

Petronet LNG

PLNG IN

Flat earnings profile but strong long-term fundamentals

- Slow processing volume ramp-up at the Kochi terminal, but capacity utilisation likely to remain high at the Dahej terminal
- We project a flat earnings profile for FY13-15, due mainly to the capitalisation of the new Kochi terminal
- Raising target price to INR175 but downgrading to Outperform post good share-price run since May 2012

 Target (INR): **170.00 → 175.00**

 Upside: **9.4%**

 26 Dec price (INR): **160.00**

- 1 Buy
- 2 Outperform (from Buy)
- 3 Hold
- 4 Underperform
- 5 Sell

How do we justify our view?


Nirmal Raghavan

(91) 22 6622 1018

nirmal.raghavan@in.daiwacm.com

■ What's new

Petronet's new liquefied natural gas (LNG) regasification terminal at Kochi is likely to be commissioned by March 2013, but we expect a slow ramp-up of LNG-processing volumes at this terminal.

■ What's the impact

Given that a new LNG market such as that near Kochi is likely to take time to develop to its full potential, we expect modest LNG-processing volumes for the Kochi terminal in its initial operating years. As such, we are reducing our LNG-processing volume forecasts for the terminal by 70%, 55% and 50% for FY13, FY14 and FY15, respectively.

We expect the company's Dahej terminal to continue to operate at high capacity utilisation levels over FY13-15, buoyed by demand for imported gas. Petronet should be able to renew LNG contracts due to expire in 2013 and maintain sound processing volumes at the Dahej terminal. Thus,

we forecast LNG-processing volume for the terminal of 547tbtu for FY13, 559tbtu for FY14, and 567tbtu for FY15, slightly below our previous forecasts.

We are raising our FY13E EPS by 8.8% to reflect increases in our forecasts for its marketing margin to USD0.8/mmbtu (from USD0.5/mmbtu) and other income. While strong marketing margins should support FY13-15 earnings, we expect its earnings to plateau over the period due to the capitalisation costs for the new Kochi terminal.

■ What we recommend

We are raising our DCF-based six-month target price to INR175 (from INR170). The long-term fundamentals of rising gas demand and a declining gas supply domestically should continue to favour Petronet's business, in our view. A domestic gas price rise would also be favourable for Petronet as it would probably increase the acceptability of, and thus the demand for, imported LNG in India. Still, its share price is up by 29% since 18 May 2012, and its FY14E PBR and PER do not look cheap to us. Thus, we downgrade our rating to Outperform (2) from Buy (1).

■ How we differ

Our FY13-15E EPS are 4-23% below the Bloomberg-consensus forecasts,

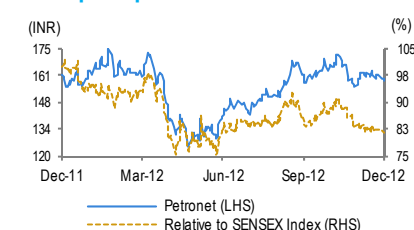
which could be due to our lower LNG-processing volume and marketing margin forecasts.

Forecast revisions (%)

Year to 31 Mar	13E	14E	15E
Revenue change	0.9	(4.9)	(4.4)
Net profit change	8.8	1.8	(1.8)
Core EPS (FD) change	8.8	1.8	(1.8)

Source: Daiwa forecasts

Share price performance



12-month range	124.60-174.60
Market cap (USDbn)	2.19
3m avg daily turnover (USDm)	3.66
Shares outstanding (m)	750
Major shareholder	GAIL India (12.5%)

Financial summary (INR)

Year to 31 Mar	13E	14E	15E
Revenue (m)	273,845	297,205	332,597
Operating profit (m)	15,910	16,454	15,935
Net profit (m)	10,572	10,120	10,145
Core EPS (fully-diluted)	14.096	13.493	13.527
EPS change (%)	(0.0)	(4.3)	0.2
Daiwa vs Cons. EPS (%)	(4.0)	(9.1)	(22.7)
PER (x)	11.4	11.9	11.8
Dividend yield (%)	2.6	2.5	2.5
DPS	4.229	4.048	4.058
PBR (x)	2.9	2.5	2.2
EV/EBITDA (x)	7.7	6.6	6.1
ROE (%)	27.4	22.3	19.5

Source: FactSet, Daiwa forecasts

- 1 Buy
- 2 Outperform (from Buy)
- 3 Hold
- 4 Underperform
- 5 Sell

How do we justify our view?

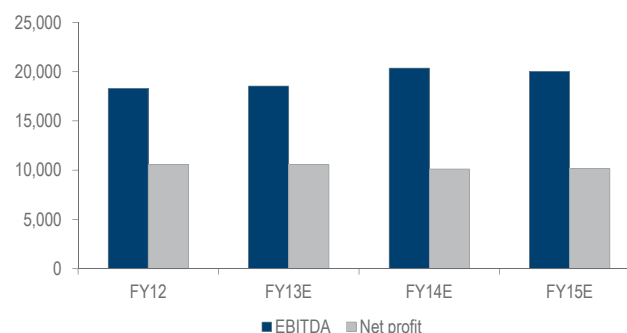
- Growth outlook ✓ ✓ ✓ ✓ ✓
- Valuation ✓ ✓ ✓ ✓ ✓
- Earnings revisions ✓ ✓ ✓ ✓ ✓

■ Growth outlook



We forecast an EBITDA CAGR of 3.8% but a net-profit CAGR of -2% for Petronet for FY13-15. This reflects higher depreciation and higher interest expenses due to the capitalisation of the company's new Kochi terminal. We forecast LNG-processing volumes at the company's Dahej terminal to rise from 547tbtus for FY13 to 559tbtus for FY14 and 567tbtus for FY15. We project a slow ramp-up of LNG-processing volumes at the Kochi terminal from 3tbtus for FY13 to 52tbtus for FY15.

■ Petronet: EBITDA and net profit (INRm)



Source: Company, Daiwa forecasts

■ Valuation



We value Petronet on a DCF basis, using a WACC of 10.1% and a terminal growth rate of 1%. We think the DCF methodology is appropriate to capture the cash flows from the company's regasification and marketing businesses. In the long term, we assume annual LNG-processing volumes of 16.5m tonnes (855tbtus) and zero marketing margins. We are raising our six-month target price slightly to INR175 (from INR170), with our valuation base rolled forward from FY13E to FY14E.

■ Petronet: DCF valuation summary

Component	Unit	Output
WACC	%	10.1
Terminal growth rate	%	1
EV	INRm	146,362
Net debt	INRm	14,961
Equity value	INRm	131,401
No. of outstanding shares	m	750
Equity value per share	INR/share	175

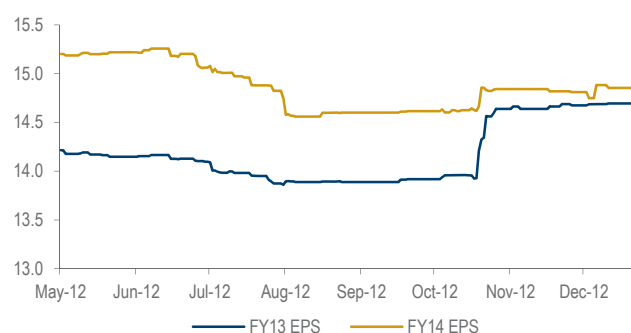
Source: Daiwa estimates

■ Earnings revisions



The Bloomberg consensus has revised up its FY13 EPS forecast for Petronet since November 2012, due mainly to the company's continued strong earnings for 1Q FY13 and 2Q FY13. We are raising our FY13 EPS forecast by 8.8%, as we explain in this report. The consensus FY14 EPS forecast has remained broadly stable since August 2012. The key downside risk to our FY13 and FY14 EPS forecasts would come from lower-than-expected LNG-processing volumes.

■ Petronet: consensus FY13 and FY14 EPS forecasts



Source: Bloomberg forecasts

Financial summary

■ Key assumptions

Year to 31 Mar	2008	2009	2010	2011	2012	2013E	2014E	2015E
Total LNG Processed Volumes	327	326	389	440	535	550	585	618
Regassification margin (INR/mmbtu)	27.78	29.17	30.63	32.16	33.77	35.46	37.20	38.60

■ Profit and loss (INRm)

Year to 31 Mar	2008	2009	2010	2011	2012	2013E	2014E	2015E
LNG Sales	65,553	84,287	106,029	131,057	224,507	271,457	293,888	329,157
Regas Services	0	0	462	915	2,452	2,388	3,317	3,440
Other Revenue	0	0	0	0	0	0	(0)	0
Total Revenue	65,553	84,287	106,491	131,973	226,959	273,845	297,205	332,597
Other income	0	0	0	0	0	0	0	0
COGS	(55,664)	(73,756)	(96,648)	(118,012)	(205,867)	(252,524)	(273,793)	(309,238)
SG&A	0	0	0	0	0	0	0	0
Other op.expenses	(2,249)	(2,543)	(2,987)	(3,645)	(4,641)	(5,412)	(6,958)	(7,424)
Operating profit	7,640	7,988	6,856	10,316	16,451	15,910	16,454	15,935
Net-interest inc./(exp.)	(488)	(247)	(861)	(1,252)	(925)	(362)	(1,572)	(1,016)
Assoc/forex/extraord./others	0	0	0	0	0	0	0	0
Pre-tax profit	7,152	7,740	5,995	9,064	15,525	15,547	14,882	14,919
Tax	(2,405)	(2,556)	(1,950)	(2,868)	(4,950)	(4,975)	(4,762)	(4,774)
Min. int./pref. div./others	0	0	0	0	0	0	0	0
Net profit (reported)	4,747	5,184	4,045	6,196	10,575	10,572	10,120	10,145
Net profit (adjusted)	4,747	5,184	4,045	6,196	10,575	10,572	10,120	10,145
EPS (reported)(INR)	6.329	6.913	5.393	8.262	14.101	14.096	13.493	13.527
EPS (adjusted)(INR)	6.329	6.913	5.393	8.262	14.101	14.096	13.493	13.527
EPS (adjusted fully-diluted)(INR)	6.329	6.913	5.393	8.262	14.101	14.096	13.493	13.527
DPS (INR)	1.500	1.750	1.750	2.478	2.500	4.229	4.048	4.058
EBIT	7,640	7,988	6,856	10,316	16,451	15,910	16,454	15,935
EBITDA	8,661	9,013	8,465	12,163	18,292	18,554	20,368	20,011

■ Cash flow (INRm)

Year to 31 Mar	2008	2009	2010	2011	2012	2013E	2014E	2015E
Profit before tax	7,152	7,740	5,995	9,064	15,525	15,547	14,882	14,919
Depreciation and amortisation	1,022	1,025	1,609	1,847	1,842	2,644	3,915	4,076
Tax paid	(1,693)	(2,656)	(1,640)	(2,179)	(4,800)	(4,664)	(4,465)	(4,476)
Change in working capital	492	(3,384)	3,026	(1,079)	(2,536)	2,089	2,922	3,178
Other operational CF items	1,444	119	1,289	1,422	925	362	1,572	1,016
Cash flow from operations	8,416	2,844	10,279	9,075	10,956	15,979	18,826	18,713
Capex	(6,043)	(7,883)	(10,470)	(8,750)	(10,902)	(13,009)	(6,009)	(2,009)
Net (acquisitions)/disposals	(2,780)	2,473	(1,886)	(56)	0	0	0	0
Other investing CF items	(414)	713	(2)	(5,960)	849	1,014	1,132	1,382
Cash flow from investing	(9,237)	(4,697)	(12,358)	(14,766)	(10,053)	(11,995)	(4,877)	(627)
Change in debt	1,944	7,039	2,181	7,163	601	(1,420)	(5,000)	(5,000)
Net share issues/(repurchases)	0	0	0	(1,806)	0	0	0	0
Dividends paid	0	(1,316)	(1,536)	(1,531)	(1,743)	(2,179)	(3,711)	(3,552)
Other financing CF items	(942)	(878)	(1,739)	0	(1,774)	(1,376)	(2,704)	(2,398)
Cash flow from financing	1,002	4,845	(1,094)	3,826	(2,917)	(4,976)	(11,415)	(10,950)
Forex effect/others	0	0	0	0	0	0	0	0
Change in cash	181	2,992	(3,173)	(1,865)	(2,013)	(992)	2,534	7,136
Free cash flow	2,373	(5,039)	(191)	325	55	2,970	12,817	16,704

Source: FactSet, Daiwa forecasts

Financial summary continued ...

■ Balance sheet (INRm)

As at 31 Mar	2008	2009	2010	2011	2012	2013E	2014E	2015E
Cash & short-term investment	3,586	6,578	3,405	1,540	9,839	8,847	11,381	18,517
Inventory	909	3,856	2,223	2,480	7,124	7,708	6,050	6,526
Accounts receivable	3,330	6,712	5,035	8,472	12,859	17,664	18,587	17,070
Other current assets	3,651	952	1,554	1,383	2,775	2,775	2,775	2,775
Total current assets	11,476	18,097	12,216	13,875	32,597	36,995	38,793	44,887
Fixed assets	26,293	33,156	42,012	49,053	58,115	68,479	70,574	68,507
Goodwill & intangibles	0	0	0	0	0	0	0	0
Other non-current assets	5,473	3,043	5,386	11,649	1,399	1,399	1,399	1,399
Total assets	43,242	54,295	59,614	74,576	92,110	106,873	110,765	114,793
Short-term debt	0	0	0	0	0	0	0	0
Accounts payable	3,388	5,715	6,043	8,317	12,686	17,742	19,928	22,064
Other current liabilities	900	1,650	1,406	2,031	5,550	7,972	7,972	7,972
Total current liabilities	4,287	7,365	7,449	10,348	18,235	25,714	27,900	30,036
Long-term debt	15,776	22,817	24,998	32,161	32,762	31,342	26,342	21,342
Other non-current liabilities	6,993	4,279	4,819	5,266	5,915	7,758	7,897	8,204
Total liabilities	27,057	34,461	37,266	47,775	56,913	64,814	62,139	59,582
Share capital	7,500	7,500	7,500	7,500	7,500	7,500	7,500	7,500
Reserves/R.E./others	8,685	12,334	14,849	19,302	27,698	34,559	41,127	47,711
Shareholders' equity	16,185	19,834	22,349	26,802	35,198	42,059	48,627	55,211
Minority interests	0	0	0	0	0	0	0	0
Total equity & liabilities	43,242	54,295	59,614	74,577	92,110	106,873	110,765	114,793
EV	132,191	136,239	141,593	150,621	142,923	142,495	134,961	122,825
Net debt/(cash)	12,191	16,239	21,593	30,621	22,923	22,495	14,961	2,825
BVPS (INR)	21.581	26.446	29.798	35.735	46.930	56.079	64.836	73.614

■ Key ratios (%)

Year to 31 Mar	2008	2009	2010	2011	2012	2013E	2014E	2015E
Sales (YoY)	19.0	28.6	26.3	23.9	72.0	20.7	8.5	11.9
EBITDA (YoY)	33.7	4.1	(6.1)	43.7	50.4	1.4	9.8	(1.8)
Operating profit (YoY)	39.9	4.6	(14.2)	50.5	59.5	(3.3)	3.4	(3.2)
Net profit (YoY)	51.5	9.2	(22.0)	53.2	70.7	(0.0)	(4.3)	0.2
Core EPS (fully-diluted) (YoY)	51.5	9.2	(22.0)	53.2	70.7	(0.0)	(4.3)	0.2
Gross-profit margin	15.1	12.5	9.2	10.6	9.3	7.8	7.9	7.0
EBITDA margin	13.2	10.7	7.9	9.2	8.1	6.8	6.9	6.0
Operating-profit margin	11.7	9.5	6.4	7.8	7.2	5.8	5.5	4.8
ROAE	32.8	28.8	19.2	25.2	34.1	27.4	22.3	19.5
ROAA	12.1	10.6	7.1	9.2	12.7	10.6	9.3	9.0
ROCE	26.1	21.4	15.2	19.4	25.9	22.5	22.2	21.0
ROIC	19.7	16.6	11.6	13.9	19.4	17.6	17.5	17.8
Net debt to equity	75.3	81.9	96.6	114.3	65.1	53.5	30.8	5.1
Effective tax rate	33.6	33.0	32.5	31.6	31.9	32.0	32.0	32.0
Accounts receivable (days)	18.5	21.7	20.1	18.7	17.2	20.3	22.3	19.6
Current ratio (x)	2.7	2.5	1.6	1.3	1.8	1.4	1.4	1.5
Net interest cover (x)	15.7	32.3	8.0	8.2	17.8	43.9	10.5	15.7
Net dividend payout	23.7	25.3	32.4	30.0	17.7	30.0	30.0	30.0

Source: FactSet, Daiwa forecasts

■ Company profile

Petronet LNG is a LNG import and regasification company. It has 10 mtpa regasification terminal at Dahej, Gujarat on the west coast of India and a terminal at Kochi. The company imports LNG from suppliers on long term, short term and spot contracts and regasifies the LNG which it sells to its offtakers - GAIL India, Indian Oil and Bharat petroleum

Flat earnings profile but strong long-term fundamentals

Downgrading to Outperform

Good share-price performance

Petronet's share price was weak post the release of its 4Q FY12 results in April 2012, as investors became sceptical about the company's capacity utilisation levels. Since 18 May 2012, however, its share price has risen by 29% as the company's quarterly utilisation levels and consequently its quarterly results have improved. Thus, we believe its share price could be range-bound in the short term, but we remain positive about the company's fundamentals on a long-term horizon.

In 2012 (to 27 December 2012), Petronet's share price has risen by 2.1%, against a 24.5% rise for the SENSEX over the same period. However, we believe this relative underperformance can be attributed mainly to the resurgence in the SENSEX, rather than to company-specific factors aside from lacklustre 4Q FY12 results.

■ Petronet: share-price performance – absolute and relative to SENSEX (2012 to 20 December) (rebased to 100)



Source: Bloomberg

Valuation: raising target price to INR175

We value Petronet using a DCF methodology. The company derives its value from regasifying LNG at its terminals and also from its marketing margins earned on spot and short-term LNG. We believe the company's regasification business model, based on back-to-back

(ie, similar contracts on both supply and offtake sides) supply and offtake contracts, provides stable and predictable cash flows (with incremental value from marketing margins). Thus, we believe DCF is the appropriate methodology to value Petronet.

In our DCF model, we assume an average cost of debt of 9%. Applying an effective tax rate of 34%, we obtain an after-tax cost of debt of 5.9%. We assume a cost of equity of 12.9% and derive a WACC of 10.1%. We assume a 1% terminal growth rate.

■ Petronet: WACC calculation

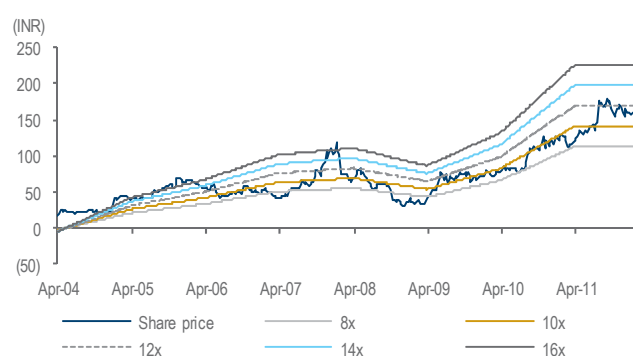
Pre-tax cost of debt	%	9.0
After-tax cost of debt	%	5.9
Risk-free rate	%	8.0
Risk premium	%	5.0
Beta	x	1.0
Cost of equity	%	12.9
Net debt to capital	%	40.0
WACC	%	10.1

Source: Daiwa estimates

Projecting the free cash flows and using a WACC of 10.1%, we derive an enterprise value of INR146.4bn, which leads to an equity value of INR131.4bn (now using FY14E as our valuation basis, rolled over from FY13E before), or INR175/share. With share-price upside potential of 9% now, we are downgrading our rating for Petronet to Outperform (2), from Buy (1).

PER and PBR valuations do not look cheap

■ Petronet: 1-year forward PER

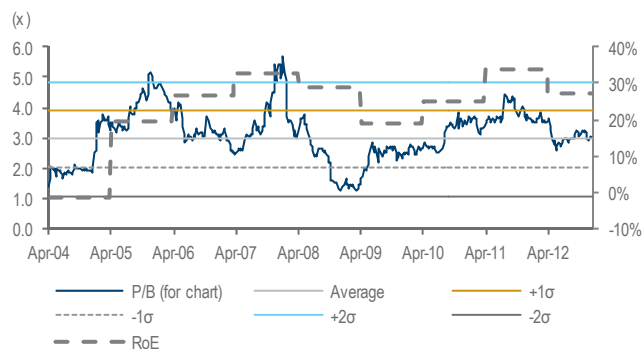


Source: Bloomberg, Company, Daiwa estimates

Petronet's forward PERs and PBRs have risen since mid-May 2012, as investors have regained confidence in: 1) capacity utilisation levels at the company's Dahej terminal, and, 2) the company's ability to maintain strong marketing margins. The stock is trading currently at a PER of 11.9x and a PBR of 2.5x, based on our forecasts for FY14. Its valuations are not cheap, in our view, in the context of the static earnings outlook we see for the company for FY13-15. As we envisage a slow ramp-up of LNG-processing volumes at the new

Kochi terminal, we forecast the company's ROE to decline from 34.1% for FY12 to 27.4% for FY13.

■ **Petronet: 1-year forward PBR (x) and ROE (%)**



■ **India gas stocks in Daiwa's universe: valuation summary**

Company	Ticker	Rating	Price (INR)	Mkt cap (USD m)	EPS (INR)			PER (x)			PBR (x)			EV/EBITDA (x)			ROAE (%)		
					FY12	FY13E	FY14E	FY12	FY13E	FY14E	FY12	FY13E	FY14E	FY12	FY13E	FY14E	FY12	FY13E	FY14E
GAIL India	GAIL IN	Hold	351	8,280	28.8	27.7	28.0	12.2	12.7	12.5	2.1	1.9	1.7	8.4	9.5	9.9	17.9	15.4	14.2
Petronet LNG	PLNG IN	Outperform	160	2,190	14.1	14.1	13.5	11.3	11.3	11.8	3.5	2.9	2.5	7.8	7.7	6.6	34.1	27.4	22.3
Gujarat State Petronet	GUJS IN	Buy	76	770	9.4	7.0	7.1	8.0	10.7	10.6	1.7	1.5	1.4	4.9	5.6	5.6	23.7	15.1	13.5
Indraprastha Gas	IGL IN	Hold	252	680	22.5	23.7	26.1	11.2	10.7	9.7	3.0	2.5	2.1	6.2	5.6	5.0	28.1	24.4	22.7
Average								10.7	11.3	11.2	2.6	2.2	1.9	6.8	7.1	6.8	25.9	20.6	18.2

Source: Bloomberg (share prices), Daiwa forecasts

Note: based on closing share prices of 26 December 2012

We project moderate LNG-processing volume growth

We expect moderate growth in LNG-processing volumes for Petronet over FY13-15, due to capacity constraints at the company's Dahej terminal (currently operating at a high utilisation level) and a slow ramp-up that we envisage of volumes at its Kochi terminal. We forecast Petronet to process LNG volumes of around 550tbtus (10.61m tonnes) for FY13, 585tbtus (11.29m tonnes) for FY14, and 618tbtus (11.94m tonnes) for FY15.

Kochi terminal: we expect a slow ramp-up of LNG-processing volumes

The company's Kochi terminal is likely to be commissioned in March 2013, according to Petronet. For FY13, we expect a single LNG cargo of 0.06m tonnes (3tbtus) to be brought to the Kochi terminal for regasification and then sold on to customers. Based on our discussions with management, we forecast LNG-processing volumes for the terminal of 26tbtus (0.6m tonnes) for FY14, comprising mainly demand from a fertiliser plant owned by Fertiliser and Chemicals Travancore and Kochin Refineries Limited.

Valuation comparison with peers

At current share prices and based on our FY13 and FY14 forecasts, Petronet trades at a par with the other India gas stocks on a PER basis, and at a premium on a PBR basis. However, we would note that Petronet's business model also earns a higher ROE compared with the other domestic gas companies. Among the gas stocks in our coverage, we continue to prefer Gujarat State Petronet (GSPL), followed by Petronet.

Developing the LNG market in and around the company's new terminal at Kochi is likely to take time, as the LNG market is new to this area. As such, we now forecast LNG-processing volumes for the terminal of 3tbtus for FY13, 26tbtus for FY14 and 52tbtus for FY15, reduced from our previous respective forecasts of 10tbtus, 57tbtus and 104tbtus.

Dahej terminal: limited capacity but utilisation should stay high

The company's Dahej terminal has a capacity of 10mtpa. This terminal is already operating at a capacity utilisation rate of around 100% (1Q FY13: 98%, 2Q FY13: 104%). We expect the terminal to operate at 110% capacity utilisation levels in both 3Q FY13 and 4Q FY13. We also expect Petronet LNG to have a capacity utilisation rate of 108% in FY14.

We forecast LNG-processing volumes for the Dahej terminal of 547tbtus for FY13, 559tbtus for FY14 and 567tbtus for FY15. These forecasts represent only marginal reductions versus our previous forecasts of 552tbtus, 559tbtus and 563tbtus for the respective years.

■ Petronet: breakdown of LNG-processing volumes

Type	Unit	FY13E	FY14E	FY15E
Long-term	tbtus	387	389	389
Short-term	tbtus	75	70	78
PLNG spot	tbtus	17	11	11
Kochi	tbtus	3	26	52
GAIL India regasification	tbtus	13	52	52
GSPC regasification	tbtus	54	37	37
Total	tbtus	550	585	618

Source: Daiwa forecasts

Note: GSPC = Gujarat State Petroleum Corporation

The new jetty at Dahej is likely to be commissioned by December 2013, according to the company, which should help to expand the Dahej terminal's capacity from 10mtpa to 12.5mtpa, though we expect the full impact of this capacity expansion in terms of higher processing volumes to materialise only in FY15 and onwards. Our FY15 LNG-processing volume forecast may have some upside potential, but we would like to see more visibility on Petronet's LNG-sourcing contracts.

A few contracts will need renewing

Although capacity at the Dahej terminal looks set to increase beyond FY14, in the meantime we believe Petronet will have to sign new LNG contracts with suppliers to utilise the capacity.

Petronet LNG has a short-term LNG contract for the supply of 1.1m tonnes which runs until the end of March 2013. It has another contract for the supply of 0.6m tonnes with GDF Suez, which runs until the end of December 2013. Petronet will have to renew these contracts with the same suppliers or sign new contracts with other suppliers in order to at least maintain its LNG-processing volumes. There is no visibility on new contracts at present, but given its proven skills in sourcing gas, we believe Petronet should be able to arrange new contracts.

■ Petronet: contracts with LNG suppliers

Contract type	Supplier	Volumes (m tonnes)	End of contract
Long-term	Ras Gas	7.5	December 2023
Short-term	Various suppliers	1.1	March 2013
Short-term	GDF Suez	0.6	December 2012
Short-term	GAIL-Marubeni	0.25	December 2013

Source: Company, Daiwa

Revisions to forecasts

■ Petronet: revisions to forecasts for processing volumes, marketing margins and earnings

Forecast	Unit	FY13E	FY14E	FY15E
EBITDA – previous	INR m	17911	20415	20547
EBITDA – new	INR m	18554	20368	20011
Change (%)		3.6%	-0.2%	-2.6%
EPS – previous	INR/share	13.0	13.3	13.8
EPS – new	INR/share	14.1	13.5	13.5
Change (%)		8.8%	1.8%	-1.8%
LNG volumes – previous	tbtus	561	616	667
LNG volumes – new	tbtus	550	585	618
Marketing margin – previous	USD/mmbtu	0.5	0.5	0.5
Marketing margin – new	USD/mmbtu	0.8	0.8	0.8

Source: Daiwa forecasts

We are raising our FY13 EPS forecast by 8.8%, mainly to reflect increases in our forecasts for the marketing margin and other income. The company's marketing margin was USD 1.11/mmbtu for 1Q FY13 and USD1.10/mmbtu for 2Q FY13, higher than our prior full-year FY13-14 forecasts of USD0.5/mmbtu. Thus, we are raising our forecasts for both FY13 and FY14 from USD0.5/mmbtu to USD0.8/mmbtu.

The minor revisions to our EPS forecasts for FY14 and FY15 are due to revisions to our forecasts for LNG-processing volumes, the marketing margin and other income.

Our FY15 EPS forecast is 23% below that of the Bloomberg consensus, which we believe is due to our lower forecasts for LNG processing volumes and the marketing margin. We believe the consensus may be expecting high YoY LNG-processing volume for FY15 due to the planned commissioning of the new jetty at the Dahej terminal by December 2013.

However, we would like to see more visibility on Petronet's LNG-sourcing contracts before raising our LNG-processing volume forecast for FY15.

Further earnings growth unlikely

On our estimates, Petronet's EPS is peaking and is unlikely to rise substantially over FY13-15.

First, as explained earlier, we expect only moderate growth in LNG processing volumes over the same period. Second, the commissioning of the Kochi terminal would lead to the terminal being capitalised on the balance sheet, and hence its entire fixed asset base starting to incur depreciation costs. As a result, we forecast the company's depreciation expenses to rise from INR1.84bn in FY12 to INR2.64bn in FY13 and INR3.91bn in FY14.

Similarly capitalisation of the Kochi terminal would also lead to an increase in interest expenses, which we forecast to rise from INR1.77bn in FY12 to INR2.7bn in FY14.

Therefore, despite the company's EBITDA rising by 9.8% from FY13E to FY14E (driven by volume expansion), we forecast the PBT to decline by 4.3% from FY13 to FY14, as depreciation and interest expenses moderate the growth.

■ Petronet: contribution from Kochi terminal at 1m tonnes

Sales volume	m tonnes	1
Regas charge	INR/mmbtu	50
Revenue	INR m	28,075
Raw-material costs	INR m	24,272
Custom duty	INR m	1,214
Gross margin	INR m	2,590
Operating expenses	INR m	562
EBITDA	INR m	2,028
Depreciation	INR m	2,062
EBIT	INR m	(33)
Interest	INR m	1,890
Profit before tax	INR m	(1,923)

Source: Daiwa estimates

Even if we assume a marketing margin of USD1.1/mmbtu for FY13-FY15, then we estimate EPS/share would decline from INR15.3 in FY13 to INR13.7 in FY15.

Long-term fundamentals remain supportive for Petronet

Limited domestic gas supply additions ahead

We forecast domestic gas supplies to rise by a mere 22mmscmd over FY12-16. We forecast a dip from 130mmscmd in FY11 to 120mmscmd in FY13, and then a slight rise to 127mmscmd in FY14. Our forecasts imply that the Indian gas market is likely to be severely constrained in terms of the supply of domestic gas.

■ India: domestic gas supply (mmscmd)

Production - mmscmd	FY11	FY12E	FY13E	FY14E	FY15E	FY16E
Total	141	130	120	127	136	152
ONGC	63	64	68	71	75	75
Oil India	6	7	8	10	12	12
Pvt/JV	72	59	44	46	49	65
Ravva	2	1	1	1	1	1
KG-DWN-98/3	56	43	27	24	22	32
CB-OS/2/Laxmi Gauri	1	1	0	0	0	0
Tapti	7	8	8	7	7	7
Panna Mukta	4	6	5	5	5	5
Raniganj- South	0	1	2	3	4	4
GSPC-Deen Dayal	-	-	-	3	4	5
NEC 25	-	-	-	-	1	3
MN-OSN-2000/2	-	-	-	-	-	1
KG-DWN-98/2	-	-	-	-	-	2
Sohagpur-RIL	-	-	-	2	4	4

Source: Petroleum Statistics, Daiwa forecasts

Good demand opportunity on the gas side

Based on our estimates, India is sitting on substantial latent demand for gas derived from various sectors, such as power, fertilizer, industrial, LPG production and city gas distribution. On our forecasts, gas demand will increase from 168mmscmd in FY11 to 372mmscmd in FY15. Government projections are even higher, with gas demand set to increase from 293mmscmd to 473mmscmd over the period of the 12th Five-Year Plan (FY12-17).

■ India: gas demand by segment

Consumption - mmscmd	FY11	FY12E	FY13E	FY14E	FY15E
Total	168	179	251	347	372
Energy purposes					
Power generation	59	58	86	110	110
Industrial fuel	20.2	30.0	50.0	70.0	90.0
Tea plantation	0.4	0.4	0.4	0.4	0.4
Domestic fuel	0.3	0.3	0.3	0.3	0.3
Captive use/LPG shrinkage	18.2	18.2	18.2	18.2	18.2
Others	4.2	4.2	4.2	4.2	4.2
Non-energy purposes					
Fertiliser industry	40.1	40.9	62.3	111	114
Petrochemicals	5.2	5.9	7.7	9.5	12.0
CNG	0.0	0.0	0.0	0.0	0.0
Others	19.7	21.1	22.1	22.8	22.8

Source: Petroleum Statistics, Daiwa forecasts

Petronet positioning itself for the opportunity

With demand for gas in the long term likely to increase and domestic gas production unlikely to fill the gap, imported gas could be an important filler. While the high price of imported LNG is a deterrent, we believe domestic gas prices in India are likely to move up over the next two years. This would make LNG more acceptable in India, and lead to a rise in demand and supply.

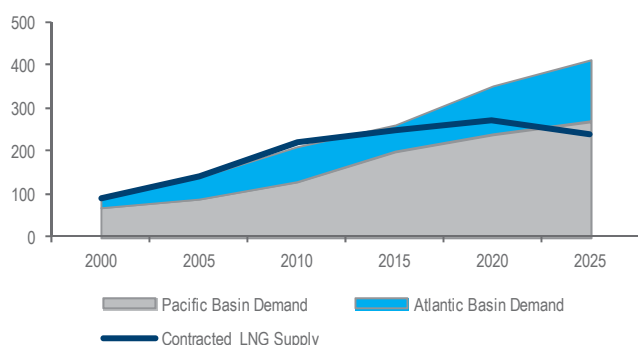
Under such a scenario, Petronet, as an importer of gas, should find itself in a sweet spot. The company is building up its LNG regas capacity to take advantage of

this situation. It is adding 5m tonnes of capacity at the Dahej terminal, part of which would be available after the addition of the jetty in December 2013. Petronet has already entered into an agreement with GAIL India for leasing out 2.5m tonnes of this expansion. The company is likely to sign a similar agreement with GSPC as well. Thus, not only is capacity being added, capacity utilisation is also being taken care of already.

Petronet is also planning to add a further 5mt of regasification capacity at Gangavaram on the east coast of India. The terminal is likely to be ready by FY17 and would be built at a projected cost of USD800m.

LNG supply: some tightness in the medium term

Global LNG demand and supply (mtpa)



Source: Industry

Industry participants expect a tight LNG market between 2013 and 2015 due to very few LNG capacity additions globally. Post the huge LNG capacity additions from Qatar during 2009-10, we expect additions of only 50.2mt between 2013 and 2015. According to energy agency Facts Global Energy, demand from the Asia Pacific Basin for the period 2013-15 will be 180-195mtpa, whereas the supply of LNG capacity is estimated to be nearly 170mtpa.

Similarly other industry participants expect LNG capacity to be in the range of 140-160mtpa, considerably short of demand, which is expected to be in a range of 170-210mtpa. Post 2015 though, due to new capacities from Australia coming online, we believe new LNG supplies should materially ease.

LNG capacities: upcoming projects

Project	Country	Capacity (bcm)	Status	Year
Angola LNG	Angola	7.1	Construction	2012
Sengkang	Indonesia	2.7	Proposed	2012
Gassi Touil	Algeria	6.4	Construction	2013
Skikda	Algeria	6.1	Construction	2013
Gorgon	Australia	20.4	Construction	2015
Gladstone LNG	Australia	4.8	Proposed	2014
Donggi Senoro	Indonesia	2.7	Proposed	2015+
Total		50.2		

Source: Daiwa estimates

Petronet should be able to source spot and short-term LNG from the new and upcoming liquefaction capacity over FY13-15. Beyond FY15, we believe it will be even easier for Petronet to source LNG, as a host of Australian liquefaction capacities come online.

Key risks

Regulatory risks

The Ministry of Petroleum and Natural Gas has recently announced new eligibility conditions for the registration of new LNG terminals.

Under the new conditions, any entity planning to establish or operate an LNG terminal must provide, after registration, 20% of its short-term uncommitted regas capacity or 0.5mt, whichever is higher, as common carrier capacity (ie, it must give any customer looking to transport LNG for less than one year access to 20% of its short-term uncommitted regas capacity).

Mandatory reservation of a portion of an LNG terminal's capacity exclusively for third parties on a common carrier basis, could result in a risk of lower capacity utilisation. However, even now Petronet regasifies LNG for third parties on a short-term and spot basis, thus we believe the eligibility conditions will not bring about a big change for Petronet.

Second, if market margins are regulated, then that could also result in a capping of marketing margins mainly on spot and short-term LNG cargoes.

Other key risk factors

1. Lower-than-expected LNG regasification volumes could result in lower-than-expected earnings, and is a key risk to the stock.
2. High prices of LNG could result in low procurement of spot LNG, which could once again result in lower-than-expected earnings.

HONG KONG			
Nagahisa MIYABE	(852) 2848 4971	nagahisa.miyabe@hk.daiwacm.com	Regional Research Head
Hiroaki KATO	(852) 2532 4121	hiroaki.kato@hk.daiwacm.com	Regional Research Co-head
John HETHERINGTON	(852) 2773 8787	john.hetherington@hk.daiwacm.com	Regional Deputy Head of Asia Pacific Research; Regional Head of Product Management
Pranab Kumar SARMAH	(852) 2848 4441	pranab.sarmah@hk.daiwacm.com	Regional Head of Research Promotion
Mingchun SUN	(852) 2773 8751	mingchun.sun@hk.daiwacm.com	Head of China Research; Chief Economist (Regional)
Dave DAI	(852) 2848 4068	dave.dai@hk.daiwacm.com	Deputy Head of Hong Kong and China Research; Pan-Asia/Regional Head of Clean Energy and Utilities; Utilities; Power Equipment; Renewables (Hong Kong, China)
Kevin LAI	(852) 2848 4926	kevin.lai@hk.daiwacm.com	Deputy Head of Regional Economics; Macro Economics (Regional)
Chi SUN	(852) 2848 4427	chi.sun@hk.daiwacm.com	Macro Economics (China)
Jonas KAN	(852) 2848 4439	jonas.kan@hk.daiwacm.com	Head of Hong Kong Research; Head of Hong Kong and China Property; Regional Property Coordinator; Property Developers (Hong Kong)
Jeff CHUNG	(852) 2773 8783	jeff.chung@hk.daiwacm.com	Automobiles and Components (China)
Grace WU	(852) 2532 4383	grace.wu@hk.daiwacm.com	Head of Greater China FIG; Banking (Hong Kong, China)
Jerry YANG	(852) 2773 8842	jerry.yang@hk.daiwacm.com	Banking/Diversified Financials (Taiwan)
Leon QI	(852) 2532 4381	leon.qi@hk.daiwacm.com	Banking (Hong Kong, China)
Joseph HO	(852) 2848 4443	joseph.ho@hk.daiwacm.com	Head of Industrials and Machineries (Hong Kong, China); Capital Goods – Electronics Equipments and Machinery (Hong Kong, China)
Bing ZHOU	(852) 2773 8782	bing.zhou@hk.daiwacm.com	Consumer/Retail (Hong Kong, China); Hotels, Restaurants and Leisure – Casinos and Gaming (Hong Kong, Macau)
Eric CHEN	(852) 2773 8702	eric.chen@hk.daiwacm.com	Pan-Asia/Regional Head of IT/Electronics; Semiconductor/IC Design (Regional)
Felix LAM	(852) 2532 4341	felix.lam@hk.daiwacm.com	Head of Materials (Hong Kong, China); Cement and Building Materials (China, Taiwan); Property (China)
John CHOI	(852) 2773 8730	john.choi@hk.daiwacm.com	Head of Multi-Industries (Hong Kong, China); Small/Mid Cap (Regional); Internet (China)
Kelvin LAU	(852) 2848 4467	kelvin.lau@hk.daiwacm.com	Head of Transportation (Hong Kong, China); Hong Kong and China Research Coordinator; Transportation (Regional)
Jibo MA	(852) 2848 4489	jibo.ma@hk.daiwacm.com	Head of Custom Products Group; Custom Products Group
Thomas HO	(852) 2773 8716	thomas.ho@hk.daiwacm.com	Custom Products Group

PHILIPPINES			
Rommel RODRIGO	(63) 2 813 7344 ext 302	rommel.rodrido@dbpdaiwacm.com.ph	Head of Philippines Research; Strategy; Capital Goods; Materials
Danielo PICACHE	(63) 2 813 7344 ext 293	danielo.picache@dbpdaiwacm.com.ph	Property; Banking; Transportation – Port

SOUTH KOREA			
Chang H LEE	(82) 2 787 9177	chlee@kr.daiwacm.com	Head of Korea Research; Strategy; Banking/Finance
Sung Yop CHUNG	(82) 2 787 9157	sychung@kr.daiwacm.com	Pan-Asia Co-head/Regional Head of Automobiles and Components; Automobiles; Shipbuilding; Steel
Anderson CHA	(82) 2 787 9185	anderson.cha@kr.daiwacm.com	Banking/Finance
Mike OH	(82) 2 787 9179	mike.oh@kr.daiwacm.com	Capital Goods (Construction and Machinery)
Sang Hee PARK	(82) 2 787 9165	sanghee.park@kr.daiwacm.com	Consumer/Retail
Jae H LEE	(82) 2 787 9173	jhlee@kr.daiwacm.com	IT/Electronics (Tech Hardware and Memory Chips)
Thomas Y KWON	(82) 2 787 9181	yskwon@kr.daiwacm.com	Pan-Asia Head of Internet & Telecommunications; Software (Korea) – Internet/On-line Game

TAIWAN			
Mark CHANG	(886) 2 8758 6245	mark.chang@daiwacm-cathay.com.tw	Head of Research; Regional Head of Small/Medium Cap; Small/Medium Cap (Regional)
Birdy LU	(886) 2 8758 6248	birdy.lu@daiwacm-cathay.com.tw	IT/Technology Hardware (Handsets and Components)
Christine WANG	(886) 2 8758 6249	christine.wang@daiwacm-cathay.com.tw	IT/Technology Hardware (PC Hardware)
Chris LIN	(886) 2 8758 6251	chris.lin@daiwacm-cathay.com.tw	IT/Technology Hardware (Panels)

INDIA			
Punit SRIVASTAVA	(91) 22 6622 1013	punit.srivastava@in.daiwacm.com	Head of Research; Strategy; Banking/Finance
Navin MATTA	(91) 22 6622 8411	navin.matta@in.daiwacm.com	Automobiles and Components
Saurabh MEHTA	(91) 22 6622 1009	saurabh.mehta@in.daiwacm.com	Capital Goods; Utilities
Mihir SHAH	(91) 22 6622 1020	mihir.shah@in.daiwacm.com	FMCG/Consumer
Deepak PODDAR	(91) 22 6622 1016	deepak.poddar@in.daiwacm.com	Materials
Nirmal RAGHAVAN	(91) 22 6622 1018	nirmal.raghavan@in.daiwacm.com	Oil and Gas; Utilities

SINGAPORE			
Adrian LOH	(65) 6499 6548	adrian.loh@sg.daiwacm.com	Head of Singapore Research, Regional Head of Oil and Gas; Oil and Gas (ASEAN and China); Capital Goods (Singapore)
Srikanth VADLAMANI	(65) 6499 6570	srikanth.vadlamani@sg.daiwacm.com	Banking (ASEAN)
David LUM	(65) 6329 2102	david.lum@sg.daiwacm.com	Property and REITs
Ramakrishna MARUVADA	(65) 6499 6543	ramakrishna.maruvada@sg.daiwacm.com	Head of ASEAN & India Telecommunications; Telecommunications (ASEAN & India)

Daiwa's Offices

Office / Branch / Affiliate	Address	Tel	Fax
DAIWA SECURITIES GROUP INC			
HEAD OFFICE	Gran Tokyo North Tower, 1-9-1, Marunouchi, Chiyoda-ku, Tokyo, 100-6753	(81) 3 5555 3111	(81) 3 5555 0661
Daiwa Securities Trust Company	One Evertrust Plaza, Jersey City, NJ 07302, U.S.A.	(1) 201 333 7300	(1) 201 333 7726
Daiwa Securities Trust and Banking (Europe) PLC (Head Office)	5 King William Street, London EC4N 7JB, United Kingdom	(44) 207 320 8000	(44) 207 410 0129
Daiwa Europe Trustees (Ireland) Ltd	Level 3, Block 5, Harcourt Centre, Harcourt Road, Dublin 2, Ireland	(353) 1 603 9900	(353) 1 478 3469
Daiwa Capital Markets America Inc	Financial Square, 32 Old Slip, New York, NY10005, U.S.A.	(1) 212 612 7000	(1) 212 612 7100
Daiwa Capital Markets America Inc. San Francisco Branch	555 California Street, Suite 3360, San Francisco, CA 94104, U.S.A.	(1) 415 955 8100	(1) 415 956 1935
Daiwa Capital Markets Europe Limited	5 King William Street, London EC4N 7AX, United Kingdom	(44) 20 7597 8000	(44) 20 7597 8600
Daiwa Capital Markets Europe Limited, Frankfurt Branch	Tranion Building, Mainzer Landstrasse 16, 60325 Frankfurt am Main, Federal Republic of Germany	(49) 69 717 080	(49) 69 723 340
Daiwa Capital Markets Europe Limited, Paris Representative Office	36, rue de Naples, 75008 Paris, France	(33) 1 56 262 200	(33) 1 47 550 808
Daiwa Capital Markets Europe Limited, London, Geneva Branch	50 rue du Rhône, P.O.Box 3198, 1211 Geneva 3, Switzerland	(41) 22 818 7400	(41) 22 818 7441
Daiwa Capital Markets Europe Limited, Moscow Representative Office	Midland Plaza 7th Floor, 10 Arbat Street, Moscow 119002, Russian Federation	(7) 495 641 3416	(7) 495 775 6238
Daiwa Capital Markets Europe Limited, Bahrain Branch	7th Floor, The Tower, Bahrain Commercial Complex, P.O. Box 30069, Manama, Bahrain	(973) 17 534 452	(973) 17 535 113
Daiwa Capital Markets Hong Kong Limited	Level 28, One Pacific Place, 88 Queensway, Hong Kong	(852) 2525 0121	(852) 2845 1621
Daiwa Capital Markets Singapore Limited	6 Shenton Way #26-08, DBS Building Tower Two, Singapore 068809, Republic of Singapore	(65) 6220 3666	(65) 6223 6198
Daiwa Capital Markets Australia Limited	Level 34, Rialto North Tower, 525 Collins Street, Melbourne, Victoria 3000, Australia	(61) 3 9916 1300	(61) 3 9916 1330
DBP-Daiwa Capital Markets Philippines, Inc	18th Floor, Citibank Tower, 8741 Paseo de Roxas, Salcedo Village, Makati City, Republic of the Philippines	(632) 813 7344	(632) 848 0105
Daiwa-Cathay Capital Markets Co Ltd	14/F, 200, Keelung Road, Sec 1, Taipei, Taiwan, R.O.C.	(886) 2 2723 9698	(886) 2 2345 3638
Daiwa Securities Capital Markets Korea Co., Ltd.	One IFC, 10 Gukjegeumyung-Ro, Yeouido-dong, Yeongdeungpo-gu, Seoul, 150-876, Korea	(82) 2 787 9100	(82) 2 787 9191
Daiwa Securities Capital Markets Co Ltd, Beijing Representative Office	Room 3503/3504, SK Tower, No.6 Jia Jianguomen Wai Avenue, Chaoyang District, Beijing 100022, People's Republic of China	(86) 10 6500 6688	(86) 10 6500 3594
Daiwa SSC Securities Co Ltd	45/F, Hang Seng Tower, 1000 Lujiazui Ring Road, Pudong, Shanghai 200120, People's Republic of China	(86) 21 3858 2000	(86) 21 3858 2111
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Daiwa Securities Capital Markets Co. Ltd, Hanoi Representative Office	Suite 405, Pacific Palace Building, 83B, Ly Thuong Kiet Street, Hoan Kiem Dist. Hanoi, Vietnam	(84) 4 3946 0460	(84) 4 3946 0461
DAIWA INSTITUTE OF RESEARCH LTD			
HEAD OFFICE	15-6, Fuyuki, Koto-ku, Tokyo, 135-8460, Japan	(81) 3 5620 5100	(81) 3 5620 5603
MARUNOUCHI OFFICE	Gran Tokyo North Tower, 1-9-1, Marunouchi, Chiyoda-ku, Tokyo, 100-6756	(81) 3 5555 7011	(81) 3 5202 2021
New York Research Center	11th Floor, Financial Square, 32 Old Slip, NY, NY 10005-3504, U.S.A.	(1) 212 612 6100	(1) 212 612 8417
London Research Centre	3/F, 5 King William Street, London, EC4N 7AX, United Kingdom	(44) 207 597 8000	(44) 207 597 8550

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