Petronet LNG

BSE code:	532522
NSE code:	PETRONET

CMP: Rs 55 Target: Rs 73 BUY

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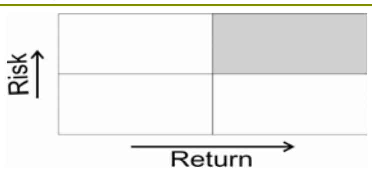
Company data

Particulars	
Market cap (Rs bn / US$ bn)	41.3/1.0
Outstanding equity shares (mn)	750.0
52-week high/low (Rs)	65.0/41.2
3-month average daily volume	1,700,121

Financial snapshot

Particulars	FY07	FY08E	FY09E
Sales (Rs bn)	55.1	70.0	85.9
Growth (%)	43.6	27.0	22.7
Adj net profit (Rs bn)	3.1	4.6	5.0
Growth (%)	60.7	47.2	7.9
FDEPS (Rs)	4.2	6.1	6.6
Growth (%)	60.7	47.2	7.9
P/E (x)	13.4	9.1	8.4
RoE (%)	26.7	32.4	28.8

Risk-return profile



Shareholding pattern

(%)	Mar-07	Dec-06
Promoters	50.0	50.0
FIIs	14.4	15.1
Banks & FIs	0.5	0.3
Public	35.1	34.6

Stock performance

Returns (%)	CMP	1-mth	3-mth	6-mth
Petronet LNG	55.0	7.8	34.1	16.5
Sensex	14,505	0.7	12.6	4.8
BSE Oil & Gas	7,599	(2.5)	18.9	22.4

Fuelled for success

Higher sales of spot cargo, expansion plans to propel growth

Investment rationale

- Engaged in the import and re-gasification of LNG; owns India's first and largest re-gasification terminal at Dahej, Gujarat.
- Demand for LNG expected to remain strong, driven by the sponge iron, power and fertiliser sectors, enlarging the demand-supply gap.
- Spot cargo volumes projected to double to 24 in FY08, which will likely drive topline growth.
- Capacity at Dahej being expanded from 5mmtpa to 12.5mmtpa by December 2008, with the set up of a new 5mmtpa terminal at Kochi.
- 25-year agreement with RasGas, Qatar for assured LNG supply; Finalising a tie-up with Gorgon Project, Australia for supply to the upcoming Kochi terminal. Exclusive time charter agreements ensure smooth transportation of LNG.
- 5% escalation clause in re-gasification charges will keep operating margins intact, going forward.

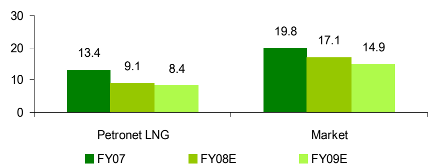
Key concerns

- Overdependence on one LNG supplier, RasGas.
- Delay in the start up of new projects.

Valuation

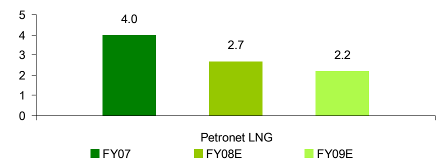
- Currently trading at a P/E of 13.4x on FY07, 9.1x on FY08E and 8.4x on FY09E; We recommend a Buy with a target price of Rs 73.

P/E multiple (x)



Source: Religare Research

EV/EBITDA multiple (x)



Source: Religare Research

Company overview

Promoted by BPCL, GAIL, IOC and ONGC, each holding a 12.5% stake

Petronet LNG (PLL) was set up in 1998 for the import and re-gasification of liquefied natural gas (LNG). It owns India's first and largest re-gasification terminal with a capacity of 5mmtpa at Dahej, Gujarat. PLL was formed as a joint venture company by oil & gas majors, BPCL, GAIL, IOC and ONGC, each holding a 12.5% stake. The company maintains a strategic partnership with GAZ De France (GDF) International, a wholly owned subsidiary of French National Gas Company, for technical assistance with the operation and maintenance of its LNG terminal. GDF holds a 10% of stake in the company, while Asian Development Bank holds 5.2%.

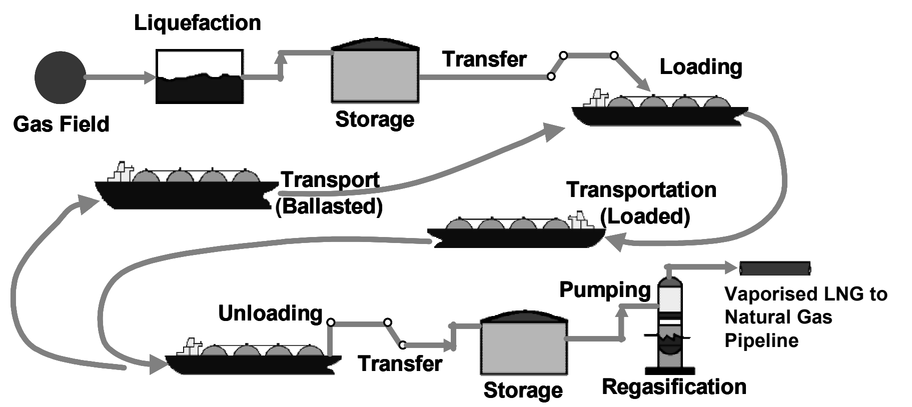
Dominant player in the LNG industry

PLL is the dominant LNG supplier in India, accounting for 25% of the country's total supplies. Domestic demand for LNG is on the rise, and the company is expected to account for nearly 30% of total gas supplies in the country by FY12.

Business model

PLL began importing LNG in January 2004 from its Dahej terminal, where it stores and re-gasifies the same for supply to GAIL, BPCL and IOCL. The company sells 60% of its production to GAIL, 30% to IOCL and 10% to BPCL. It recovers all operational costs from its customers and thereafter charges a fixed re-gasification charge based on an index of Rs 23.7/mmbtu in FY04, subject to 5% appreciation every year.

LNG supply chain



Source: Company

Long-term contracts for uninterrupted supply of LNG

PLL is currently receiving 5mmtpa of LNG at its Dahej terminal and is expected to scale up capacity to 12.5mmtpa by FY09. The company has signed a 25-year LNG sale and purchase agreement (SPA) with Ras Laffan Liquefied Natural Gas Company II (RasGas), Qatar that ensures an uninterrupted supply of LNG to it till 2029. According to the agreement, PLL will be obliged to buy LNG from RasGas at a fixed price of US$ 2.5/mmbtu during 2004-08, after which the price would be linked to the Japan Crude Cocktail price (JCC).

Full capacity utilisation within second year of operation

100% utilisation at Dahej in second year of operation

PLL has achieved 100% capacity utilisation at its Dahej LNG terminal in 2005-06, its second year of operation. In 2006-07, the terminal operated at around 115%.

Investment rationale

Higher quantum of spot cargo to fuel growth

12 spot cargoes unloaded during FY07, which reflects 115% capacity utilisation

Better capacity utilisation has raised spot cargo offtake

PLL has been able to raise production at its Dahej terminal substantially above its installed capacity of 5mmtpa via de-bottlenecking initiatives and efficient utilisation of equipment. The company has unloaded 12 spot cargoes during FY07, which reflects 5.8mmtpa of LNG production (115% capacity utilisation). Realisations in the spot market are higher than that of contracted cargo, which substantially expands margins.

Contracted and spot volumes

Particulars	FY06	FY07	FY08E
Contracted volumes			
- No. of cargo	80	80	80
- In tbtu	258	258	258
- In mmtpa	5	5	5
Spot volumes			
- No. of cargo	0	12	24
- In tbtu	0	38.7	77.4
- In mmtpa	0	0.7	1.5
Actual production volumes			
- No. of cargo	80	92	104
- In tbtu	247.8	292.8	335.4
- In mmtpa	5	5.7	6.5

Source: Company, Religare Research

Contract with RGPPL for the supply of an additional 1.5mmtpa of LNG till Sep-09

Volumes of spot cargo expected to double in FY08

The company expects to further raise production at Dahej to 6.5mmtpa in FY08, implying a doubling in spot cargo from 12 to 24 during the year. The company has already entered into a contract with Ratnagiri Gas and Power (RGPPL) to supply the additional 1.5mmtpa of gas till September 2009. Half of the spot cargo for this contract will be sourced from RasGas and the other half from Australian company, Gorgon Project. PLL will receive gas at Dahej at US$ 4.83/mmbtu and supply it to RGPPL at US$ 5.93/mmbtu. This compares favourably with the average rate of US$ 3.6/mmbtu earned on contracted cargo in FY07, and is likely to expand the net profit margins going forward.

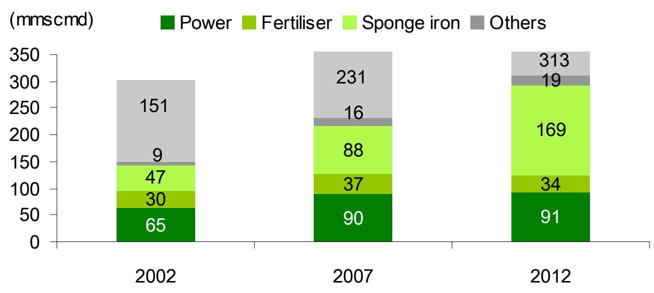
Capacity augmentation to meet rising demand

Strong demand from power, fertiliser and sponge iron sectors

The demand for natural gas is increasing at 7% annually, supported by rising demand from major industries such as power, fertiliser and sponge iron. Natural gas currently accounts for about 8% of the total primary commercial energy consumption in the country. This is expected to increase to 20% by 2011-12.

The power and fertiliser sectors cumulatively generate about 72% of total gas demand, while other sectors such as steel, chemicals, petrochemicals, glass and ceramics contribute to about 10% of the demand.

Sector-wise demand for natural gas



Source: Company, Religare Research

Significant demand-supply gap

Natural gas supply shortfall of 118.5mmscmd in FY07

India is facing a severe shortage of LNG currently, which has resulted in the line-up of several fresh natural gas projects in the country. During FY07, there was an estimated natural gas shortfall of 118.5mmscmd, though this is likely to decrease to 36mmscmd by the end of 2012 with the start up of various new projects.

Demand-supply mismatch

(mmscmd)	2002	2007E	2012E
Total domestic gas production (A)	90.2	95.0	192.0
LNG imports			
- Dahej	0	17.5	43.8
- Kochi	0	0	17.5
- Dabhol	0	0	17.5
- Hazira	0	0	6.2
Total LNG imports (B)	0	17.5	85.0
Total gas supply (A+B)	90.2	112.5	277.0
Total gas demand	151.0	231.0	313.0
Demand-supply gap	60.8	118.5	36.0

Source: Company

Expansion at Dahej, new terminal at Kochi

In view of the tight demand-supply situation, PLL is planning to expand its existing Dahej LNG terminal and also set up a new terminal at Kochi.

Capacity expansion plan

	Current capacity (mmtpa)	After expansion (mmtpa)	Expected time of completion	Capex required (Rs bn)	Debt (Rs bn)	Equity (Rs bn)
Dahej terminal	5..0	12.5	Dec 2008	16.0	12.3	3.7
Kochi terminal	-	5.0	Dec 2010	26.0	18.2	7.8
Total	5.0	17.5	-	42.0	30.5	11.5

Source: Company

Capacity at Dahej being raised to 12.5mmtpa; new 5mmtpa LNG terminal at Kochi

- **Dahej terminal:** The company initially invested ~Rs 20.1bn towards the set up of its 5mmtpa terminal at Dahej, with an option to expand capacity to 10mmtpa. It is now raising this capacity further to 12.5mmtpa at an aggregate cost of Rs 16bn, to be met through a mix of debt and equity (77:23). The terminal is expected to commence production by December 2008.

- **New Kochi terminal:** PLL is also setting up a 5mmtpa LNG re-gasification terminal at Kochi to meet the growing demand from the southern region. This terminal is expected to be complete by December 2010 at a total capex of Rs 26bn, of which 70% will be met through debt and 30% through equity.

- **Solid cargo port at Dahej:** In September 2006, PLL formed a 50:50 joint venture with the Adani Group for building a Solid Cargo Port at Dahej. The two phases of the project are likely to cost around Rs 11.5bn in all, funded via a debt-equity mix of 70:30. The project is likely to be completed within 36 months. The solid cargo port will have facilities to import and export coal, steel, fertiliser, etc.

Assured LNG supply

RasGas tie-up, Pact with Gorgon Project

Australia's Gorgon Project likely to supply 2.5mmtpa of LNG for upcoming Kochi terminal

PLL's SPA with RasGas will ensure an uninterrupted supply of 5mmtpa of LNG for its Dahej terminal for a period of 25 years till 2029. By December 2007, the company also expects to finalise the sourcing of an additional 2.5mmtpa from Australia's Gorgon Project for its upcoming terminal at Kochi. PLL is in talks with various other potential suppliers in Malaysia, Oman, Qatar, Abu Dhabi, and Algeria for further LNG imports.

Exclusive time charters for LNG carriage

PLL currently has exclusive time charter agreements with Mitsui OSK Lines, Japan for two LNG tankers (3.1tbtu capacity each), which transport the gas from Qatar to Dahej. In order to meet the added transportation requirements at this terminal post-expansion, PLL has executed a third time charter with Mitsui in February 2006. This tanker is scheduled to commence operations in September 2009. For the Kochi LNG terminal, PLL has pre-qualified six ship owners and operators for two vessels of 175,000 cubic meter capacity each.

Margins to remain intact

5% escalation clause will keep margins stable

Escalation clause for re-gasification to keep operating margins at 13.5-14%

PLL sells LNG at a price which includes the LNG purchase price, shipping costs, customs duty, exchange rate fluctuations and fixed re-gasification charges. Re-gasification charges are based on an index of Rs 23.7/mmbtu in FY04 with a clause for 5% appreciation every year. This is expected to counter the impact of incremental operating costs, and insulate margins to some extent. The company recorded an operating margin of 11.8% in FY07, and we expect the margin to stabilise at 13.5-14% in the long term.

Key concerns

Overdependence on one supplier

The company currently procures all its required LNG from RasGas, Qatar, which is a cause for concern. Although, PLL has tied up the supply via a long-term contract with RasGas, any unfavourable incident at the supplier's end or any disturbance in Qatar may severely impact the company's performance.

Delay in start-up of new projects

The scheduled commissioning dates for the Dahej and Kochi terminals are December 2008 and December 2010 respectively. Any delay in commissioning may result in cost-overruns and dent the company's expected future revenues.

Financial outlook

Strong volume-led revenue growth over FY05-FY07

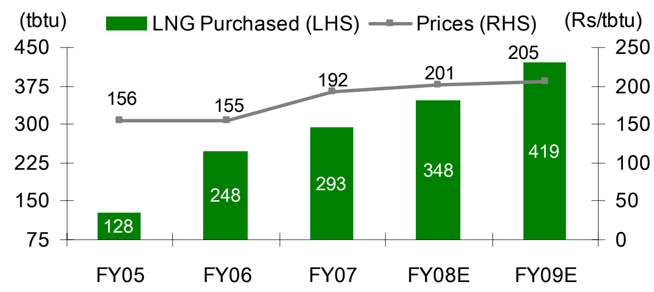
PLL's total LNG production has grown at a CAGR of 51% to 293tbtu over FY05-FY07, primarily due to higher capacity utilisation at the Dahej terminal. In addition, the company's average price realisation has increased to Rs 192/tbtu in FY07 from Rs 156 in FY06 due to higher rates for spot cargo and the 5% escalation clause for re-gasification charges. This fuelled a 68.3% CAGR in revenues to Rs 55.1bn over the past three years.

Spot cargo to drive future growth

Doubling of spot cargo to drive 25% revenue CAGR over FY07-FY09 to Rs 86bn

We expect revenues to clock a 24.9% CAGR over FY07-FY09 to Rs 85.9bn as volumes of spot cargo expand. Since the company is likely to deliver 24 cargo loads to RGPPL in FY08, we have built in a continued supply of 24 loads during FY09 as well. In addition, expanded production from the Dahej terminal is expected to commence from Q4FY09 which will further boost topline growth.

LNG purchased and average price realisation



Source: Company , Religare Research

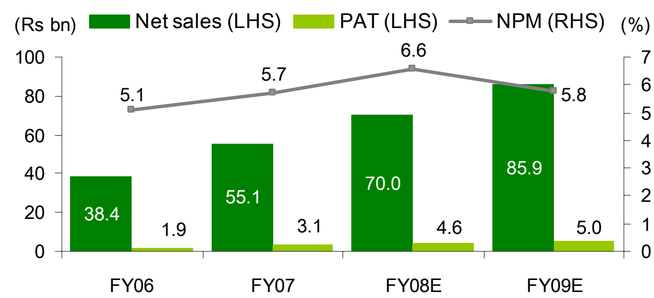
Operating margins to expand in FY08

We expect the company's operating margin to increase from 11.8% in FY07 to 14% in FY08 and thereafter remain stable from FY09 onwards. The stability will come mainly from the annual 5% appreciation in re-gasification charges, which will offset higher operating expenses. The spike in FY08 is mainly on account of higher price realisations from the spot cargo.

Net profit CAGR of 26% expected over FY07-FY09

PLL's net profit is expected to grow at a CAGR of 26% over FY07-FY09 to ~Rs 5bn. Higher interest and depreciation expenses are expected to keep PLL's net profit margins constant at 5.8% till FY09.

Expected revenue and profit trend



Source: Company , Religare Research

Valuation

Our target of Rs 73 represents a 33% potential upside

Buy with a target price of Rs 73

At the current price, the company is trading at P/E multiples of 13.4x on FY07, 9.1x on FY08E and 8.4x on FY09E. Historically, the stock has been trading at a P/E of 12x one-year forward earnings. We have valued PLL using the free cash flow to equity (FCFE) methodology. Based on the assumptions outlined below, our valuation yields a March 2008 target price of Rs 73, which represents a potential upside of 33% from the current level. Buy.

DCF assumptions

Particulars	Assumption
Risk free rate of return (%)	8.0
Beta	1.2
Market risk premium (%)	7.0
Cost of equity (%)	16.7
Terminal growth rate (%)	2.0
Explicit forecast period (years)	2008-15
Total value of equity (mn)	54,706.0
Number of shares (mn)	750.0
Fair value per share (Rs)	73

Source: Religare Research

Financials

Profit and Loss statement

(Rs bn)	FY06	FY07	FY08E	FY09E
Revenues	38.4	55.1	70.0	85.9
Growth (%)	97.3	43.6	27.0	22.7
EBITDA	4.9	6.5	9.8	12.0
Growth (%)	224.4	32.8	51.2	22.6
Depreciation	(1.0)	(1.0)	(1.3)	(2.2)
EBIT	4.1	5.8	8.5	9.8
Growth (%)	507.5	43.3	45.3	16.3
Interest	(1.1)	(1.1)	(1.5)	(2.3)
Other income	0.2	0.4	0.0	0.0
EBT	3.0	4.8	7.0	7.5
Growth (%)	595.1	61.2	46.6	7.9
Tax	(1.0)	(1.6)	(2.4)	(2.6)
Effective tax rate	33.9	34.1	33.9	33.9
Adj net income	1.9	3.1	4.6	5.0
Growth (%)	585.3	60.7	47.2	7.9
Shares outstanding (mn)	750.0	750.0	750.0	750.0
FDEPS (Rs)	2.6	4.2	6.1	6.6
DPS (Rs)	0.0	1.2	1.8	2.0
CEPS (Rs)	4.9	7.7	7.9	9.5

Source: Company, Religare Research

Balance sheet

(Rs bn)	FY06	FY07	FY08E	FY09E
Cash and cash eq	2.5	3.4	3.0	1.9
Accounts receivable	1.3	3.3	3.5	4.3
Inventories	1.0	2.1	2.1	2.6
Others current assets	0.9	2.1	1.4	1.7
Current assets	5.7	10.9	10.0	10.5
LT investments	1.6	2.8	2.8	2.8
Net fixed assets	17.4	16.4	29.8	47.9
CWIP	1.2	4.8	0.0	0.0
Total assets	25.9	34.9	42.6	61.2
Payables	1.4	3.1	4.0	5.0
Others	0.4	2.8	5.1	5.8
Current liabilities	1.7	5.9	9.0	10.8
LT debt	12.6	13.8	17.9	31.5
Other liabilities	0.9	2.5	0.0	0.0
Equity capital	7.5	7.5	7.5	7.5
Reserves	3.2	5.3	8.2	11.4
Net Worth	10.7	12.8	15.7	18.9
Total liabilities	25.9	34.9	42.6	61.2
BVPS (Rs)	14.3	17.0	20.9	25.2

Source: Company, Religare Research

Cash flow statement

(Rs bn)	FY06	FY07	FY08E	FY09E
Net income	1.9	3.1	4.6	5.0
Depreciation	(1.0)	(1.0)	(1.3)	(2.2)
Other adjustments	0.7	1.6	0.0	0.0
Changes in WC	(2.3)	(0.1)	3.6	0.1
Operating cash flow	(0.6)	3.6	6.9	2.9
Capital expenditure	1.3	(1.6)	(7.2)	(15.9)
Investments	(1.4)	(1.2)	0.0	0.0
Other investing inc/(exp)	0.0	0.0	0.0	0.0
Investing cash flow	(0.1)	(2.8)	(7.2)	(15.9)
Free cash flow	(0.7)	0.8	(0.3)	(13.0)
Issue of equity	0.0	0.0	0.0	0.0
Issue/repay debt	0.0	1.2	4.1	13.6
Dividends paid	0.0	(1.1)	(1.6)	(1.7)
Others	0.3	0.0	(2.6)	0.0
Financing cash flow	0.3	0.1	(0.1)	11.8
Beg. cash & cash eq	3.0	2.5	3.4	3.0
Chg in cash & cash eq	(0.5)	0.9	(0.4)	(1.1)
Closing cash & cash eq	2.5	3.4	3.0	1.9

Source: Company, Religare Research

Financial ratios

	FY06	FY07	FY08E	FY09E
EBITDA margin (%)	12.7	11.8	14.0	14.0
EBIT margin (%)	10.6	10.6	12.1	11.5
Net profit margin (%)	5.1	5.7	6.6	5.8
FDEPS growth (%)	585.3	60.7	47.2	7.9
Receivables (days)	12.2	22.0	18.1	18.1
Inventory (days)	9.9	13.9	11.2	11.2
Payables (days)	13.0	20.7	20.7	21.1
Current ratio (x)	3.3	1.9	1.1	1.0
Interest coverage (x)	3.6	5.4	5.7	4.2
Debt/equity ratio (x)	1.2	1.1	1.1	1.7
ROE (%)	19.7	26.7	32.4	28.8
ROCE (%)	11.9	15.4	18.6	15.5
ROAE (%)	7.6	10.3	11.9	9.6
EV/Sales (x)	0.7	0.5	0.4	0.3
EV/EBITDA (x)	5.3	4.0	2.7	2.2
P/E (x)	21.2	13.2	8.9	8.3
P/BV (x)	3.8	3.2	2.6	2.2
P/CEPS (x)	11.1	7.1	6.9	5.8

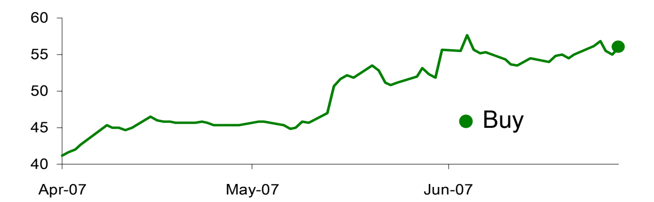
Source: Company, Religare Research

Recommendation history

Date	Event	Target (Rs)	Reco
29-Jun-07	Initiating Coverage	73	Buy

Source: Religare Research

Stock performance



Source: Religare Research

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