Flashnote

HSBC
Global Research

Nat Resources & Energy
Oil & Gas
Equity – India

Petronet Lng Ltd (PLNG IN)

Neutral

Target price (INR)	185.00
Share price (INR)	168.00
Potential return (%)	10.1

Note: Potential return equals the percentage difference between the current share price and the target price

Performance	1M	3M	12M
Absolute (%)	7.3	0.7	38.6
Relative^ (%)	-2.9	-4.7	41.9

Index^	BOMBAY SE IDX
RIC	PLNG.BO
Bloomberg	PLNG IN
Market cap (USDm)	2,548
Market cap (INRm)	126,000
Enterprise value (INRm)	155412
Free float (%)	50

Note: (V) = volatile (please see disclosure appendix)

15 February 2012

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N: higher utilization offset by risk of marketing margin

- **We expect PLNG to continue with impressive capacity utilisation of its terminal in Gujarat but expect utilization ramp up at Kochi to be only gradual**
- **The risk of regulation of marketing margins will remain an overhang as Regulator has already started data gathering**
- **We maintain a Neutral rating and target price of INR185**

Petronet to continue demonstrating strong earnings near term. We expect Petronet to continue to run its terminal at full capacity and earn impressive marketing margins on imported gas as it makes the most of declining domestic gas volumes and increasing demand. However, we believe risks of regulation of marketing margins and poor utilisation of its new Kochi terminal will keep the stock range bound.

Risk of marketing margins. Our calculations suggest that Petronet earned 30-50c/mmbtu of marketing margins in last 3 quarters and made a surplus profit from its efficiencies in process boil-off. Regulator has now commenced the data gathering with the objective of determining the marketing margin already. We factor in this risk by lowering our long term marketing margins estimates to 0.135c/mmbtu in our DCF valuation.

Capacity utilisation at Kochi to be slow and gradual. PLNG's Dahej terminal is already running at peak capacity and expansion through additional jetty is expected only by 2QFY14 and new tanks in 2016. We expect utilisation to stabilise at 91% once its new terminals come on-stream. We believe Kochi terminal is expected to commission in 3QFY13 but its volume to ramp up will be slowly as this is the first time natural gas will be made available in that region.

Valuation and risk. In order to factor the long-term potential of various growth plan of the company and to account for the risks on marketing margin, we are now valuing the stock on DCF basis (earlier at 15x PE on FY13e EPS) over the life of the asset at WACC of 13%. However, we still arrive at the same valuation of INR185 and hence retain Neutral rating on the stock. Any increase or decrease in the LNG import volumes, marketing margins and the regassification tariff from our assumptions is a key risk to the stock.

Financials & valuation

Financial statements

Year to	03/2011a	03/2012e	03/2013e	03/2014e
Profit & loss summary (INRm)				
Revenue	131,973	247,912	432,750	511,110
EBITDA	12,163	18,848	19,931	19,621
Depreciation & amortisation	-1,847	-1,846	-2,390	-4,269
Operating profit/EBIT	10,316	17,002	17,541	15,351
Net interest	-1,252	-606	-1,372	-1,859
PBT	9,064	16,396	16,169	13,492
HSBC PBT	9,064	16,396	16,169	13,492
Taxation	-2,868	-5,198	-5,389	-4,497
Net profit	6,196	11,198	10,780	8,995
HSBC net profit	6,196	11,198	10,780	8,995
Cash flow summary (INRm)				
Cash flow from operations	7,866	11,313	11,526	15,408
Capex	-8,888	-20,003	-13,750	-9,734
Cash flow from investment	-8,944	-20,098	-13,750	-9,734
Dividends	-1,743	-1,749	-1,755	-1,755
Change in net debt	1,016	12,341	3,979	-3,919
FCF equity	-1,240	-8,900	-3,217	2,526
Balance sheet summary (INRm)				
Intangible fixed assets	0	0	0	0
Tangible fixed assets	49,053	67,210	78,569	84,034
Current assets	24,790	34,921	54,276	67,563
Cash & others	12,456	12,852	16,585	23,160
Total assets	74,577	102,960	133,675	152,426
Operating liabilities	10,348	18,135	31,114	36,821
Gross debt	30,356	43,093	50,805	53,461
Net debt	17,900	30,241	34,220	30,301
Shareholders funds	26,802	36,251	45,276	52,516
Invested capital	51,039	71,144	85,146	91,616

Ratio, growth and per share analysis

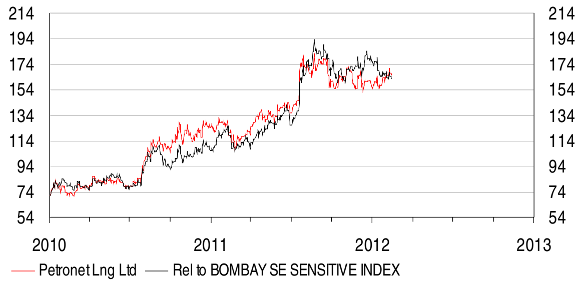
Year to	03/2011a	03/2012e	03/2013e	03/2014e
Y-o-y % change				
Revenue	23.9	87.9	74.6	18.1
EBITDA	43.7	55.0	5.7	-1.6
Operating profit	50.5	64.8	3.2	-12.5
PBT	51.2	80.9	-1.4	-16.6
HSBC EPS	53.2	80.7	-3.7	-16.6
Ratios (%)				
Revenue/IC (x)	2.8	4.1	5.5	5.8
ROIC	14.9	19.0	15.0	11.6
ROE	25.2	35.5	26.4	18.4
ROA	11.2	13.9	10.4	7.8
EBITDA margin	9.2	7.6	4.6	3.8
Operating profit margin	7.8	6.9	4.1	3.0
EBITDA/net interest (x)	9.7	31.1	14.5	10.6
Net debt/equity	66.8	83.4	75.6	57.7
Net debt/EBITDA (x)	1.5	1.6	1.7	1.5
CF from operations/net debt	43.9	37.4	33.7	50.8
Per share data (INR)				
EPS reported (fully diluted)	8.26	14.93	14.37	11.99
HSBC EPS (fully diluted)	8.26	14.93	14.37	11.99
DPS	2.00	2.00	2.00	2.00
Book value	35.74	48.33	60.37	70.02

Valuation data

Year to	03/2011a	03/2012e	03/2013e	03/2014e
EV/sales	1.1	0.6	0.4	0.3
EV/EBITDA	11.8	8.2	8.0	7.9
EV/IC	2.8	2.2	1.9	1.7
PE*	20.3	11.3	11.7	14.0
P/Book value	4.7	3.5	2.8	2.4
FCF yield (%)	-1.0	-7.1	-2.6	2.0
Dividend yield (%)	1.2	1.2	1.2	1.2

Note: * = Based on HSBC EPS (fully diluted)

Price relative



Source: HSBC

Note: price at close of 15 Feb 2012

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Investment thesis

Petronet LNG's earnings have grown at a CAGR of 9% over FY08-11, generating an average ROE of 25% for the period. We expect the ROE to decline to 18% by FY14. We expect Petronet LNG to achieve a CAGR of 13% on earnings over FY11-14e, though earnings are likely to decline from FY12 till FY14 and again grow from FY15 onwards. This is the reason why we change our valuation methodology to DCF. Our estimates are based on the assumption of 100% near-term capacity utilisation at the Dahej terminal and gradually increasing utilisation at the Kochi terminal, which we expect to be commissioned in the second half of FY13.

Risk of marketing margins. Our calculations suggest that Petronet earned 30-50c/mmbtu of marketing margins in last 3 quarters and made a surplus profit from its efficiencies in boil off. We expect some normalisation in FY13 expecting it to stay at 30c/mmbtu. PNGRB has now been assigned with the task of determination of marketing margins for gas marketers. While the scope of the task is still ambiguous, we believe there is a likely risk of clamp down on PLNG's marketing margin. We factor in this risk by lowering our long term marketing margins estimates to 0.135c/mmbtu

Capacity utilisation to come under pressure PLNG's Dahej terminal is already running at peak capacity and expansion through additional jetty is expected only by 2QFY14 and new tanks in 2016-17. We expect higher utilisation in initial year but expect utilisation to stabilise at 91% once its new terminals come on-stream. We believe Kochi terminal is expected to commission in 3QFY13 but expect its volume to ramp up slowly as Kochi's virgin territory will take time to absorb its first gas.

Assumptions and financials

Key Assumptions and Forecast changes

		FY12e	FY13e	FY14e	Remarks
Total Volumes (mt)	New	11.0	11.3	12.2	We now assume higher utilisation rate for Dahej terminal in near future as the company has demonstrated in last few quarters. We reduce initial utilisation rate of Kochi terminal as it is new model
	Old	10.4	10.7	13.4	
	Change	*6%*	*6%*	*-9%*	
Spot volumes (mt)	New	3.5	3.8	4.8	
	Old	3.0	3.2	5.2	
	Change	*15%*	*19%*	*-9%*	
EBITDA	New	18,848	19,931	19,621	We expect earnings decline over next 2 years as we expect more normalised marketing margin over the coming year and build in a risk of marketing margin of 12c/mmbtu in FY14
	Old	16,272	16,574	22,367	
	Change	*16%*	*20%*	*-12%*	
PAT	New	11,198	10,780	8,995	Our earnings estimate increase for FY12/13 due to higher utilisation and better marketing margins than our expectations
	Old	9,069	9,132	10,670	
	Change	*23%*	*18%*	*-16%*	
EPS	New	14.9	14.4	12.0	Our EPS for FY14 would be INR14.5 if PLNG continues to enjoy the same level of margins and is able to share benefit from its efficiency gains ait is enjoying now
	Old	12.1	12.2	14.2	
	Change	*23%*	*18%*	*-16%*	

Source: HSBC estimates

Valuation

We are changing valuation methodology from a PE multiple based to a DCF based in view of likely commissioning of the new terminal at Kochi. The ROCE of the company is going to reduce post the Kochi commissioning thereby rendering the past multiple irrelevant. In order to capture the current uncertainty around marketing margin that may have long term impact on the valuation, we now value the company on DCF basis. The salient assumptions are shown below:

We assume long term marketing margins at 12c/mmbtu over and above surplus profit from efficiencies. The value of the company is essentially the value of its regas terminals in Dahej and Kochi. Hence, our DCF valuations account for the entire life of these assets.

DCF valuation (INR mn)

	2013F	2014F	2015F	2016F
Dahej Volume (mt)	11.1	11.2	12.9	13.9
Kochi volume (mt)	0.2	1.0	1.2	1.5
Dahej regas tariff (INR/mmbtu)	35.5	37.2	39.1	40.8
Kochi regas tariff (INR/mmbtu)	45.0	46.1	47.3	48.5
EBITDA from Dahej	19,694	18,574	22,458	25,520
EBITDA from Kochi	237	1,047	1,431	1,842
Total EBITDA	19,931	19,621	23,890	27,362
Capex at Dahej	-9,750	-9,617	-7,150	-2,662
Capex at Kochi	-4,000	-117	-150	-158
Value of Dahej	135,970			
Value of Kochi Terminal	37,157			
Net Debt	34,220			
Value of Equity	138,907			
Number of Share (mn)	750			
Value per share (INR)	**185**			

Source: HSBC estimates

Even on DCF, our equity valuation is at INR138.6bn implying a target price of INR185 per share. Our DCF value is based on 13% WACC and cash flows over the entire projected life of the asset. Since our target price of INR185 implies only a 10% potential return, we rate the stock Neutral. Potential return equals the percentage difference between the current share price and the target price, including the forecast dividend yield when indicated.

Risks and sensitivity

Key risks to our rating and valuation are as follows:

- LNG import volume being higher or lower than we expect. The company believes there is a long list of customers with unmet gas demand, which will ultimately depend on imported gas. However, we believe a large portion of this unmet demand is price sensitive.
- Regas tariffs at the Dahej project to continue increasing by 5% every year and Kochi tariff being higher or lower than our estimates. We have assumed Dahej regas tariff will rise 5% per year till 2015 and 2.5% per year thereafter.

The table below shows our key sensitivities applied to the share price.

Sensitivity to valuation (INR/share)

	INR/share
Impact if regas tariff continues to increase by 5% till end of life of Dahej plant	43
Impact if regas tariff for Kochi terminal is lower by INR10/Mmbtu	-15
Impact if there is 1MMt lower volume at Dahej from FY17	-8
Impact if there is 1MMt higher volume at Kochi from FY20	7
Impact of USD0.10/mmbtu higher marketing margin in FY14 onwards	4

Source: HSBC estimates

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Disclosure appendix

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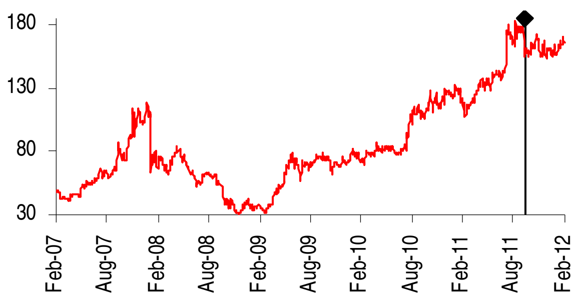
Underweight (Sell)	13%	(15% of these provided with Investment Banking Services)

Share price and rating changes for long-term investment opportunities

Petronet Lng Ltd (PLNG.BO) Share Price performance INR Vs HSBC rating history



Source: HSBC

Recommendation & price target history

From	To	Date
N/A	Neutral	27 September 2011
Target Price	**Value**	**Date**
Price 1	185.00	27 September 2011

Source: HSBC

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