Petronet LNG (PLNG.BO)

Equity

Sell: Disappointing 1Q Results

- **1Q well below estimates** — PLNG's 1Q PAT came in at Rs1.03bn, down 2.2% YoY and significantly below our expectations. Despite volumes increasing QoQ from 82 to 99 TBTUs as was expected, EBITDA did not grow correspondingly and in fact registered a sharp decline (46.8% QoQ, 5.2% YoY) due to losses made on spot cargoes.

- **Losses on spot cargoes drive down profitability** — Petronet bought and regassified c5 spot cargoes during the quarter, which contributed to the QoQ increase in volumes. Though global LNG prices were down sharply in the quarter due to the economic slowdown, Petronet had probably contracted these at higher prices and was unsuccessful in passing the prices to consumers when prices fell. This was likely further exacerbated by the commencement of KG gas which resulted in consumers shifting away from spot gas. This is a trend that we expect will likely continue over the coming few quarters and is the main thesis our Sell recommendation is premised on.

- **Maintain Sell** — Given total capacity of 17.5 MMTPA after expansion, PLNG would have to sign more long-term contracts or continue its reliance on spot cargoes to improve its utilization levels (we factor total long-term plus spot volumes of 14.1 MMTPA in the long-term in our DCF). Spot volumes could be under risk with commencement of KG gas and if LNG prices pick up from current levels. Besides, robust long-term LNG outlook increases uncertainty for the company. Power plans, though interesting, are still a few years away and would be contingent on competitive pricing of long-term LNG. At current prices, the stock appears fully valued. W maintain our Sell (3H) rating.

Sell/High Risk	3H
Price (20 Jul 09)	Rs68.95
Target price	Rs71.00
Expected share price return	3.0%
Expected dividend yield	2.5%
Expected total return	**5.5%**
Market Cap	Rs51,713M US$1,065M

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

Statistical Abstract

Year to 31 Mar	Net Profit (RsM)	Diluted EPS (Rs)	EPS growth (%)	P/E (x)	P/B (x)	ROE (%)	Yield (%)
2007A	3,133	4.18	60.7	16.5	4.1	26.7	1.8
2008A	4,747	6.33	51.5	10.9	3.2	32.8	2.2
2009E	5,184	6.91	9.2	10.0	2.6	28.8	2.5
2010E	5,795	7.73	11.8	8.9	2.2	26.4	2.9
2011E	6,238	8.32	7.6	8.3	1.8	23.8	2.9

Source: Powered by dataCentral

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Fiscal year end 31-Mar	2007	2008	2009E	2010E	2011E
Valuation Ratios					
P/E adjusted (x)	16.5	10.9	10.0	8.9	8.3
EV/EBITDA adjusted (x)	9.3	7.0	7.1	5.8	5.8
P/BV (x)	4.1	3.2	2.6	2.2	1.8
Dividend yield (%)	1.8	2.2	2.5	2.9	2.9
Per Share Data (Rs)					
EPS adjusted	4.18	6.33	6.91	7.73	8.32
EPS reported	4.18	6.33	6.91	7.73	8.32
BVPS	17.01	21.58	26.50	31.94	37.98
DPS	1.25	1.50	1.75	2.00	2.00
Profit & Loss (RsM)					
Net sales	55,090	65,553	84,287	143,885	141,018
Operating expenses	-49,629	-57,914	-76,299	-133,659	-129,897
EBIT	**5,460**	**7,640**	**7,988**	**10,226**	**11,121**
Net interest expense	-1,070	-1,024	-1,012	-1,733	-1,785
Non-operating/exceptionals	366	536	765	235	59
Pre-tax profit	**4,756**	**7,152**	**7,740**	**8,728**	**9,395**
Tax	-1,623	-2,405	-2,556	-2,933	-3,157
Extraord./Min.Int./Pref.div.	0	0	0	0	0
Reported net income	**3,133**	**4,747**	**5,184**	**5,795**	**6,238**
Adjusted earnings	3,133	4,747	5,184	5,795	6,238
Adjusted EBITDA	6,481	8,661	9,013	12,125	13,036
Growth Rates (%)					
Sales	43.6	19.0	28.6	70.7	-2.0
EBIT adjusted	41.0	39.9	4.6	28.0	8.8
EBITDA adjusted	32.8	33.7	4.1	34.5	7.5
EPS adjusted	60.7	51.5	9.2	11.8	7.6
Cash Flow (RsM)					
Operating cash flow	**5,106**	**8,288**	**5,813**	**7,495**	**8,225**
Depreciation/amortization	1,020	1,022	1,025	1,899	1,915
Net working capital	-131	2,300	-427	-513	-266
Investing cash flow	**-3,765**	**-6,042**	**-9,470**	**-12,844**	**-10,300**
Capital expenditure	-3,765	-6,042	-9,470	-12,844	-10,300
Acquisitions/disposals	0	0	0	0	0
Financing cash flow	**136**	**628**	**727**	**1,290**	**290**
Borrowings	1,233	1,944	2,224	3,000	2,000
Dividends paid	-1,097	-1,316	-1,497	-1,710	-1,710
Change in cash	**1,478**	**2,874**	**-2,930**	**-4,059**	**-1,785**
Balance Sheet (RsM)					
Total assets	**34,936**	**43,242**	**53,924**	**67,531**	**74,015**
Cash & cash equivalent	3,405	3,586	5,939	1,880	95
Accounts receivable	3,313	3,330	3,926	6,701	6,568
Net fixed assets	21,273	26,293	34,738	45,683	54,068
Total liabilities	**22,181**	**27,057**	**34,051**	**43,572**	**45,529**
Accounts payable	3,125	3,388	8,083	14,244	13,816
Total Debt	13,832	15,776	18,000	21,000	23,000
Shareholders' funds	**12,755**	**16,186**	**19,873**	**23,958**	**28,486**
Profitability/Solvency Ratios (%)					
EBITDA margin adjusted	11.8	13.2	10.7	8.4	9.2
ROE adjusted	26.7	32.8	28.8	26.4	23.8
ROIC adjusted	17.5	20.0	16.5	16.9	15.0
Net debt to equity	81.7	75.3	60.7	79.8	80.4
Total debt to capital	52.0	49.4	47.5	46.7	44.7

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Figure 1. Petronet LNG – 1QFY10 Results

Rs m	1QFY09	4QFY09	1QFY10	% YoY	Comments
Net Sales	**16,459**	**26,549**	**26,124**	**58.7%**	Revenues not commensurate with rise in volumes due to negative margins on spot volumes
Raw Material	14,231	22,533	24,020	68.8%	
Staff Cost	39	84	41	5.9%	
Other expenditure	271	514	245	-9.5%	
EBITDA	**1,918**	**3,417**	**1,818**	**-5.2%**	Decline due to losses made on spot cargoes, which were contracted at higher prices that could not be passed on to consumers, combined with commencement of KG gas which saw consumers switching away from spot volumes
EBITDA Margin	*11.7%*	*12.9%*	*7.0%*		
Interest	251	265	283	13.0%	To increase from 1Q following commissioning of the Dahej expansion in July
Depreciation	255	253	256	0.3%	To increase from 1Q following commissioning of the Dahej expansion in July
Other Income	167	199	288	73.2%	Includes some forex gains which are a pass through but which get included in other income
PBT	1,578	3,098	1,567	-0.7%	
Tax - Current	512	1,048	522	2.0%	
Tax - Deferred	10	7	12	20.0%	
Tax rate	*33.0%*	*34.0%*	*34.1%*		
PAT	**1,056**	**2,044**	**1,033**	**-2.2%**	
Volumes (TBTUs)	78.0	82.5	95.8	22.9%	Includes long-term volumes of 63 TBTU (flat qoq), RGPPL volumes, and ~5 spot cargoes during the quarter

Source: Company Reports, Citi Investment Research and Analysis estimates

Petronet LNG

Company description

Petronet LNG was promoted as a joint venture of four state-owned oil & gas companies (GAIL, IOC, ONGC, and BPCL), which together hold 50% of its equity. Gaz De France owns 10% of PLNG's equity. PLNG runs a 5MTPA LNG receiving and regassification terminal at Dahej on the western coast of India, which is being expanded to 10MTPA by end-08. It is also setting up another greenfield terminal at Kochi with a capacity of 2.5MTPA by 1QCY12. Regassified LNG from the Dahej terminal has access to the developed gas markets of Gujarat and, through GAIL's Dahej-Vijaipur pipeline, its gas is piped to the consumption centers linked to GAIL's HBJ pipeline.

Investment strategy

We rate PLNG shares as Sell / High Risk (3H). PLNG earns a fixed, steady regassification charge and has de-risked its business model from the commodity cycles. We have a negative view on the stock owing to: 1) limited long-term visibility on volumes compared to its total capacity with increasing reliance on spot volumes, 2) risk to demand for spot with KG gas commencing production and spot prices expected to recover by end-2009, and 3) long-term global LNG outlook remaining robust which will support LT LNG prices. Further, with Henry Hub prices likely to rise over the medium-term, and the long-term LNG market remaining robust, spot LNG prices could recover from current lows (c.US$4 ex-ship). This could pressure PLNG's utilization levels and marketing margins especially given the start of KG gas, notwithstanding improved economics vis-à-vis naphtha.

Valuation

Our target price of Rs71 is based on our DCF-based fair value estimate for Mar-2010E. We use a DCF-based valuation, as we think it captures the value of the projects over their lifetime, especially given that PLNG's near-term cash flow is affected by its aggressive expansion. In our DCF analysis, we have used explicit forecasts for 10 years, long-term volumes of 14.1 MMTPA, a terminal growth rate of 3%, and a WACC varying with the D/E structure of the company (based on risk-free rate of 6.5%, cost of debt of 9.5%, beta of 1.0x, market risk premium of 6.0%).

Risks

We assign a High Risk rating for PLNG shares in line with our quantitative risk-rating system, which tracks 260-day historical share price volatility. Upside risks which could cause the shares to trade above our target price include: (1) higher utilization or faster commissioning of regassification capacities than assumed by us, (2) better acceptability of higher-priced spot LNG by the domestic market, and (3) tie-up of long-term gas supplies for the expanded capacity.

Appendix A-1

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Petronet LNG (PLNG.BO)
Ratings and Target Price History
Fundamental Research
Analyst: Saurabh Handa
Covered since June 6 2007

	Date	Rating	Target Price	Closing Price
1	25-Sep-07	*3M	*78.00	86.30
2	21-Jul-08	3M	*60.00	54.90
3	20-Oct-08	*1H	*51.00	39.10
4	27-Apr-09	*3H	*53.00	52.00
5	28-May-09	3H	*71.00	68.90

* Indicates change

Rating/target price changes above reflect Eastern Standard Time

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