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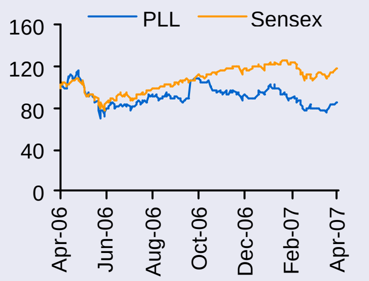
Petronet LNG Ltd (Q4 FY07) - Investment Update

Recommendation	BUY
CMP	Rs46
Target Price	Rs54
Upside	17.4%
Sensex	13,607
52 Week H/L	Rs68/35.5
Average Vol.(3M)	536,336
Market Cap	Rs34.5bn
Face Value	Rs10
BSE Code	532522
NSE Code	PETRONET
Reuters Code	PLNG.BO
Bloomberg Code	PLNG@IN

Share holding pattern

Dec '06	(%)
Foreign	25.0
Non Promoter Corp Holding	2.0
Promoters	50.0
Public and Others	22.0

Share price chart



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Petronet LNG Ltd (PLL) announced its Q4 FY07 results, which were below expectations on the revenue front as the volumes from Ras Gas were down by more than 10% qoq to 60.2 TBTUs. The dip was compensated by 4 spot cargos, which provided incremental volumes of 13.1 TBTUs. Operating margins during the quarter slipped by 250bps yoy as spot cargos command lower operating margins in terms of percentage (in absolute terms OPM on spot cargos are higher than regular business as they include some element of marketing margins). 121.2% yoy jump in other income translated into a 60.3% yoy growth in PAT to Rs1,060mn. Going ahead, PLL has tied up for 36 spot cargos which it would regasify to supply fuel to the Dabhol power project. With Dahej expansion to 10mn tons slated to commence operations in Q4 FY09, PLL is all set to tap the opportunity provided by the strained demand-supply scenario for natural gas in the country. We believe that PLL will clock a CAGR of 14.1% in topline and 14.3% in PAT during FY07-FY09. We recommend a BUY on the stock with a one year target of Rs54, up 17.4% from current levels. The target price was arrived at by assigning a P/E multiple of 10x to FY09 EPS estimate of Rs5.4.

Increase in spot cargos to drive growth in FY08

PLL has tied up for 36 spot cargos to be regasified and supplied to Dabhol power project. The supplies shall commence from July 2007 and are likely to spread over till December 2008. The company has been able to source the gas at cheaper rates compared to the prevailing prices in the Asia – Pacific region. PLL has increased its nameplate capacity by 1.5mmtpa to 6.5mmtpa through de-bottlenecking at Dahej terminal.

Capacity expansions to fuel growth beyond FY09

PLL is currently expanding the capacity at Dahej by another 5mmtpa which is likely to commence operations by December 2008. The company has a tieup with Ras Gas which already provides for additional supplies of 2.5mmtpa of LNG and is in process of finalizing for the remaining 2.5mmtpa. Further, the greenfield project at Kochi with a capacity of 5mmtpa will commence operations from FY10. We believe that PLL will process 6.8mmtpa of LNG in FY09 as against 5.6mmtpa in FY07.

Valuation Summary

	FY06	FY07 P	FY08 P	FY09 P
Sales	38,372	55,006	66,311	71,629
Growth (%)	97.3	43.4	20.6	8.0
PAT	1,949	3,093	3,674	4,039
Growth (%)		58.7	18.8	9.9
OPM (%)	12.7	11.6	11.6	11.9
EPS (Rs)	2.6	4.1	4.9	5.4
P/E (x)	17.7	11.2	9.4	8.5
EV/EBIDTA	8.8	7.0	6.1	5.6
ROCE (%)	21.8	23.4	23.2	22.6
RONW (%)	18.2	22.4	21.0	18.8

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Q4 FY07 result analysis

Financial highlights

(Rs mn)	Q4 FY07	Q4 FY06	Growth (%)	FY07	FY06	Growth (%)
Net sales	15,388	9,417	63.4	55,090	38,372	43.6
Total Expenditure	(13,397)	(7,965)	68.2	(48,609)	(33,490)	45.1
Operating Profit	1,991	1,453	37.1	6,481	4,882	32.8
Other Income	148	67	121.2	366	194	88.2
Interest	(259)	(265)	(2.2)	(1,070)	(1,116)	(4.1)
Depreciation	(252)	(251)	0.2	(1,020)	(1,010)	1.1
PBT	1,629	1,004	62.3	4,756	2,950	61.2
Tax	(569)	(342)	66.1	(1,623)	(1,001)	62.1
PAT	1,060	661	60.3	3,133	1,949	60.7
Equity	7,500	7,500		7,500	7,500	
OPM(%)	12.9	15.4	(2.5)	11.8	12.7	(1.0)
NPM(%)	6.9	7.0	(0.1)	5.7	5.1	0.6
EPS Annualized Rs	5.7	3.5		4.2	2.6	
CMP (Rs)	46.0			46.0		
P/E (x)	8.1			11.0		

Higher volumes and regassification charges spur up revenues

Petronet LNG Ltd (PLL) reported a 63.4% yoy jump in net sales to Rs15.4bn primarily driven by 22% yoy surge in volumes to 73.3 TBTUs coupled with 5% increase in regasification charges which currently stands at Rs27.44/mmbtu. The volumes were higher as the company processed 4 spot cargos during Q4 FY07 translating into incremental volumes of 13.1 TBTUs. Regular volumes however declined on a qoq basis from 67.5 TBTUs in Q3 FY07 to 60.2 TBTUs. The fall was on account of disruption of 2 cargos from Ras Gas. Rising spot cargos have also resulted into jump in realizations from US$3.5/mmbtu in Q4 FY06 to US$4.8/mmbtu in Q4 FY07. For FY07 net sales were up by 43.6% yoy to Rs55.1bn driven by 17.6% yoy rise in volumes to 290 TBTUs.

Chart: Trend in volumes for PLL

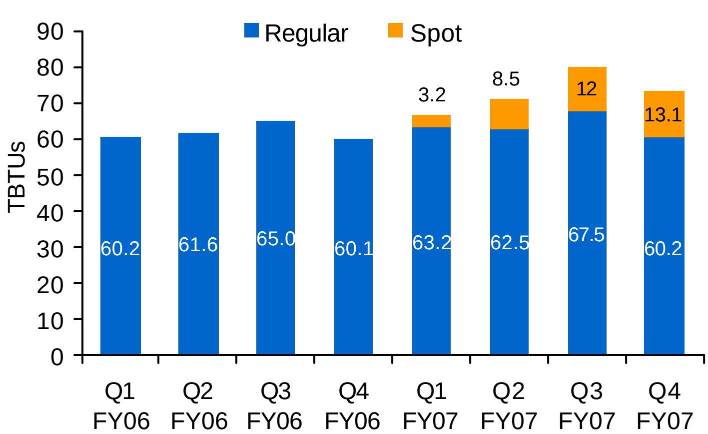
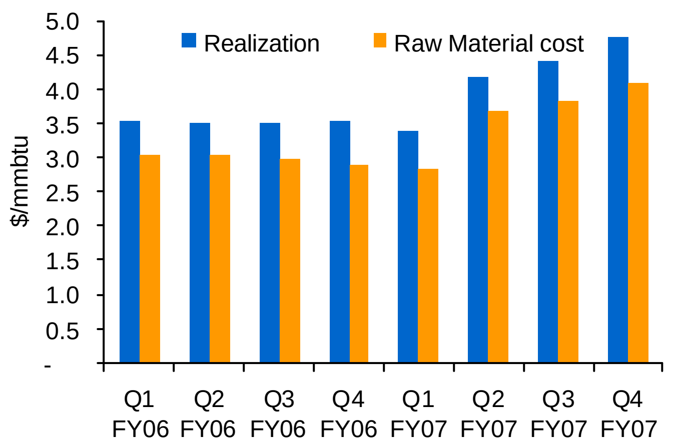


Chart: Trend in Realization and Raw Material cost for PLL



Source: Company, India Infoline Research

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Operating margins dip as spot cargos sourced at higher prices

PLL reported a 250bps dip in operating margins because of lower operating margins in percentage terms for the spot cargos as depicted in the table below. The impact was however, offset to some extent on account of write backs of excess provisions leading to reduction in overheads as a percentage of sales by 134bps yoy.

Table: Difference in operating margins for spot and regular regasification

(Rs mn)	Spot	Regular	Total
Volumes (TBTU)	13.1	60.2	73.3
Raw Material Cost	4,628	8,570	13,198
Regas Charge	539#	1,651	2,190
Other Expenses	36	163	199
Total Expenditure	4,663	8,734	13,397
Sales	5,167	10,221	15,388
Operating Profit	504	1,488	1,991
OPM (%)	9.7	14.6*	12.9

 # Assumed marketing margins of 50% on regas charges
** Margins higher for regular business on account of write backs*
Source: India Infoline Research

Table: Cost Analysis

As % of Sales	Q4 FY07	Q4 FY06	Growth (%)	FY07	FY06	Growth (%)
Raw Material	85.8	81.9	3.9	86.2	84.8	1.4
Staff Cost	0.2	0.3	(0.1)	0.2	0.3	(0.1)
Other Expenditure	1.1	2.4	(1.3)	1.9	2.2	(0.3)
Total Expenditure	87.1	84.6	2.5	88.2	87.3	1.0

Source: Company, India Infoline Research

Higher other income boosts fuels growth

PLL is sitting on a huge cash balance of Rs6bn, significant portion of which the company has invested in mutual funds. With appreciation on the bourses the NAVs kept track and PLL took the opportunity to book profits partly. Hence other income for Q4 FY07 was higher by 121% to Rs148mn. This translated into a 60.3% yoy jump in PAT to Rs1,060mn translating into an annualized EPS of Rs5.7.

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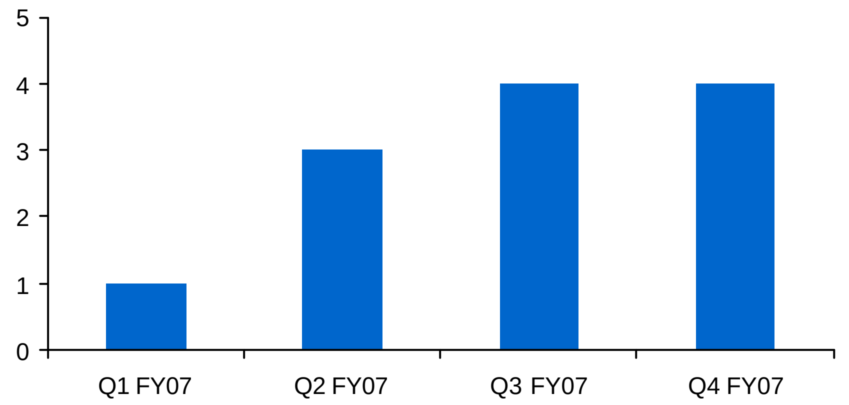
Investment rationale

Spot volumes to drive growth in FY08

During FY07, PLL processed 12 spot cargos including 1 of GAIL, taking the total processed volumes to 5.7mmtpa, 13.8% higher than its nameplate capacity of 5mmtpa. The company through de-bottlenecking has increased the nameplate capacity to 6.5mmtpa. This will enable PLL to process more spot contracts during FY08. The company has tied up for 36 spot contracts for providing gas to the Dabhol power project beginning from July 2007 to December 2008.

Chart: Number of spot cargos



Source: Company

LNG demand to remain strong

India, has been facing acute power shortage with significant portion of gas based power plants being non operational on account of lower availability of gas. The demand will only increase as gas based power plants are not only cost efficient but also are low on pollution. Currently, India sources 5mmtpa of LNG from Qatar and is likely to increase to 10mmtpa in couple of years. Availability of gas is also increasing with liquefaction capacities likely to grow at a faster pace.

Table: Natural gas demand supply scenario

	2002	2007E	2012E
Total Demand	151.0	231.0	313.0
Total Supply			
Offshore Gas	62.8	80.0	138.0
Onshore Gas	27.4	15.0	20.0
Total Domestic Gas Production	90.2	95.0	158.0
LNG Terminals			
Dahej	-	17.5	17.5
Dahej Expansion	-	-	24.5
Hazira	-	-	-
Kochi	-	-	17.5
Dabhol	-	-	17.5
Ennore Mangalore	-	-	-
Total LNG Imports	-	17.5	77.0
Total LNG + Domestic Gas	90.2	112.5	235.0
Demand-Supply Gap	60.8	118.5	78.0

Source: Company

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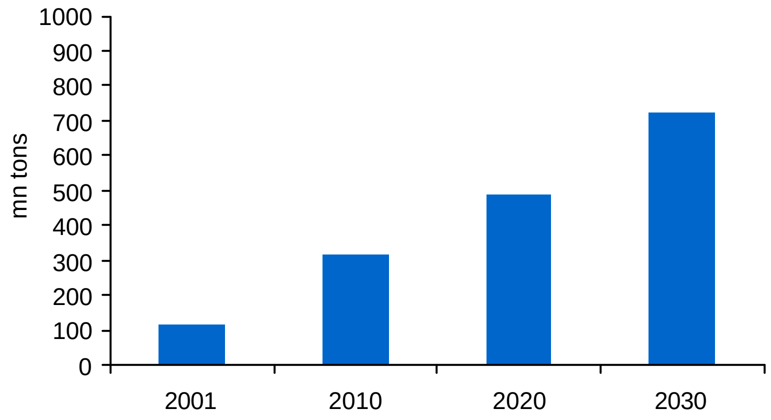
Chart: Liquefaction capacity globally



Source: EIA

Capacity expansions to drive growth beyond FY09

Currently PLL has a 5mmtpa regasification plant at Dahej, which is expandable to 10mmtpa. The expansion process has begun and is likely to come on stream by December 2008. Gas supplies for additional 2.5mmtpa are tied up with Ras Gas whereas for the remaining 2.5mmtpa the company is very close to concluding a deal. Further, PLL is putting up a plant at Kochi with a capacity of 2.5mmtpa expandable to 5mmtpa, which will commence production from FY10. The total outlay for the two projects is expected to be about Rs35bn to be funded by a 50:50 mix of debt and equity.

Operating margins supported by 5% escalation clause for regas charges

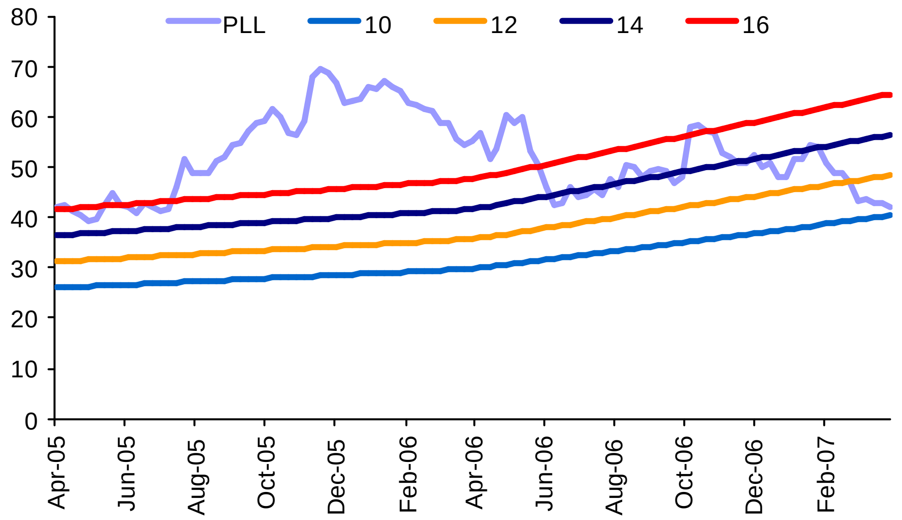
As per the sales agreement with GAIL, IOC and BPCL, PLL is entitled to a hike of 5% in regasification charges every year. Hence, operating margins will stabilize in spite of increasing contribution of spot volumes.

Concerns

√ Rise in LNG prices could lower demand
√ Delay in project execution could lead to cost overruns
√ Availability of spot cargos could be an issue

Valuation

Chart: P/E Band for PLL



Source: Bloomberg, India Infoline Research

We believe that with the volume growth on back of rising spot cargos and 5% escalation clause for regas charges should allow the stock to trade at 10 times one year forward earnings. With EPS of Rs5.4 for FY09E, we believe that the stock should appreciate to Rs54 within a time frame of one year yielding an upside of 17.4%.

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Financials

Projected Income Statement

Period to (Rs mn)	FY05 (12)	FY06 (12)	FY07 (12)	FY08P (12)	FY09P (12)
Net Sales	19,453	38,372	55,006	66,311	71,629
Operating expenses	(17,927)	(33,490)	(48,609)	(58,627)	(63,127)
Operating profit	1,526	4,882	6,397	7,684	8,502
Other income	133	194	366	350	350
PBIDT	1,658	5,076	6,763	8,034	8,852
Interest	(1,094)	(1,116)	(1,070)	(1,212)	(1,248)
Depreciation	(968)	(1,010)	(1,020)	(1,271)	(1,503)
Amortisation	(21)	-			
Profit before tax (PBT)	(424)	2,950	4,673	5,551	6,101
Tax	140	(1,001)	(1,579)	(1,876)	(2,062)
Profit after tax (PAT)	(284)	1,949	3,093	3,674	4,039

Projected Balance Sheet

Period to (Rs mn)	FY05 (12)	FY06 (12)	FY07P (12)	FY08P (12)	FY09P (12)
Sources					
Share Capital	7,500	7,500	7,500	7,500	7,500
Reserves	1,270	3,219	6,313	9,987	14,026
Net Worth	8,770	10,719	13,813	17,487	21,526
Loan Funds	12,599	12,599	15,099	17,099	17,599
Def Tax liability	-	605	610	630	650
Total	**21,369**	**23,923**	**29,522**	**35,216**	**39,775**
Uses					
Gross Block	19,088	19,421	26,421	32,921	38,921
Accd Depreciation	(990)	(1,997)	(3,017)	(4,288)	(5,791)
Net Block	18,099	17,424	23,404	28,633	33,130
Capital WIP	804	1,203	350	150	150
Total Fixed Assets	18,903	18,627	23,754	28,783	33,280
Investments	179	1,569	1,700	1,700	1,700
Total Current Assets	5,732	5,452	6,380	7,473	7,750
Total Current Liabilities	(3,585)	(1,725)	(2,312)	(2,740)	(2,955)
Net Working Capital	2,148	3,727	4,068	4,733	4,795
Def Tax assets	140	-	-	-	-
Total	**21,369**	**23,923**	**29,522**	**35,216**	**39,775**

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Projected Cash Flow Statement

Year to (Rs mn)	FY06	FY07P	FY08P	FY09P
Net profit before tax and extraordinary items	2,950	4,673	5,551	6,101
Depreciation	1,010	1,020	1,271	1,503
Interest expense	1,116	1,070	1,212	1,248
Interest income	(136)	0	0	0
Operating profit before wkg capital changes	4,940	6,763	8,034	8,852
Add: changes in working capital				
(Inc)/dec in sundry debtors	(81)	(554)	(376)	(177)
(Inc)/dec in inventories	228	(450)	(306)	(144)
(inc)/dec in other current assets	(3)	6	0	0
Inc/(dec) in sundry creditors	(2,137)	593	403	190
Inc/(dec) in other current liabilities	277	(6)	25	25
Net change in working capital	(1,716)	(411)	(254)	(106)
Cash from operating activities	3,224	6,352	7,779	8,745
Less: Income tax	(1,001)	(1,579)	(1,876)	(2,062)
Inc/Dec in Def Tax Asset/liability	745	5	20	20
Net cash from operating activities	2,967	4,778	5,923	6,703
Extraordinary inc/(exp)	0	0	0	0
Cash Profit	2,967	4,778	5,923	6,703
Cash flows from investing activities				
(Inc)/Dec in fixed assets	(734)	(6,147)	(6,300)	(6,000)
(Inc)/Dec in Investments	(1,390)	(131)	0	0
Interest received	136	0	0	0
Net cash from investing activities	(1,988)	(6,278)	(6,300)	(6,000)
Cash flows from financing activities				
Inc/(Dec) in debt	0	2,500	2,000	500
Interest expense	(1,116)	(1,070)	(1,212)	(1,248)
(inc)/dec in loans & advances	(337)	(77)	(50)	(50)
Net cash used in financing activities	(1,453)	1,353	738	(798)
Net increase in cash and cash equivalents	(474)	(147)	361	(95)
Cash at start of the year	2,980	2,506	2,359	2,720
Cash at end of the year	2,506	2,359	2,720	2,625

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Key Ratios

Period to	FY05 (12)	FY06 (12)	FY07P (12)	FY08P (12)	FY09P (12)
Per share ratios					
EPS (Rs)	(0.4)	2.6	4.1	4.9	5.4
Div per share	0.0	0.0	10.0	10.0	10.0
Book value per share	11.7	14.3	18.4	23.3	28.7
Valuation ratios					
P/E		17.7	11.2	9.4	8.5
P/BV	3.9	3.2	2.5	2.0	1.6
EV/sales	2.3	1.2	0.9	0.7	0.7
EV/ PBIT	65.9	11.0	8.2	7.2	6.7
EV/PBIDT	26.6	8.8	7.0	6.1	5.6
Profitability ratios					
OPM (%)	7.8	12.7	11.6	11.6	11.9
PAT %	(1.5)	5.1	5.6	5.5	5.6
ROCE	7.8	21.8	23.4	23.2	22.6
RONW	(3.2)	18.2	22.4	21.0	18.8
Liquidity ratios					
Current ratio	1.6	3.2	2.8	2.7	2.6
Debtors days	22.5	12.2	12.2	12.2	12.2
Inventory days	23.8	9.9	9.9	9.9	9.9
Leverage ratios					
Debt / Total equity	1.44	1.18	1.09	0.98	0.82
Component ratios					
Raw material	87.2	84.8	86.3	86.6	86.4
Staff cost	0.5	0.3	0.2	0.2	0.2
Other expenditure	4.5	2.2	1.9	1.6	1.6

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