs trucks that join the fleet every year could run on LNG, as it would bring nearly 30-40% price advantage compared to other fuels.

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 858 TBTUs in FY18E, 917 TBTUs in FY19E and 962 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 expect PLNG's earnings to grow at a CAGR of ~14% 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. Some of the key strategic advantages PLNG enjoys are location advantage as the Dahej terminal is the least expensive facility giving pricing power to PLNG over the new plants. Relatively lower re-gasification tariffs compare to competitors (~26% lower Regas charges compare to Dabhol terminal), and tied up capacity with off-takers ensure decent utilization of its terminals.

We recommend BUY on Petronet LNG with a price target of Rs.276

We expect PLNG to report an EPS of Rs.14.0 for FY18E, an EPS of Rs.14.8 for FY19E and an EPS of Rs.16.5 for FY19E. At CMP, we believe that the stock is reasonably valued at 14.2x FY20E earnings. We maintain **BUY** on the stock with a revised price target of Rs.276/- 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.

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 12 months
ACCUMULATE	–	We expect the stock to deliver 5% - 12% returns over the next 12 months
REDUCE	–	We expect the stock to deliver 0% - 5% returns over the next 12 months
SELL	–	We expect the stock to deliver negative returns over the next 12 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.

Fundamental Research Team

Sanjeev Zarbade
Capital Goods, Engineering
sanjeev.zarbade@kotak.com
+91 22 6218 6424

Ruchir Khare
Capital Goods, Engineering
ruchir.khare@kotak.com
+91 22 6218 6431

Amit Agarwal
Logistics, Paints, Transportation
agarwal.amit@kotak.com
+91 22 6218 6439

Nipun Gupta
Information Technology
nipun.gupta@kotak.com
+91 22 6218 6433

Teena Virmani
Construction, Cement, Building Mat
teena.virmani@kotak.com
+91 22 6218 6432

Ritwik Rai
FMCG, Media
ritwik.rai@kotak.com
+91 22 6218 6426

Jatin Damania
Metals & Mining
jatin.damania@kotak.com
+91 22 6218 6440

Jayesh Kumar
Economy
kumar.jayesh@kotak.com
+91 22 6218 5373

Arun Agarwal
Auto & Auto Ancillary
arun.agarwal@kotak.com
+91 22 6218 6443

Sumit Pokharna
Oil and Gas
sumit.pokharna@kotak.com
+91 22 6218 6438

Pankaj Kumar
Midcap
pankajr.kumar@kotak.com
+91 22 6218 6434

K. Kathirvelu
Production
k.kathirvelu@kotak.com
+91 22 6218 6427

Technical Research Team

Shrikant Chouhan
shrikant.chouhan@kotak.com
91 22 6218 5408

Amol Athawale
amol.athawale@kotak.com
+91 20 6620 3350

Derivatives Research Team

Sahaj Agrawal
sahaj.agrawal@kotak.com
+91 79 6607 2231

Malay Gandhi
malay.gandhi@kotak.com
+91 22 6218 6420

Prashanth Lalu
prashanth.lalu@kotak.com
+91 22 6218 5497

Prasenjit Biswas, CMT
prasenjit.biswas@kotak.com
+91 33 6625 9810

Disclosure/Disclaimer

Kotak Securities Limited established in 1994, is a subsidiary of Kotak Mahindra Bank Limited. Kotak Securities is one of India's largest brokerage and distribution house.

Kotak Securities Limited is a corporate trading and clearing member of Bombay Stock Exchange Limited (BSE), National Stock Exchange of India Limited (NSE), Metropolitan Stock Exchange of India Limited (MSE). Our businesses include stock broking, services rendered in connection with distribution of primary market issues and financial products like mutual funds and fixed deposits, depository services and Portfolio Management.

Kotak Securities Limited is also a depository participant with National Securities Depository Limited (NSDL) and Central Depository Services (India) Limited (CDSL). Kotak Securities Limited is also registered with Insurance Regulatory and Development Authority as Corporate Agent for Kotak Mahindra Old Mutual Life Insurance Limited and is also a Mutual Fund Advisor registered with Association of Mutual Funds in India (AMFI). We are registered as a Research Analyst under SEBI (Research Analyst) Regulations, 2014.

We hereby declare that our activities were neither suspended nor we have defaulted with any stock exchange authority with whom we are registered in last five years. However SEBI, Exchanges and Depositories have conducted the routine inspection and based on their observations have issued advise/warning/deficiency letters/ or levied minor penalty on KSL for certain operational deviations. We have not been debarred from doing business by any Stock Exchange / SEBI or any other authorities; nor has our certificate of registration been cancelled by SEBI at any point of time.

We offer our research services to clients as well as our prospects.

This document is not for public distribution and has been furnished to you solely for your information and must not be reproduced or redistributed to any other person. Persons into whose possession this document may come are required to observe these restrictions.

This material is for the personal information of the authorized recipient, and we are not soliciting any action based upon it. This report is not to be construed as an offer to sell or the solicitation of an offer to buy any security in any jurisdiction where such an offer or solicitation would be illegal. It is for the general information of clients of Kotak Securities Ltd. It does not constitute a personal recommendation or take into account the particular investment objectives, financial situations, or needs of individual clients.

We have reviewed the report, and in so far as it includes current or historical information, it is believed to be reliable though its accuracy or completeness cannot be guaranteed. Neither Kotak Securities Limited, nor any person connected with it, accepts any liability arising from the use of this document. The recipients of this material should rely on their own investigations and take their own professional advice. Price and value of the investments referred to in this material may go up or down. Past performance is not a guide for future performance. Certain transactions -including those involving futures, options and other derivatives as well as non-investment grade securities - involve substantial risk and are not suitable for all investors. Reports based on technical analysis centers on studying charts of a stock's price movement and trading volume, as opposed to focusing on a company's fundamentals and as such, may not match with a report on a company's fundamentals.

Opinions expressed are our current opinions as of the date appearing on this material only. While we endeavor to update on a reasonable basis the information discussed in this material, there may be regulatory, compliance or other reasons that prevent us from doing so. Prospective investors and others are cautioned that any forward-looking statements are not predictions and may be subject to change without notice. Our proprietary trading and investment businesses may make investment decisions that are inconsistent with the recommendations expressed herein.

Kotak Securities Limited has two independent equity research groups: Institutional Equities and Private Client Group. This report has been prepared by the Private Client Group. The views and opinions expressed in this document may or may not match or may be contrary with the views, estimates, rating, target price of the Institutional Equities Research Group of Kotak Securities Limited.

We and our affiliates/associates, officers, directors, and employees, Research Analyst(including relatives) worldwide may: (a) from time to time, have long or short positions in, and buy or sell the securities thereof, of company (ies) mentioned herein or (b) be engaged in any other transaction involving such securities and earn brokerage or other compensation or act as a market maker in the financial instruments of the subject company/company (ies) discussed herein or act as advisor or lender / borrower to such company (ies) or have other potential/material conflict of interest with respect to any recommendation and related information and opinions at the time of publication of Research Report or at the time of public appearance. Kotak Securities Limited (KSL) may have proprietary long/short position in the above mentioned scrip(s) and therefore may be considered as interested. The views provided herein are general in nature and does not consider risk appetite or investment objective of particular investor; readers are requested to take independent professional advice before investing. This should not be construed as invitation or solicitation to do business with KSL. Kotak Securities Limited is also a Portfolio Manager. Portfolio Management Team (PMS) takes its investment decisions independent of the PCG research and accordingly PMS may have positions contrary to the PCG research recommendation. Kotak Securities Limited does not provide any promise or assurance of favourable view for a particular industry or sector or business group in any manner. The investor is requested to take into consideration all the risk factors including their financial condition, suitability to risk return profile and take professional advice before investing.

The analyst for this report certifies that all of the views expressed in this report accurately reflect his or her personal views about the subject company or companies and its or their securities, and no part of his or her compensation was, is or will be, directly or indirectly related to specific recommendations or views expressed in this report.

No part of this material may be duplicated in any form and/or redistributed without Kotak Securities' prior written consent.

Details of Associates are available on our website ie www.kotak.com

Research Analyst has served as an officer, director or employee of subject company(ies): No

We or our associates may have received compensation from the subject company(ies) in the past 12 months.

We or our associates have managed or co-managed public offering of securities for the subject company(ies) in the past 12 months: No

We or our associates may have received compensation for investment banking or merchant banking or brokerage services from the subject company(ies) in the past 12 months. We or our associates may have received any compensation for products or services other than investment banking or merchant banking or brokerage services from the subject company(ies) in the past 12 months. We or our associates may have received compensation or other benefits from the subject company(ies) or third party in connection with the research report. Our associates may have financial interest in the subject company(ies).

Research Analyst or his/her relative's financial interest in the subject company(ies): No

Kotak Securities Limited has financial interest in the subject company(ies) at the end of the month immediately preceding the date of publication of Research Report: Yes

Our associates may have actual/beneficial ownership of 1% or more securities of the subject company(ies) at the end of the month immediately preceding the date of publication of Research Report.

Research Analyst or his/her relatives has actual/beneficial ownership of 1% or more securities of the subject company(ies) at the end of the month immediately preceding the date of publication of Research Report: No.

Kotak Securities Limited has actual/beneficial ownership of 1% or more securities of the subject company(ies) at the end of the month immediately preceding the date of publication of Research Report: No

Subject company(ies) may have been client during twelve months preceding the date of distribution of the research report.

"A graph of daily closing prices of securities is available at www.nseindia.com and http://economictimes.indiatimes.com/markets/stocks/stock-quotes. (Choose a company from the list on the browser and select the "three years" icon in the price chart)."

Kotak Securities Limited. Registered Office: 27 BKC, C 27, G Block, Bandra Kurla Complex, Bandra (E), Mumbai 400051. CIN: U99999MH1994PLC134051, Telephone No.: +22 43360000, Fax No.: +22 67132430. Website: www.kotak.com/www.kotaksecurities.com. Correspondence Address: Infinity IT Park, Bldg. No 21, Opp. Film City Road, A K Vaidya Marg, Malad (East), Mumbai 400097. Telephone No: 42856825. SEBI Registration No: NSE INB/INF/INE 230808130, BSE INB 010808153/INF 011133230, MSE INE 260808130/INB 260808135/INF 260808135, AMFI ARN 0164, PMS INP000000258 and Research Analyst INH000000586. NSDL/CDSL: IN-DP-NSDL-23-97. Our research should not be considered as an advertisement or advice, professional or otherwise. The investor is requested to take into consideration all the risk factors including their financial condition, suitability to risk return profile and the like and take professional advice before investing. Investments in securities market are subject to market risks, read all the related documents carefully before investing. Derivatives are a sophisticated investment device. The investor is requested to take into consideration all the risk factors before actually trading in derivative contracts. Compliance Officer Details: Mr. Manoj Agarwal. Call: 022 - 4285 8484, or Email: ks.compliance@kotak.com.

In case you require any clarification or have any concern, kindly write to us at below email ids:

- **Level 1**: For Trading related queries, contact our customer service at 'service.securities@kotak.com' and for demat account related queries contact us at ks.demat@kotak.com or call us on: Online Customers - 30305757 (by using your city STD code as a prefix) or Toll free numbers 18002099191 / 1800222299, Offline Customers - 18002099292
- **Level 2:** If you do not receive a satisfactory response at Level 1 within 3 working days, you may write to us at ks.escalation@kotak.com or call us on 022-42858445 and if you feel you are still unheard, write to our customer service HOD at ks.servicehead@kotak.com or call us on 022-42858208.
- **Level 3:** If you still have not received a satisfactory response at Level 2 within 3 working days, you may contact our Compliance Officer (Mr. Manoj Agarwal) at ks.compliance@kotak.com or call on 91- (022) 4285 8484.
- **Level 4:** If you have not received a satisfactory response at Level 3 within 7 working days, you may also approach CEO (Mr. Kamlesh Rao) at ceo.ks@kotak.com or call on 91- (022) 4285 8301.