Motilal Oswal

3QFY11 Results Update

SECTOR: **OIL & GAS**

# Petronet LNG

| BSE SENSEX | S&P CNX |
|---|---|
| 19,092 | 5,724 |
| Bloomberg | PLNG IN |
| Equity Shares (m) | 750.0 |
| 52-Week Range (Rs) | 136/69 |
| 1,6,12 Rel. Perf. (%) | 8/48/54 |
| M.Cap. (Rs b) | 97.5 |
| M.Cap. (US$ b) | 2.1 |

**Rs130** **Buy**

| YEAR END | NET SALES (RS M) | PAT (RS M) | Adj. EPS (RS) | EPS GROWTH (%) | P/E (X) | P/BV (X) | ROE (%) | ROCE (%) | EV/ SALES | EV/ EBITDA |
|---|---|---|---|---|---|---|---|---|---|---|
| 03/10A | 106,491 | 4,045 | 5.4 | -22.0 | 24.1 | 4.4 | 19.2 | 23.0 | 1.1 | 14.5 |
| 03/11E | 128,230 | 6,019 | 8.0 | 48.8 | 16.2 | 3.7 | 24.8 | 26.6 | 1.0 | 10.1 |
| 03/12E | 150,449 | 7,041 | 9.4 | 17.0 | 13.8 | 3.2 | 24.8 | 25.4 | 0.9 | 9.0 |
| 03/13E | 186,234 | 8,512 | 11.3 | 20.9 | 11.5 | 2.7 | 25.7 | 32.6 | 0.7 | 6.7 |

- **EBITDA, PAT above estimates:** Petronet LNG reported 3QFY11 PAT of Rs1.7b against our estimate of Rs1.3b (up 105% YoY and up 30% QoQ). EBITDA was Rs3.5b (up 66% YoY and up 27% QoQ) higher than our estimate of Rs2.74b, led by increased throughput and strong marketing margins on spot cargoes.

- **Strong marketing margins on spot cargo:** Petronet earned marketing margins of ~Rs26/mmbtu in 3QFY11 (calculated) on its spot cargo over and above re-gasification charges on long-term cargo of Rs31.75/mmbtu. These marketing margins are considerably high and indicate strong gas demand in India. We model FY12 marketing margins of Rs5/mmbtu.

- **New 1.1mmtpa, two-year Dahej contract, expanded Kochi terminal to boost growth:** Petronet LNG signed a 1.1mmtpa LNG contract for FY12 and FY13 and back-to-back contracts with Indian customers. The signing of this contract eases the run rate pressure for capacity utilization. The Petronet board has approved expansion of its Kochi terminal to 5mmtpa and the new terminal is expected to be commissioned by 3QFY13. It signed a 1.5mmtpa gas source contract with Gorgon Australia, which is expected to deliver the full contract volume in FY14.

- **Valuation and view:** We are increasing our FY11 EPS by 15% to Rs8 to factor-in strong 3QFY11 reported numbers and higher volume assumptions in 4QFY11. The stock trades at 11.5x FY13E EPS of Rs11.4. We value Petronet LNG at Rs150/share, the average of the results of two valuation methodologies (1) P/E (13x FY13E EPS, Rs160/share) and (2) DCF (Rs140/share). Maintain **Buy**.

**QUARTERLY PERFORMANCE** **(RS MILLION)**

| Y/E MARCH | FY10 | | | | FY11 | | | | FY10 | FY11E |
|---|---|---|---|---|---|---|---|---|---|---|
| | 1Q | 2Q | 3Q | 4Q | 1Q | 2Q | 3Q | 4QE | | |
| **Net Sales** | **26,124** | **34,067** | **22,446** | **23,855** | **25,260** | **30,577** | **36,276** | **35,813** | **106,491** | **127,926** |
| *Change (%)* | *58.7* | *105.8* | *-9.2* | *-10.1* | *-3.3* | *-10.2* | *61.6* | *0.5* | *26.3* | *20.1* |
| Raw Material (incl. inv chg) | 24,020 | 31,189 | 20,026 | 21,413 | 22,333 | 27,547 | 32,389 | 31,656 | 96,648 | 113,925 |
| Staff Cost | 41 | 41 | 41 | 81 | 73 | 53 | 57 | 53 | 204 | 237 |
| Other Expenditure | 245 | 299 | 291 | 339 | 376 | 261 | 374 | 400 | 1,174 | 1,410 |
| **EBITDA** | **1,818** | **2,537** | **2,088** | **2,022** | **2,477** | **2,716** | **3,456** | **3,704** | **8,465** | **12,353** |
| *% of Net Sales* | *7.0* | *7.4* | *9.3* | *8.5* | *9.8* | *8.9* | *9.5* | *10.3* | *7.9* | *9.7* |
| *% Change* | *-5* | *39* | *13* | *-41* | *36* | *7* | *66* | *83* | *-6.1* | *45.9* |
| Depreciation | 256 | 430 | 466 | 456 | 461 | 466 | 465 | 525 | 1,609 | 1,917 |
| Interest | 283 | 511 | 534 | 511 | 498 | 495 | 507 | 508 | 1,839 | 2,007 |
| Other Income | 288 | 191 | 167 | 332 | 126 | 186 | 54 | 245 | 978 | 611 |
| **PBT** | **1,567** | **1,787** | **1,255** | **1,386** | **1,644** | **1,941** | **2,539** | **2,917** | **5,995** | **9,040** |
| Tax | 534 | 580 | 423 | 414 | 530 | 630 | 830 | 1,033 | 1,950 | 3,023 |
| *Rate (%)* | *34.1* | *32.5* | *33.7* | *29.8* | *32.2* | *32.5* | *32.7* | *35.4* | *32.5* | *33.4* |
| **PAT** | **1,033** | **1,207** | **832** | **973** | **1,114** | **1,311** | **1,709** | **1,884** | **4,045** | **6,018** |
| *Change (%)* | *-2.2* | *16.8* | *-20.8* | *-52.4* | *7.8* | *8.6* | *105.4* | *93.7* | *97.9* | *48.8* |
| **Gas Volume (TBTU)** | **98.0** | **113.5** | **95.2** | **91.8** | **95.2** | **99.8** | **119.7** | **120.7** | **398.5** | **435.4** |

*E: MOSt Estimates*

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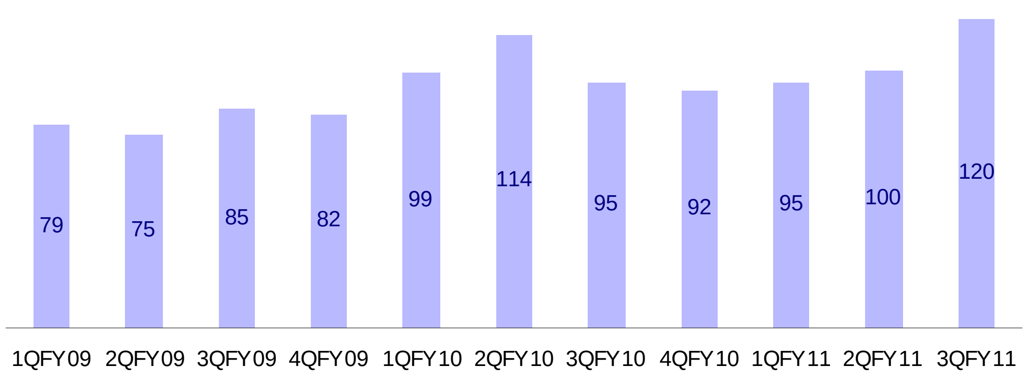
## EBITDA, PAT above estimates

Petronet LNG reported 3QFY11 PAT of Rs1.7b against our estimate of Rs1.3b (up 105% YoY and up 30% QoQ). EBITDA was Rs3.5b (up 66% YoY and up 27% QoQ) higher than our estimate of Rs2.74b, led by increased throughput and strong marketing margins on spot cargo.

Petronet's total 3QFY11 throughput was 120tbtu (2.4mmt/38mmscmd) against 100tbtu (2mmt/32mmscmd) in 2QFY11 and 95tbtu (1.92mmt/29.6mmscmd) in 3QFY10. Volumes were more than our estimate of 105tbtu (2.1mmt/33.3mmscmd), led by increased re-gasification volumes (third-party volumes) of 9tbtu against 0.3tbtu in 2QFY11.

**20% QoQ jump in Petronet's re-gasification volumes (tbtu)**




Source: Company/MOSL

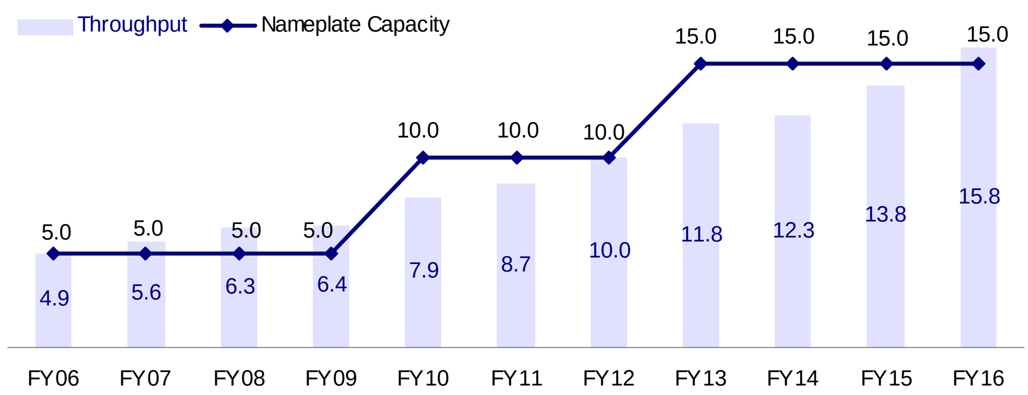
## Strong marketing margins on spot cargo

Petronet earned marketing margins of ~Rs26/mmbtu in 3QFY11 (calculated) on its spot cargo over and above its re-gasification charges on long term cargo of Rs31.75/mmbtu. These marketing margins are considerably high and indicate strong gas demand in India against a backdrop of a continued supply deficit. We model FY12 marketing margins of Rs5/mmbtu.

## New 1.1mmtpa, two-year Dahej contract, expanded Kochi terminal to boost growth

Petronet LNG has signed an LNG contract of 1.1mmtpa for FY12 and FY13 and back-to-back contracts with Indian customers. The signing of this contract eases the run rate pressure for capacity utilization. The Petronet board has approved expansion of its Kochi terminal to 5mmtpa and the new terminal is expected to be commissioned by 3QFY13. Petronet signed a 1.5mmtpa gas source contract with Gorgon Australia, which is expected to deliver full contract volume in FY14.

**Petronet in a sweet spot: expect 12% volume CAGR over FY13-16 (mmtpa)**




Source: Company/MOSL

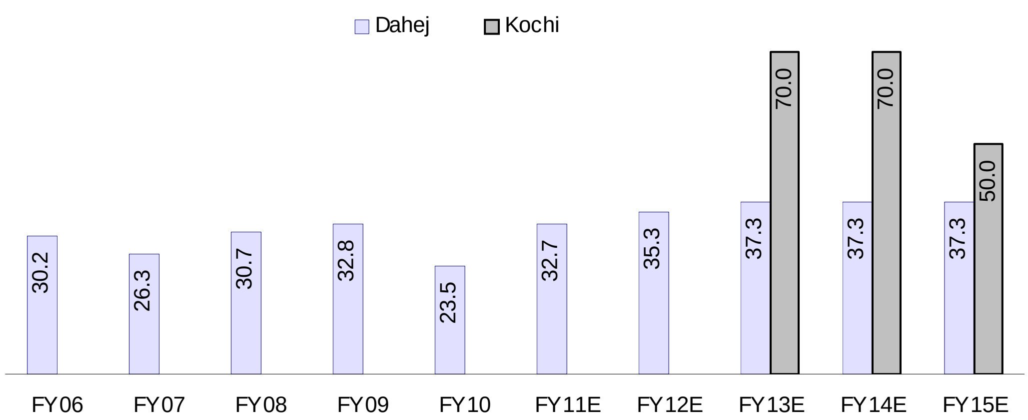
## Petronet to benefit from domestic gas scarcity

RIL indicated it would not increase its KG-D6 volumes beyond 60mmcmd until FY13. After reaching 60mmscmd, gas volumes fell to 52mmscmd in recent months. We believe this situation augurs well for Petronet as imported LNG will be the only option for gas consumers. With potential demand still unmet in India, Petronet is expected to ramp-up to full capacity of 10mmt in FY12 (currently annualized at 9.5mmtpa).

## Re-gasification charges, short-term contracts ensure 25%+ RoE

We expect Petronet's RoE to be over 25% led by (1) a 5% annual increase in re-gasification charges, (2) low gas prices reducing operating costs, and (3) high margins on short-term contracts. Since inception, Petronet increased re-gasification charges by 5% a year to the current Rs33.3/mmbtu in January 2011.

**No risk to re-gasification charges (Rs/mmbtu)**




Source: Company/MOSL

## Valuation and view

We are increasing our FY11 EPS by 15% to Rs8 to factor in strong 3QFY11 reported numbers and higher volume assumptions in 4QFY11. The stock trades at 11.5x FY13E EPS of Rs11.3. We value Petronet LNG at Rs150/share, the average of the results of two valuation methodologies (1) P/E (13x FY13E EPS, Rs160/share) and (2) DCF (Rs140/share). Maintain **Buy**.

## Key assumptions

We model gas sales at 10mmtpa (40mmscmd) in FY12 and 10.8mmtpa (43.2mmscmd) in FY13. We are assuming a 5% annual escalation in re-gasification charges (similar to previous years) and Rs5/mmbtu as marketing margin on short-term contracts.

### FY12 EPS sensitivity to marketing margins

| | | Marketing Margin (Rs/mmbtu) | | | | |
|---|---|---|---|---|---|---|
| | | 0 | 5.00 | 15.00 | 25.00 | 35.00 |
| Volume (mmtpa) | 9.8 | 8.6 | 9.1 | 10.1 | 11.1 | 12.2 |
| | 10.0 | 8.8 | 9.4 | 10.5 | 11.6 | 12.8 |
| | 10.2 | 9.1 | 9.7 | 10.9 | 12.1 | 13.4 |
| | 10.4 | 9.4 | 10.0 | 11.3 | 12.6 | 13.9 |

Source: MOSL

# Petronet LNG: an investment profile

## Company description

Petronet LNG was formed as a joint venture by the government of India to import LNG and set up LNG terminals in India. Each promoter, GAIL, ONGC, IOCL and BPCL, holds 12.5% stake in Petronet. The company owns and operates India's first LNG receiving and re-gasification terminal (current capacity: 10mmtpa) at Dahej, commissioned in February 2004. It is setting up a 5mmtpa terminal at Kochi. It is also augmenting the capacity of the existing Dahej terminal from 10mmtpa to 12.5/13mmtpa. It has a long-term supply contract of 7.5mmtpa with Ras Gas Qatar, with back-to-back customer contracts in India.

## Key investment arguments

- Petronet has been increasing re-gasification charges by 5% every year and earning additional margins (marketing margins) on short-term and spot contracts, thus enabling it to make 25% RoE.
- Its new terminal at Kochi is expected to be commissioned by 1QFY13 and will serve as the next growth driver. The other growth driver will be a 25-30% capacity augmentation of its 10mmtpa Dahej terminal, expected by 1QFY14.
- Slow ramp-up of KG-D6 gas and huge gas demand in the country will help Petronet to post 16% CAGR growth in volumes.

## Key investment risks

- There is a single long term gas source that is tied up from Ras Gas, Qatar. This implies a notional supply risk.
- Petronet LNG's business is unregulated. Going forward, if there is any Act or regulation formulated to regulate the LNG business, it could pose a threat to earnings.

## Recent developments

- Petronet recently signed up gas supplies totaling 1.1mmtpa for FY12 and FY13 and commencing from April 2011.
- Petronet also increased its re-gasification charges by 5% to Rs33.3/mmbtu, from January 2011.

## Valuation and view

- The stock trades at 13.8x FY12E EPS of Rs9.4.
- Our target for Petronet is Rs150, based on average of DCF and PE methodology. Maintain **Buy**.

## Sector view

- A gas surplus situation in the US, led by the emergence of shale gas has resulted in over capacity in the LNG market and will keep international LNG prices soft. Although India's domestic gas supply is likely to post 16% CAGR over FY10-14, India will still be gas deficient. Given India's gas deficit and LNG availability at reasonable prices, we expect Petronet's Dahej terminal to post 12% volume CAGR to 12.5mmtpa (50mmscmd) by FY14.

### Target Price and Recommendation

| Current Price (Rs) | Target Price (Rs) | Upside (%) | Reco. |
|---|---|---|---|
| 130 | 150 | 15.4 | Buy |

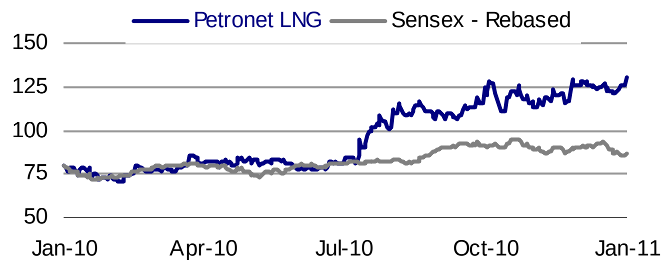
### EPS: MOSL forecast v/s Consensus (Rs)

| | MOSL Forecast | Consensus Forecast | Variation (%) |
|---|---|---|---|
| FY11 | 8.0 | 7.1 | 12.5 |
| FY12 | 9.4 | 8.4 | 12.0 |

### Shareholding Pattern (%)

| | Dec-10 | Sep-10 | Dec-09 |
|---|---|---|---|
| Promoter | 50.0 | 50.0 | 50.0 |
| Domestic Inst | 10.4 | 9.6 | 2.2 |
| Foreign | 21.4 | 20.9 | 21.9 |
| Others | 18.2 | 19.5 | 25.9 |

### Stock performance (1 year)



## Financials and Valuation

| INCOME STATEMENT | | | | | (Rs Million) |
|---|---|---|---|---|---|
| **Y/E MARCH** | **2009** | **2010** | **2011E** | **2012E** | **2013E** |
| **Net Sales** | **84,287** | **106,491** | **128,230** | **150,449** | **186,234** |
| *Change (%)* | *28.6* | *26.3* | *20.4* | *17.3* | *23.8* |
| Raw Material Consumed | 73,756 | 96,648 | 113,925 | 132,679 | 162,431 |
| Employee Costs | 196 | 204 | 237 | 249 | 411 |
| Other Expenditure | 1,322 | 1,174 | 1,410 | 2,763 | 3,749 |
| **EBITDA** | **9,013** | **8,465** | **12,657** | **14,759** | **19,643** |
| *% of Net Sales* | *10.7* | *7.9* | *9.9* | *9.8* | *10.5* |
| Depreciation | 1,025 | 1,609 | 1,917 | 2,083 | 4,428 |
| Interest | 1,012 | 1,839 | 2,310 | 2,599 | 2,984 |
| Other Income | 765 | 978 | 611 | 463 | 512 |
| Extraordinary Items (net) | | | | | |
| **PBT** | **7,740** | **5,995** | **9,042** | **10,540** | **12,742** |
| Tax | 2,556 | 1,950 | 3,023 | 3,499 | 4,230 |
| *Rate (%)* | 33.0 | 32.5 | 33.4 | 33.2 | 33.2 |
| PAT | 5,184 | 4,045 | 6,019 | 7,041 | 8,512 |
| **PAT** | **5,184** | **4,045** | **6,019** | **7,041** | **8,512** |
| *Change (%)* | *9.2* | *-22.0* | *48.8* | *17.0* | *20.9* |
| **Adj PAT** | **5,184** | **4,045** | **6,019** | **7,041** | **8,512** |

| BALANCE SHEET | | | | | (Rs Million) |
|---|---|---|---|---|---|
| **Y/E MARCH** | **2009** | **2010** | **2011E** | **2012E** | **2013E** |
| Share Capital | 7,500 | 7,500 | 7,500 | 7,500 | 7,500 |
| Reserves | 12,334 | 14,849 | 18,755 | 23,061 | 28,267 |
| **Net Worth** | **19,834** | **22,349** | **26,255** | **30,561** | **35,767** |
| Long Term Loans | 22,817 | 24,998 | 33,998 | 38,798 | 38,798 |
| Deferred Tax | 2,722 | 3,262 | 3,355 | 3,467 | 3,590 |
| **Capital Employed** | **45,373** | **50,609** | **63,609** | **72,826** | **78,155** |
| Gross Fixed Assets | 19,748 | 35,495 | 35,495 | 36,345 | 76,345 |
| Less: Depreciation | 5,062 | 6,667 | 8,583 | 10,667 | 15,095 |
| **Net Fixed Assets** | **14,686** | **28,829** | **26,912** | **25,678** | **61,250** |
| Capital WIP | 18,470 | 13,184 | 23,486 | 33,539 | 355 |
| Investments | 3,043 | 5,386 | 5,386 | 5,386 | 5,386 |
| **Curr. Assets, L & Adv.** | | | | | |
| Inventory | 3,856 | 2,223 | 3,162 | 3,710 | 4,592 |
| Debtors | 6,712 | 5,035 | 7,026 | 8,244 | 10,205 |
| Cash & Bank Balance | 6,577 | 3,405 | 6,642 | 6,713 | 9,092 |
| Loans & Adv. and Other A | 783 | 1,523 | 1,523 | 1,523 | 1,523 |
| Other Current Assets | 168 | 31 | 31 | 31 | 31 |
| **Current Liab. & Prov.** | | | | | |
| Liabilities | 7,365 | 7,449 | 8,739 | 10,178 | 12,460 |
| Provisions | 1,557 | 1,557 | 1,820 | 1,820 | 1,820 |
| **Net Current Assets** | **9,174** | **3,210** | **7,824** | **8,222** | **11,162** |
| **Application of Funds** | **45,373** | **50,608** | **63,608** | **72,825** | **78,154** |

*E: MOSL Estimates*

| RATIOS | | | | | |
|---|---|---|---|---|---|
| **Y/E MARCH** | **2009** | **2010** | **2011E** | **2012E** | **2013E** |
| **Basic (Rs)** | | | | | |
| **EPS** | **6.9** | **5.4** | **8.0** | **9.4** | **11.3** |
| Cash EPS | 5.5 | 3.2 | 5.5 | 6.6 | 5.4 |
| Book Value | 26.4 | 29.8 | 35.0 | 40.7 | 47.7 |
| DPS | 1.5 | 1.8 | 2.4 | 3.1 | 3.8 |
| Payout (incl. Div. Tax.) | 25 | 38 | 35 | 39 | 39 |
| **Valuation (x)** | | | | | |
| P/E | 18.8 | 24.1 | 16.2 | 13.8 | 11.5 |
| Cash P/E | 23.4 | 40.0 | 23.8 | 19.7 | 23.9 |
| EV / EBITDA | 12.9 | 14.5 | 10.1 | 9.0 | 6.7 |
| EV / Sales | 1.4 | 1.1 | 1.0 | 0.9 | 0.7 |
| Price / Book Value | 4.9 | 4.4 | 3.7 | 3.2 | 2.7 |
| Dividend Yield (%) | 1.2 | 1.3 | 1.9 | 2.4 | 2.9 |
| **Profitability Ratios (%)** | | | | | |
| RoE | 28.8 | 19.2 | 24.8 | 24.8 | 25.7 |
| RoCE | 27.0 | 23.0 | 26.6 | 25.4 | 32.6 |
| **Turnover Ratios** | | | | | |
| Debtors (No. of Days) | 17 | 18 | 18 | 18 | 18 |
| Asset Turnover (x) | 1.3 | 1.5 | 1.4 | 1.4 | 1.6 |
| **Leverage Ratio** | | | | | |
| Net Debt / Equity (x) | 1.0 | 1.1 | 1.2 | 1.2 | 0.9 |

| CASH FLOW STATEMENT | | | | | (Rs Million) |
|---|---|---|---|---|---|
| **Y/E MARCH** | **2009** | **2010** | **2011E** | **2012E** | **2013E** |
| OP/(Loss) before Tax | 7,740 | 5,995 | 9,042 | 10,540 | 12,742 |
| Depreciation | 1,025 | 1,609 | 1,917 | 2,083 | 4,428 |
| Others | -731 | -450 | 0 | 0 | 0 |
| Interest | 1,012 | 1,740 | 0 | 0 | 0 |
| Direct Taxes Paid | -2,656 | -1,640 | -2,929 | -3,388 | -4,107 |
| (Inc)/Dec in Wkg. Capital | -3,384 | 3,026 | -1,377 | -327 | -561 |
| **CF from Op. Activity** | **3,006** | **10,279** | **6,653** | **8,909** | **12,502** |
| (Inc)/Dec in FA & CWIP | -7,894 | -10,472 | -10,302 | -10,903 | -6,817 |
| (Pur)/Sale of Investment: | 2,473 | -2,337 | 0 | 0 | 0 |
| Inc from Invst | 695 | 452 | 0 | 0 | 0 |
| **CF from Inv. Activity** | **-4,726** | **-12,358** | **-10,302** | **-10,903** | **-6,817** |
| Issue of Shares | 0 | 0 | 0 | 0 | 0 |
| Inc / (Dec) in Debt | 7,041 | 2,181 | 9,000 | 4,800 | 0 |
| Interest Paid | -1,012 | -1,740 | 0 | 0 | 0 |
| Dividends Paid (incl.tax) | -1,316 | -1,536 | -2,113 | -2,735 | -3,306 |
| **CF from Fin. Activity** | **4,712** | **-1,094** | **6,887** | **2,065** | **-3,306** |
| **Inc / ( Dec) in Cash** | **2,992** | **-3,173** | **3,238** | **70** | **2,380** |
| Add: Opening Balance | 3,585 | 6,577 | 3,405 | 6,642 | 6,713 |
| **Closing Balance** | **6,577** | **3,405** | **6,642** | **6,713** | **9,092** |

# N O T E S

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| Disclosure of Interest Statement | Petronet LNG |
|---|---|
| 1. Analyst ownership of the stock | No |
| 2. Group/Directors ownership of the stock | No |
| 3. Broking relationship with company covered | No |
| 4. Investment Banking relationship with company covered | No |