Petronet LNG

Strong show continues

January 28, 2012

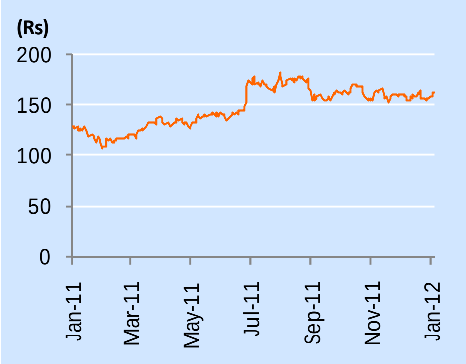
Deepak Pareek
deepakpareek@plindia.com
+91-22-66322241

Rating	**BUY**
Price	Rs164
Target Price	Rs197
Implied Upside	20.1%
Sensex	17,234
Nifty	5,205

(Prices as on January 27, 2012)

Trading data			
Market Cap. (Rs bn)			122.8
Shares o/s (m)			750.0
3M Avg. Daily value (Rs m)			337.1
Major shareholders			
Promoters			50.00%
Foreign			14.55%
Domestic Inst.			7.92%
Public & Other			27.53%
Stock Performance			
(%)	**1M**	**6M**	**12M**
Absolute	2.3	(9.0)	29.0
Relative	(5.6)	(2.1)	38.1
How we differ from Consensus			
EPS (Rs)	**PL**	**Cons.**	***% Diff.***
2013	15.7	13.6	*15.3*
2014	17.2	14.8	*16.1*

Price Performance (RIC: PLNG.BO, BB: PLNG IN)



Source: Bloomberg

Petronet LNG's (PLNG's) Q3FY12 result was significantly better than our expectation on the EBITDA and bottom-line front. Top-line registered a growth of 74.5% YoY to Rs63.3bn (Rs36.3bn) on account of 20.8% YoY growth in volumes, coupled with 43.9% YoY growth in realisations. EBITDA/TBTU witnessed an expansion, from Rs33.2/TBTU in Q2FY12 to Rs34.7/TBTU in Q3FY12. Bottom-line, during the quarter, stood at Rs2,953m (Rs1,708m), registering an increase of 72.9% YoY v/s our expectation of Rs2,495m during the quarter.

- **Performance led by spot marketing margins:** Our calculation suggests that the company made gross marketing profits on spot volumes of Rs1,757m (28.0% of the reported gross margins for the quarter). The share of marketing margins in overall gross margins has increased from 11% in Q3FY11 to 28% in Q3FY12. We believe, PLNG has witnessed a 39% QoQ growth in marketing margins from US$1.0/mmbtu (Q2FY12 to US$1.39/mmbtu (Q3FY12). Volumes during Q2FY12 were at 145TBTU (120TBTU); the same were slightly higher than our estimate of 142TBTU. PLNG imported around 45 cargoes in the quarter compared to 42 cargoes handled in Q2FY12.

- **Outlook:** PLNG's utility nature of business (stable re-gasification margins and term contracts), low regulatory risks (re-gasification margins are not currently under PNGRB's purview) and expanding volumes on account of strong demand estimates, hold it in good stead. We have increased our marketing margins assumption for the on account of strong demand. We believe that continued strength in the marketing margins on the spot volumes, coupled with positive news-flow pertaining to Kochi terminal, is likely to provide positive catalyst to the stock price. We maintain **'BUY'**, with a DCF-based target price of Rs197/share, implying a P/E of 12.6x FY13E.

Key financials (Y/e March)	**2011**	**2012E**	**2013E**	**2014E**
Revenues (Rs m)	131,973	217,931	352,528	476,736
Growth (%)	*23.9*	*65.1*	*61.8*	*35.2*
EBITDA (Rs m)	12,163	19,016	20,799	25,861
PAT (Rs m)	6,196	10,869	11,795	12,897
EPS (Rs)	8.3	14.5	15.7	17.2
Growth (%)	*53.2*	*75.4*	*8.5*	*9.3*
Net DPS (Rs)	2.0	2.1	2.4	2.8

Profitability & Valuation	**2011**	**2012E**	**2013E**	**2014E**
EBITDA margin (%)	*9.2*	*8.7*	*5.9*	*5.4*
RoE (%)	*25.2*	*34.7*	*29.0*	*25.4*
RoCE (%)	*14.1*	*18.4*	*16.3*	*16.7*
EV / sales (x)	1.2	0.7	0.4	0.3
EV / EBITDA (x)	12.6	8.2	7.6	5.8
PE (x)	19.8	11.3	10.4	9.5
P / BV (x)	4.6	3.4	2.7	2.2
Net dividend yield (%)	*1.2*	*1.3*	*1.5*	*1.7*

Source: Company Data; PL Research

Q3FY12 Result Update

Exhibit 1: Q3FY12 Result Overview (Rs m)

Y/e March	Q3FY12	Q3FY11	YoY gr. (%)	Q2FY11	9MFY12	9MFY11	YoY gr. (%)
Net Sales	**63,303**	**36,276**	***74.5***	**53,669**	**163,204**	**92,113**	***77.2***
Expenditure							
Raw material	57,006	32,389	*76.0*	48,138	146,474	82,269	*78.0*
% of net sales	*90.1*	*89.3*		*89.7*	*89.7*	*89.3*	
Personnel cost	64	57	*11.8*	62	190	184	*3.3*
% of net sales	*0.1*	*0.2*		*0.1*	*0.1*	*0.2*	
Other operating expenses	1,200	374	*221.0*	986	2,643	1,011	*161.5*
% of net sales	*1.9*	*1.0*		*1.8*	*1.6*	*1.1*	
EBITDA	**5,032**	**3,456**	***45.6***	**4,484**	**13,897**	**8,650**	***60.7***
Margin (%)	*7.9*	*9.5*		*8.4*	*8.5*	*9.4*	
Depreciation	463	465	*(0.4)*	463	1,384	1,392	*(0.6)*
EBIT	**4,570**	**2,991**	***52.8***	**4,021**	**12,513**	**7,257**	***72.4***
Interest	345	507	*(32.0)*	458	1,267	1,500	*(15.5)*
Other Income	164	54	*203.0*	201	628	366	*71.5*
PBT	**4,389**	**2,538**	***72.9***	**3,763**	**11,874**	**6,123**	***93.9***
Total taxes	1,435	830	*72.9*	1,160	3,750	1,990	*88.4*
ETR (%)	*32.7*	*32.7*		*30.8*	*31.6*	*32.5*	
Rep. PAT	**2,954**	**1,708**	***72.9***	**2,603**	**8,124**	**4,133**	***96.6***
Exceptional Items	-	-		-	-	-	
Adj. PAT	**2,954**	**1,708**	***72.9***	**2,603**	**8,124**	**4,133**	***96.6***

Source: Company Data, PL Research

Exhibit 2: Operating Metrics

Y/e March	Q3FY12	Q3FY11	YoY gr. (%)	Q2FY11	9MFY12	9MFY11	YoY gr. (%)
Contracted Sales (TBTUs)	98.2	100.0	*(1.8)*	90.2	188.5	189.5	*(0.5)*
Spot Volumes (TBTUs)	24.9	11.4	*118.5*	27.7	49.3	11.4	*332.3*
Tolling Volumes (TBTUs)	21.8	8.6	*153.8*	17.2	40.5	14.2	*185*
EBITDA/TBTU	34.7	28.8	*20.5*	33.2	33.8	27.4	*23.2*

Source: Company Data, PL Research

Key Conference Call Highlights

Kochi terminal: PLNG expects to commission Kochi terminal in Q3CY12, with a capacity of 2.5 MMTPA; the same would be expanded to 5.0MMTPA within a span of six months of commissioning of 2.5MMTPA (around 95% of the mechanical work at the Kochi terminal is completed). Management does not expect any issue on account of delay of pipeline commissioning and expects pipeline to come in a synchronised manner with the Kochi terminal. It expects to run the terminal on the spot volumes/medium-term contract till the gas from the Gorgon fields arrives in early 2015. PLNG expects to replace the liquid fuel demand via LNG in the Southern region. Commenting on the utilisation of the Kochi terminal, management expects the utilisation of the terminal to be low in first couple of years. Management expects to bring the first cargo to the terminal around August 2012 for the commissioning purpose (likely to last for 15-20 days) and expects to commercially start utilising the terminal from Q4FY12 onwards. Regasification tariffs at the terminal will be fixed in a manner to provide PLNG 16% equity IRR from the project. Against the planned capex of around Rs42.5bn, capex till date on the project has been around Rs29bn. Company has spent close to around Rs13bn from internal resources, while the balance Rs16bn is funded via the debt. The balance capex for the terminal of Rs13.5bn is likely to be met out of debt.

PLNG finalised Gangawaram as site for new LNG terminal: PLNG management has finalised the location of its proposed third LNG terminal at Gangawaram in Andhra Pradesh with a likely name plate capacity of 5.0MMTPA. Company will take a final FID for the proposed terminal, going ahead. Gangawaram was selected due to its better marine tranquillity and breakwater than other location. Feasibility study of the same is likely to be completed by end of FY12. The port is close to Vizag refinery of HPCL and Vizag steel plant. From the transportation point of view, RIL's East-West Pipeline is around 100 kms away from the Port location. Management believes HPCL refinery is capable of offtaking around 1MMTPA of the volumes from the proposed LNG terminal.

Management highlighted that EPC award can happen within six months of feasibility process. Moreover, given the time period of around 36 months involved in construction, earliest we can expect with regards to commissioning of the terminal is around Early CY2016.

Additional Jetty at Dahej: Management expects the jetty to be operational from October-November 2012. Commenting on the possibilities of the delay of the same, management said, given the heavy penalties involved and timelines achieved till date, the chances of delay of the same is very slim. We believe, given historical execution track record of company, Jetty is likely to be operational on the proposed time. Post commissioning of the jetty, given the spare vaporizer capacity, the operational capacity of the Dahej terminal would stand at 12.5-13.0MMTPA.

Capacity expansion and additional Jetty at Dahej: Management expects the jetty to be operational from October-November 2013. Commenting on the possibilities of the delay of the same, management said, given the heavy penalties involved and timelines achieved till date, the chances of delay of the same is very slim. Thus, the incremental capacity over the current operational capacity of 11.5MMTPA is likely to come from second half of FY2014. We believe, given historical execution track record of company, Jetty is likely to be operational on the proposed time. Post commissioning of the jetty, given the spare vaporizer capacity, the operational capacity of the Dahej terminal would stand at 12.5-13.0MMTPA.

Management highlighted that it is likely to enter into contract with GAIL (for capacity of 2.5MMTPA) and GSPC (for capacity of 1.0MMTPA) for the storage tanks soon and the capacity expansion for the same is likely to take place in 2H2015. Moreover, there are additional requirements also by IOC and BPCL. Thus, there are no concerns over the utilisation of the expanded terminal capacity. Contract terms for the new capacity are likely to be similar to the current regasification margins. Petronet also expects to get upfront advance from GAIL and GSPL for building the tankers. Given the fact that company intends not to puts its money at work, it pointed towards 30% advance from the parties.

The construction periods for the tank are around 36 months from the award of EPC contract. However, the vaporiser capacity could come earlier than the additional tanker capacity in order to leverage the strong demand potential. The timeline for vaporisers stands at around 24-30 months from the date of award of the contract. EPC awarded for the capacity expansion is likely to take place after period of around 3-4 months.

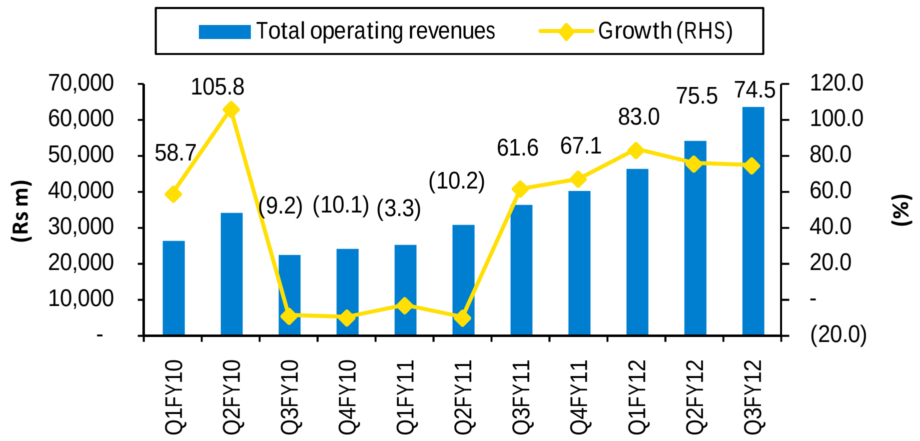
Capacity utilisation of Dahej and other operational highlights: While the management clearly highlighted the fact that there remains no risk on the downside regarding the utilisation of the Dahej terminal. Management highlights that it can maintain the utilisation rate between 110%-115% on the stable basis. Internal consumption of LNG has decline with higher volumes processed as the internal consumption associated with FOB volumes stands at 1.2%-1.3%, where the internal consumption for DES volumes stands at 0.3%-0.4% (due to absence of shipping losses). Thus, the average range has reduced to 0.7%-0.8%. Thus, as the short term volumes are procured on DES basis, internal consumption declines, therefore, providing efficiency gains for PLNG.

Regulation of the marketing margins: PLNG believes the recent issue with regards to regulation of the marketing margins pertains to domestic gas, where the government has fixed the price and it is unlikely to be impacted on this count.

Quarterly Highlights

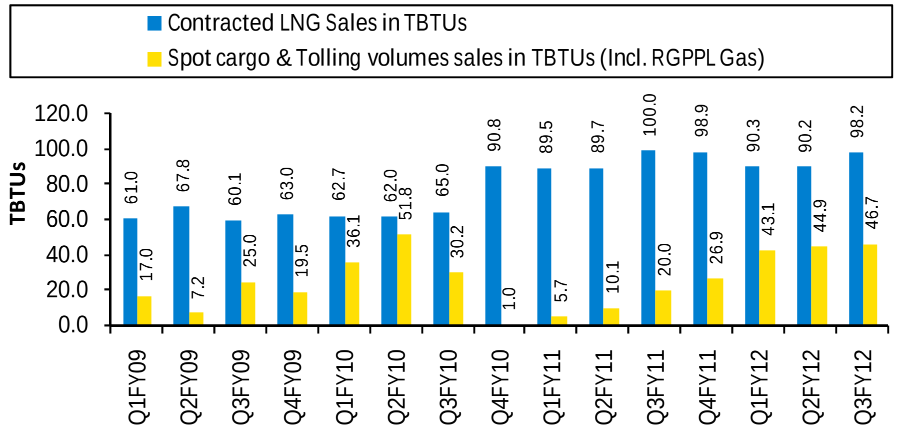
Volume and top-line increased YoY: For Q3FY12, PLNG's R-LNG volumes increased by 20.8% YoY, mainly on account of higher spot and tolling volumes. Volumes processed during the quarter stood at 144.9TBTU, higher than our expectation of 142.0TBTUs. Tolling volumes during the quarter stood at 21.8TBTU (8.6TBTU). Contractual volumes were almost flat on a YoY basis at 98.2TBTUs (100TBTUs). Spot volumes stood at 24.9TBTU against 11.4TBTU registered in Q2FY11. Capacity utilization during the quarter stood at 115% as against 95.0% in Q3FY11. On the revenue front, the company reported a 74.5% YoY increase in revenue to Rs63,303m (Rs36,276m), which was higher than our expectation of Rs64,651m. Realisation during the quarter registered 43.9% YoY growth on account of increased RasGas LNG and higher spot gas prices.

Exhibit 3: Operating revenue – Growth trend (YoY)



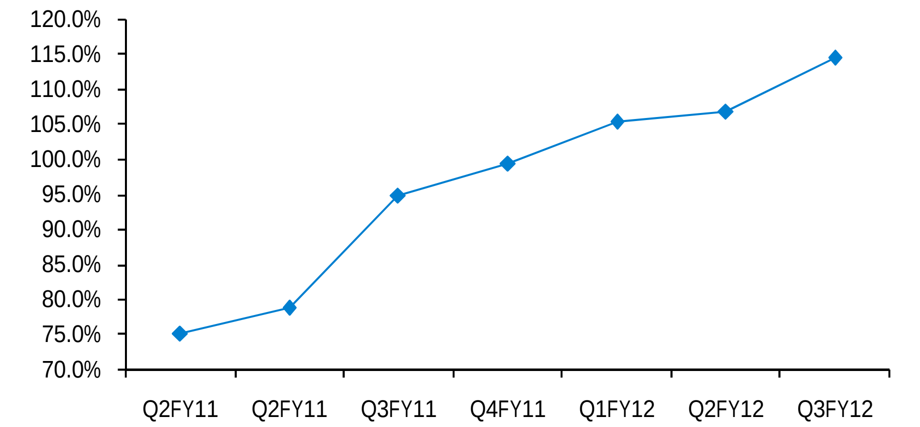
Source: Company Data, PL Research

Exhibit 4: R-LNG Volumes



Source: Company Data, PL Research

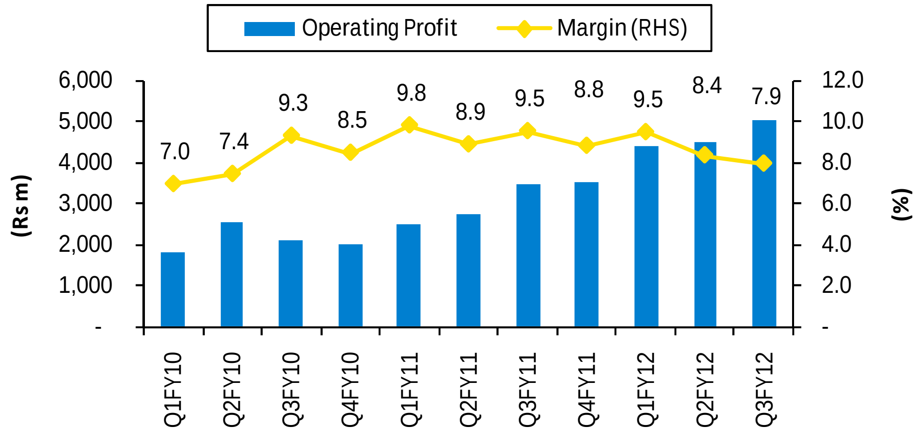
Exhibit 5: Capacity Utilisation



Source: Company Data, PL Research

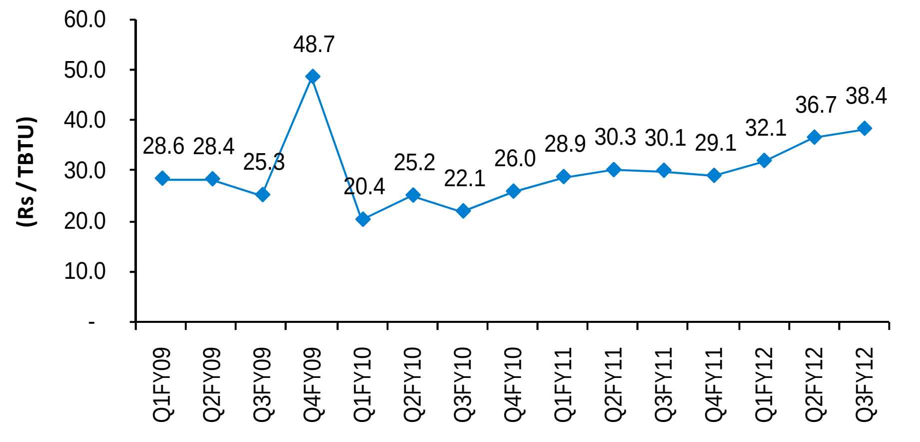
Better operating performance led by higher spot margins: Net re-gasification margins during the quarter rose by 27.5% YoY to Rs38.4/mmbtu (Rs30.1/mmbtu) on account of higher margins on the spot volumes. Moreover, the same was inflated to an extent as the impact of rupee depreciation on the cost of gas was classified in the other expenditure front (below the line item for re-gasification margin calculation); the pass through of the rupee impact was factored in the sales. On tolling volumes (21.8TBTU), the company's tolling margins stood at Rs33.4/mmbtu during the quarter. Operating profit increased by 45.6% YoY to Rs5,032m (Rs3,456m) and was higher than our expectation of Rs4,633m on higher-than-anticipated margins on the spot volumes.

Exhibit 6: Operating performance trend



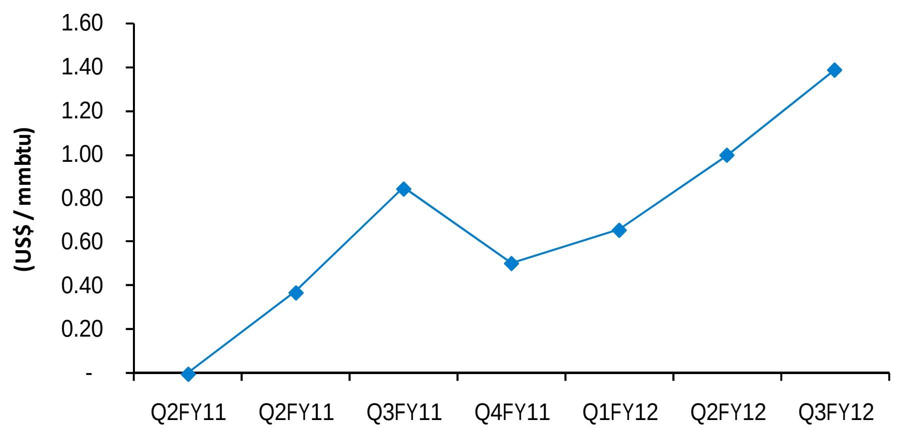
Source: Company Data, PL Research

Exhibit 7: Netback margin trend



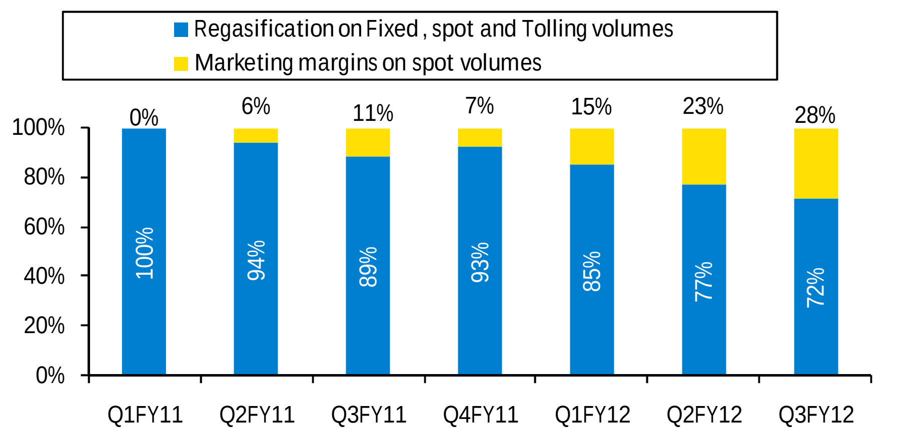
Source: Company Data, PL Research

Exhibit 8: Marketing Margins on Spot Gas



Source: Company Data, PL Research

Exhibit 9: Gross Margin Composition

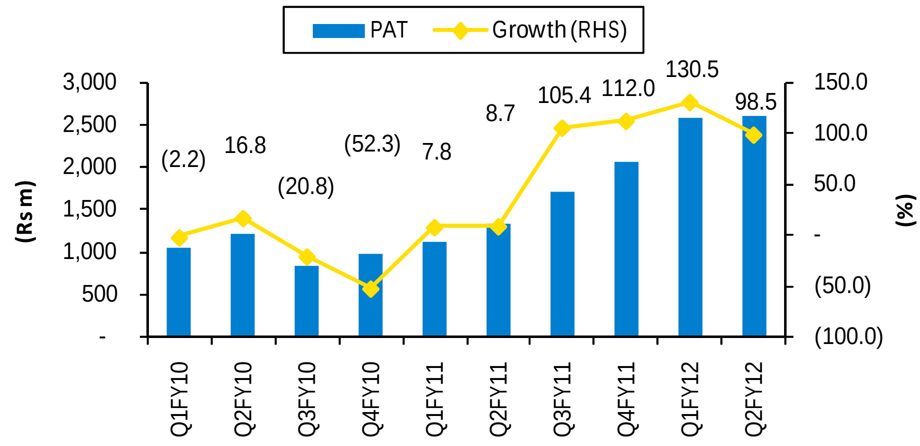


Source: Company Data, PL Research

Depreciation in line, interest lower-than-anticipated: Depreciation cost during Q3FY11 was flattish at Rs463m (Rs465m). Interest expenditure declined by 32.0% YoY to Rs345m (Rs507m). The interest decline was on account of prepayment of the Rs5bn worth of debt by the company.

PAT increases 72.9% YoY: During the quarter, PLNG witnessed better-than expected bottom-line performance, driven by higher-than-expected marketing margins on the spot volumes. PAT registered an increase of 72.9% YoY to Rs2,954m (Rs1,708m) and was higher than our expectation of Rs2,495m.

Exhibit 10: PAT – Growth trend (YoY)



Source: Company Data, PL Research

Outlook

PLNG has addressed the concerns over the utilization of capacity over and above the fixed contracted volumes to a larger extent by higher utilisation during H1FY12. Moreover, management has also laid to rest the concerns rising on account of adverse impact of spot LNG prices on profitability of the company.

We continue to believe that the changing volume mix in favour of spot volumes on account of strong demand estimates is likely to keep PLNG in good stead. Moreover, we expect the strength in marketing margins to continue, going ahead, due to subdued domestic gas production profile. Moreover, we expect gradual de-risking of the Kochi terminal going ahead, which augers well for the company's business model. Increase in news flows on the new LNG terminal planned on the east coast and capacity expansion at Dahej is likely to guide Petronet LNG into high growth orbit, going ahead.

While PLNG's utility nature of business (stable re-gasification margins and term contracts), low regulatory risks (re-gasification margins are not currently under PNGRB's purview), coupled with domestic gas shortages, will result in significant re-rating of the stock. We maintain **'BUY'**, with a DCF-based target price of Rs197/share, implying a P/E of 12.6x FY13E.

Exhibit 11: Key Assumptions

Y/e March	FY12E	FY13E	FY14E
Installed capacity (TBTU)	586	586	663
Total volumes processed (TBTU)	524	575	616
Fixed contract (Rasgas)	251	252	252
Fixed contract (Rasgas Tranche 'A')	125	125	125
Spot/medium term contracts	105	155	196
Tolling Volumes	40.0	40.0	40.0
Total Volumes processed (MMTPA)	10.3	11.3	12.1
Effective capacity utilisation	*89.3*	*98.1*	*93.0*
Regasification charges (Rs per mmbtu)	33.8	35.5	36.8
EBITDA per TBTU (Rs)	36.5	36.4	36.4

Source: Company Data, PL Research

Income Statement (Rs m)

Y/e March	2011	2012E	2013E	2014E
Net Revenue	**131,973**	**217,931**	**352,528**	**476,736**
Raw Material Expenses	118,012	196,837	328,712	447,572
Gross Profit	13,961	21,095	23,816	29,164
Employee Cost	306	325	519	554
Other Expenses	1,493	1,754	2,499	2,749
EBITDA	**12,163**	**19,016**	**20,799**	**25,861**
Depr. & Amortization	1,847	1,848	2,420	4,092
Net Interest	1,931	1,693	1,818	3,957
Other Income	680	800	1,100	1,500
Profit before Tax	**9,064**	**16,275**	**17,661**	**19,312**
Total Tax	2,868	5,406	5,867	6,415
Profit after Tax	**6,196**	**10,869**	**11,795**	**12,897**
Ex-Od items / Min. Int.	—	—	—	—
Adj. PAT	**6,196**	**10,869**	**11,795**	**12,897**
Avg. Shares O/S (m)	**750.0**	**750.0**	**750.0**	**750.0**
EPS (Rs.)	**8.3**	**14.5**	**15.7**	**17.2**

Balance Sheet Abstract (Rs m)

Y/e March	2011	2012E	2013E	2014E
Shareholder's Funds	26,802	35,840	45,530	56,006
Total Debt	32,161	35,561	42,575	42,575
Other Liabilities	3,480	3,588	4,057	4,571
Total Liabilities	**62,443**	**74,990**	**92,162**	**103,152**
Net Fixed Assets	49,053	59,738	71,589	72,196
Goodwill	—	—	—	—
Investments	11,649	11,649	11,649	11,649
Net Current Assets	1,741	3,602	8,925	19,306
Cash & Equivalents	*1,540*	*1,768*	*6,764*	*16,656*
Other Current Assets	*12,334*	*20,964*	*33,127*	*44,352*
Current Liabilities	*12,134*	*19,130*	*30,966*	*41,702*
Other Assets	—	—	—	—
Total Assets	**62,443**	**74,990**	**92,162**	**103,152**

Cash Flow Abstract (Rs m)

Y/e March	2011	2012E	2013E	2014E
C/F from Operations	9,075	11,997	14,800	19,155
C/F from Investing	(14,766)	(11,733)	(13,170)	(3,200)
C/F from Financing	3,826	(36)	3,365	(6,062)
Inc. / Dec. in Cash	(1,865)	228	4,996	9,893
Opening Cash	3,405	1,540	1,768	6,764
Closing Cash	1,540	1,768	6,764	16,656
FCFF	7,606	11,083	(19,093)	(4,051)
FCFE	14,769	14,483	(12,079)	(4,051)

Quarterly Financials (Rs m)

Y/e March	Q4FY11	Q1FY12	Q2FY12	Q3FY12
Net Revenue	**39,860**	**46,233**	**53,669**	**63,303**
EBITDA	**3,513**	**4,381**	**4,484**	**5,032**
% of revenue	*8.8*	*9.5*	*8.4*	*7.9*
Depr. & Amortization	455	458	463	463
Net Interest	431	464	458	345
Other Income	314	263	201	164
Profit before Tax	**2,941**	**3,722**	**3,763**	**4,389**
Total Tax	878	1,155	1,160	1,435
Profit after Tax	**2,063**	**2,567**	**2,603**	**2,954**
Adj. PAT	**2,063**	**2,567**	**2,603**	**2,954**

Key Financial Metrics

Y/e March	2011	2012E	2013E	2014E
Growth				
Revenue (%)	23.9	65.1	61.8	35.2
EBITDA (%)	43.7	56.3	9.4	24.3
PAT (%)	53.2	75.4	8.5	9.3
EPS (%)	53.2	75.4	8.5	9.3
Profitability				
EBITDA Margin (%)	9.2	8.7	5.9	5.4
PAT Margin (%)	4.7	5.0	3.3	2.7
RoCE (%)	14.1	18.4	16.3	16.7
RoE (%)	25.2	34.7	29.0	25.4
Balance Sheet				
Net Debt : Equity	1.1	0.9	0.8	0.5
Net Wrkng Cap. (days)	(1)	2	2	2
Valuation				
PER (x)	19.8	11.3	10.4	9.5
P / B (x)	4.6	3.4	2.7	2.2
EV / EBITDA (x)	12.6	8.2	7.6	5.8
EV / Sales (x)	1.2	0.7	0.4	0.3
Earnings Quality				
Eff. Tax Rate	31.6	33.2	33.2	33.2
Other Inc / PBT	7.5	4.9	6.2	7.8
Eff. Depr. Rate (%)	5.2	5.2	3.5	4.6
FCFE / PAT	238.4	133.3	(102.4)	(31.4)

Source: Company Data, PL Research.

Key Operating Metrics

Y/e March	2011	2012E	2013E	2014E
Contracted Sales (TBTUs)	379	376	409	505
Spot LNG (TBTUs)	36	105	155	324
EBITDA/MMBTU	28	36	35	36

Source: Company Data, PL Research.

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Prabhudas Lilladher Pvt. Ltd.
3rd Floor, Sadhana House, 570, P. B. Marg, Worli, Mumbai-400 018, India
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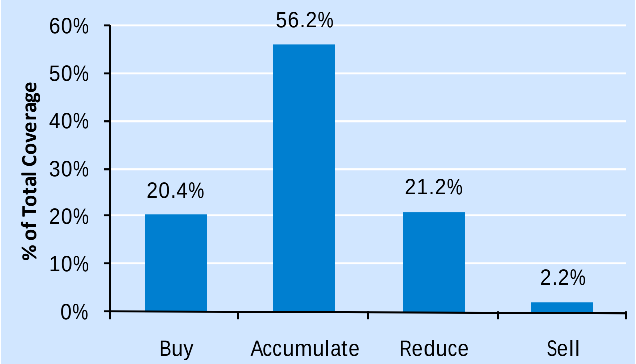

PL's Recommendation Nomenclature

BUY	:	Over 15% Outperformance to Sensex over 12-months	**Accumulate**	:	Outperformance to Sensex over 12-months
Reduce	:	Underperformance to Sensex over 12-months	**Sell**	:	Over 15% underperformance to Sensex over 12-months
Trading Buy	:	Over 10% absolute upside in 1-month	**Trading Sell**	:	Over 10% absolute decline in 1-month
Not Rated (NR)	:	No specific call on the stock	**Under Review (UR)**	:	Rating likely to change shortly

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