Petronet LNG Ltd. (PLL)

July 20, 2012 | HOLD | MEDIUM RISK | PRICE Rs.147 | TARGET Rs.167

OIL & GAS

EARLIER RECO (Short Report)

BUY	
Price	Rs.138
Target	Rs.167
Date	June 25, 2012

SHARE HOLDING (%)

Promoters	50.0
FII	14.7
FI / MF	5.9
Body Corporate	14.4
Public & Others	15.0

STOCK DATA

Reuters Code	**PLNG.BO**
Bloomberg Code	**PLNG IN**
BSE Code	**532522**
NSE Symbol	**PETRONET**
Market Capitalization*	**Rs. 110,250 mn US$ 2004.5 mn**
Shares Outstanding*	**750.0 mn**
52 Weeks (H/L)	**Rs.186 /122**
Avg. Daily Volume (6m)	**1,932,117 Shares**

Price Performance (%)

1M	3M	6M
14	(8)	(7)

***On fully diluted equity shares**

200 days EMA Rs.150

Part of Sushil Bonanza

ANALYST
Shreyas Bhukhanwala | +91 22 4093 5096
shreyas.bhukhanwala@sushilfinance.com

SALES:
Devang Shah | +91 22 4093 6060/61
devang.shah@sushilfinance.com

STRENGTH: Sound Business Model, Long Term Revenue Visibility, Early Mover Advantage, Strong Parental Support, Consistent Cash Flows, Healthy Return Ratios **WEAKNESS:** Inability to Source Long Term Gas **OPPORTUNITIES:** Consistently Increasing Gas Demand **THREAT:** Delay in Commissioning of New Capacities, Rising International Gas Prices, Regulatory Intervention.

Capacity expansion to drive volume growth

Foreseeing huge opportunity with increasing demand-supply mismatch, PLL has chalked out aggressive capex plans to increase its capacity from current 10 MMTPA to ~17.5 MMTPA over the next 3 years with the total capital outlay of ~Rs.54 bn. This would be majorly led by Greenfield expansion at Kochi (5.0 MMTPA – Dec'12) & capacity expansion at Dahej (2.5 MMTPA – FY15) by way of additional jetty. Apart from above, the Company also plans to set-up additional capacity of ~10 MMTPA i.e. 5.0 MMTPA each at Gangavaram & Dahej, taking its total capacity to ~27.5 MMTPA by 2017-18. However considering the long-gestation period, we have not factored in the 10 MTPA expansion in our earnings estimates.

Petronet LNG – 'Ideally positioned to capture huge opportunity in LNG space'

With increasing gas demand coupled with reducing domestic gas supplies, LNG seems to be the optimal solution to bridge the gap. PLL being the largest established player in the space is well positioned to capture this huge opportunity. Also, Gail being one of its promoters enables the Company to have access to its vast distribution network which not only provides easy access to its clients but also helps in exploring newer markets. Besides, the Company also enjoys the lower capital cost for its Dahej facility compared to current cost of setting up new facilities resulting into lower re-gasification charges which would act as a strong entry barrier for its competitors.

Healthy Balance-sheet coupled with strong operating cash flows provides comfort

Despite huge ongoing capex, the Company has been able to maintain its D/E in comfortable zone (~1x) largely due to its strong operating cash flows, which provides enough room for further leverage. On an average, the Company has been able to generate cash-flows to the tune of ~Rs.7-8 bn every year, which is further likely to improve going ahead. Also the Company has strong return ratios with ROE & ROCE pegged at 34% & 27% respectively. Healthy balance-sheet, strong operating cash-flows coupled with robust return ratios would not only provide better financial stability but would also support huge expansion plan in near future.

OUTLOOK & VALUATION

PLL being the largest established player is well placed to capture the huge opportunity in the LNG space which has emerged due to strong domestic gas demand. Aggressive capex plan (10 to 17.5 MMTPA) to meet the increasing gas demand is likely to result in strong volume growth over the next few years. Also strong parental support coupled with capital cost advantage at Dahej provides competitive edge over its peers. Healthy balance-sheet along with strong operating cash-flows not only provides better financial stability but would also support huge expansion plan in future. At the CMP of Rs.147, the stock is quoting at 10.4x and 2.2x its FY14E EPS & BV of Rs.14.1 and Rs.67.6 respectively. Hence, considering the sound business model, huge capacity expansion coupled with strong financials, we maintain our positive outlook on the stock & recommend 'HOLD' with a DCF based price target of Rs.167.

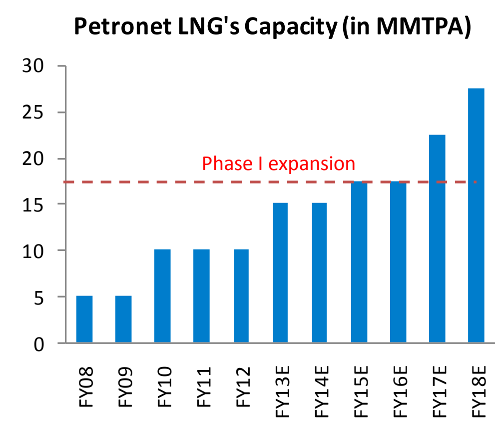
KEY FINANCIALS

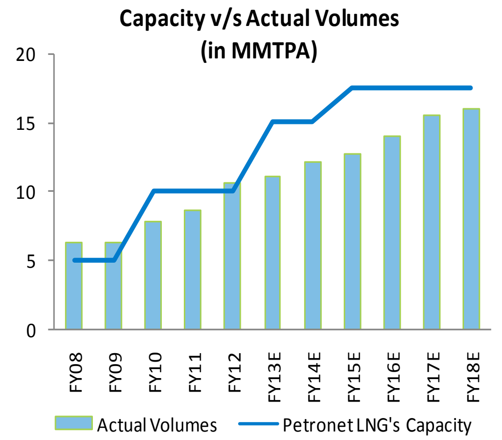
Y/E Mar.	Revenue (Rs mn)	APAT (Rs mn)	AEPS (Rs)	AEPS (% Ch.)	P/E (x)	ROCE (%)	ROE (%)	P/BV (x)
FY12	226959	10575	14.1	70.7	10.4	26.9	34.1	3.1
FY13E	**302394**	**9738**	**13.0**	**(7.9)**	**11.3**	**22.5**	**25.0**	**2.6**
FY14E	**354997**	**10557**	**14.1**	**8.4**	**10.4**	**23.0**	**22.6**	**2.2**

Investment Arguments

Aggressive capex plans to drive volume growth

Rising demand coupled with tapering domestic gas supplies has widened the demand-supply gap, thus creating leeway for imported LNG. Foreseeing such huge opportunity, PLL has chalked out aggressive capex plans to increase its capacity from current 10 MMTPA to ~17.5 MMTPA over the next 3 years. The total capital investment for the Phase I expansion is to the tune of ~Rs.54 bn of which the Company has already incurred ~Rs.33 bn by FY12.





Source: Company, Sushil Finance Research Estimates

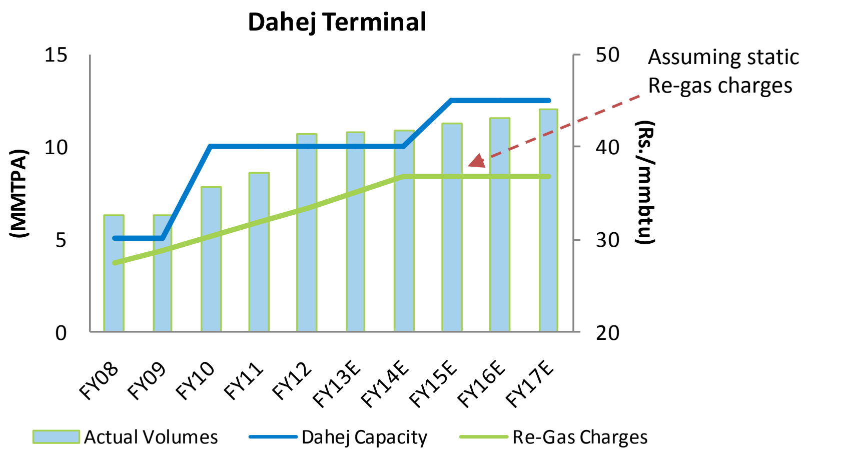
This Phase I expansion would be majorly led by Greenfield expansion at Kochi wherein the Company is setting up 5.0 MMTPA facility which is likely to get operational by Dec'12. The Company is also expanding its capacity at Dahej by 2.5 MMTPA by constructing an additional jetty which would come on-stream by Q4FY14. Both the facilities once operational would raise the overall capacity of the Company to 17.5 MMTPA by FY15E.

Apart from above, the Company also plans to set-up an additional capacity of ~10 MMTPA i.e. 5.0 MMTPA each at Gangavaram in Andhra Pradesh & Dahej in Gujarat (Phase II), which would increase its total capacity to ~27.5 MMTPA by 2017-18. The total estimated cost for these 2 projects would be to the tune of ~Rs.76 bn which is likely to be funded by 70:30 D/E. ***However considering the long-gestation period, we have not factored in the Phase II expansion i.e.10 MMTPA in our earnings estimates.***

Historically, the Company has been operating at more than its name-plate capacity i.e.100%, which not only indicates the strong domestic gas demand but also company's ability to source adequate gas at reasonable prices. However, considering the lesser clarity on long-term gas sourcing agreements, we have factored in lower capacity utilization for both the terminals (Dahej – 96% & Kochi – 90%) which in turn provides potential upside risk to our assumptions.

Dahej Terminal – 'in a sweet spot'

Located in Gujarat, Dahej terminal has been the backbone to the company's operations enjoying various inherent benefits. The Company not only enjoys the location advantage but is also placed in the most industrialized state having largest gas pipeline network. Being an associate of Gail, it also has access to its major pipelines like HVJ & DVPL connecting various consumers across states.



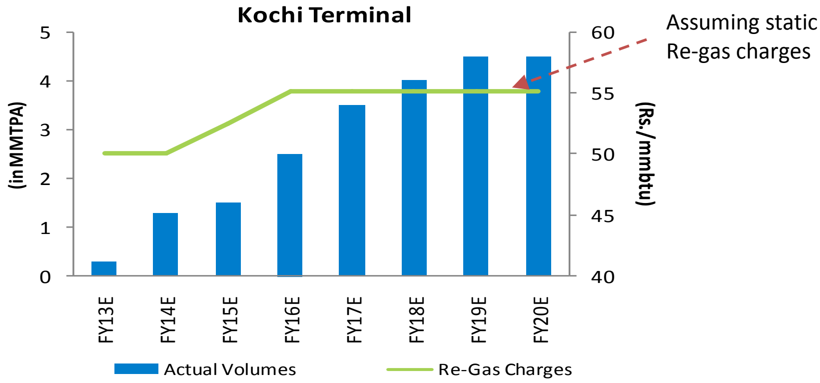
Source: Company, Sushil Finance Research Estimates

One of the major benefits which the terminal enjoys is the lower capital cost resulting into competitive re-gas charges, thus giving it an edge over its competitors. Capital investment to set-up new facility of ~5 MMTPA is ~Rs.40-45 bn compared to ~Rs.18-20 bn incurred for Dahej terminal. As per the arrangement, the Company has been increasing re-gas charges by 5% every year since inception & currently charges ~Rs.35/mmbtu. ***However, going ahead we have assumed static re-gas charges at Rs.36.8/mmbtu from FY14 onwards which has potential to increase further, thus providing upside risk to our earnings estimates.***

Also the Company has scope for further brown-field expansion at Dahej which would not only enable the Company to expand its capacities at relatively lower cost but also benefit from higher operational efficiencies. In addition to above, the Company has entered into a long-term supply contract with Ras Gas, Qatar for supply of ~7.5 MMTPA of gas for 25 years for its Dahej terminal. Pricing currently stands at ~$8.5/mmbtu (FOB) which is cheaper compared to spot prices ($13-14/mmbtu), however the same would be linked to Japanese Crude Cocktail (JCC) from 2014 onwards. Hence considering the above advantages, Dahej seems to be in a sweet spot to survive the upcoming competition.

Gradual ramp-up in Kochi facility

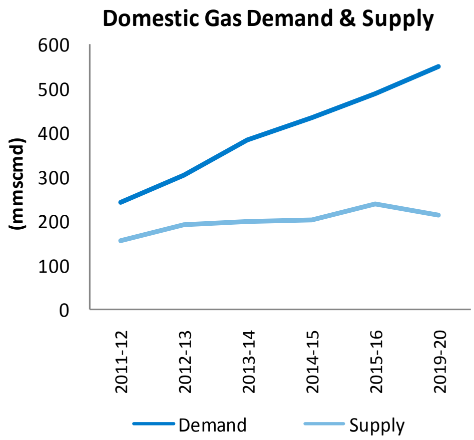
With Kochi facility coming on-stream from Q4FY13, the overall name-plate capacity of the Company would increase by ~50% to 15 MMTPA. However, considering the lesser clarity on long-term gas sourcing agreements along with delays in laying pipelines we have assumed slower than expected ramp-up in utilization levels. Till now, the Company has been able to tie up for only 1.5 MT with Gorgon LNG, Australia for its Kochi terminal wherein the supply is likely to commence from 2015-16. This would require PLL to rely more on spot volumes initially to meet the consumer demand. Also on connectivity front, Gail has been facing some delays in laying pipelines to connect the major demand centers i.e. Kochi – Mangalore – Bangalore. In order to synchronize with the commissioning of the Kochi facility, Gail has expedited its work on a section of pipeline covering ~45 kms in order to complete it by Dec'12, thus enabling the Company to connect to nearby consumers. However the two major pipelines, one which connects Kochi to Mangalore and then Kochi to Bangalore via Tamil Nadu have been facing some delays & is likely to get completed by 2013 end.

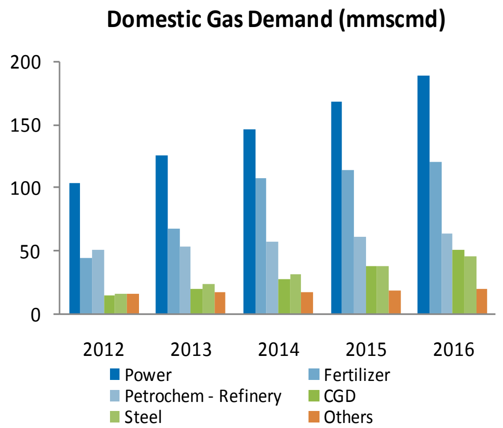


Source: Company, Sushil Finance Research Estimates

Considering the above issues, we have assumed gradual pick-up in utilization levels from FY16 & have capped the same at 90% from FY19 onwards thus giving some leeway for further improvement. ***Moreover, we have assumed initial re-gas charges to be Rs.50/mmbtu for FY13-14 which would increase by 5% every year to Rs.55.1/mmbtu by FY16 & thereafter remain constant.***

Petronet LNG – 'Ideally positioned to capture huge opportunity in LNG space'





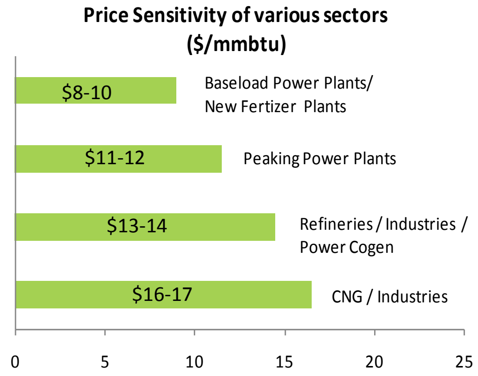
Source: Mercados Analysis 2011, DGH

Continuously rising demand coupled with tapering domestic gas supplies has widened the demand-supply gap which is expected to further widen going ahead considering the current domestic supply scenario. Considering the lack of new domestic supply sources in the near future, Imported LNG seems to be the only optimal solution to bridge this gap. Hence PLL being the largest established player in the space is well positioned to reap the benefits of widening gas deficit. Also, Gail being one of its promoters enables the Company to have access to its vast distribution network which not only provides easy access to its clients but also helps in exploring newer markets.

Also one of the strong competitive advantages PLL enjoys is the lower capital cost for its Dahej facility resulting into lower re-gas charges. Criterions of 16% IRR on total capital investment links re-gas charges directly to capital investment. Hence higher the investment, higher would be the re-gas charges. Capital investment to set-up new facility of ~5 MMTPA is ~Rs.40-45 bn compared to the capital investment of ~Rs.18-20 bn for Dahej terminal resulting into much higher re-gasification charges, thus giving a competitive edge to the Company.

Long term sourcing of Gas remains a key

With huge capacity expansion lined-up over the next few years, the company would require to tie up for new long-term gas agreements. Such agreement not only provides long-term gas visibility but also offers access to cheaper gas. Blend of short & long term gas augurs well to serve different class of consumers according to their affordability.

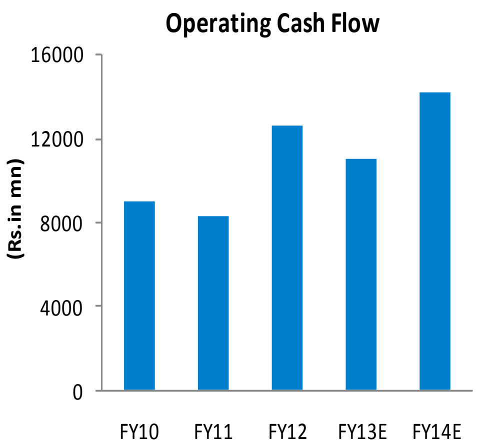


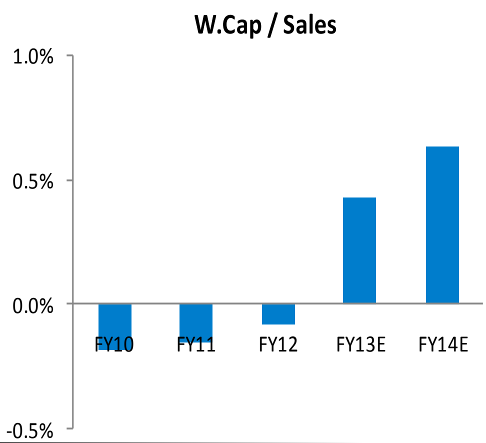
Long-term LNG supply contracts (in mmtpa)			
Supplier	Qty (MTPA)	Term (Yrs.)	Period
RasGas	5	25	2004-29
RasGas	2.5	25	2009-34
Gorgon LNG	1.5	20	2015-35
Gazprom	2.5	25	2016-40

Source: Company Presentation

The above table depicts long-term LNG supply contracts entered into by PLL with various global suppliers. At present, the Company sources ~75% of its gas requirement from RasGas, Qatar while the remaining is sourced from the spot market. After a long haul, the Company was successful in securing long-term gas contracts for ~4 MMTPA with Gorgon & Gazprom, the supply of which is likely to begin from 2015-16. However going ahead, with increasing capacities & higher spot prices, the Company needs to secure few more long-term contracts in order to retain high volume visibility.

Strong operating cash-flows to support huge expansion plans

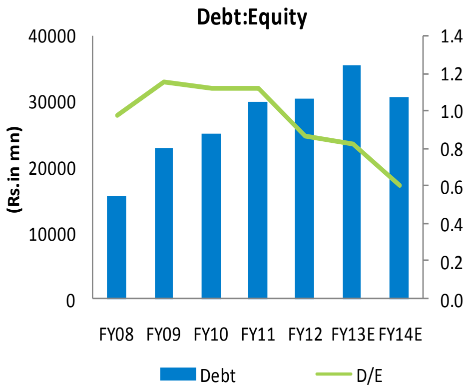


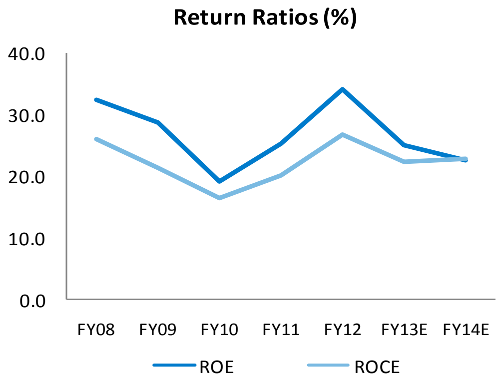


Source: Company, Sushil Finance Research Estimates

Historically the Company has been generating strong operating cash-flows (~Rs.7-8 bn every year), which not only enables the Company to fund its capex but also helps maintaining its D/E in comfort zone. One of the major reasons being lower working capital requirement wherein the Company had negative working capital in 4 out of last 5 years. However with new capacities coming on-stream, we have assumed the working capital to increase over the next few years. Despite of increase in working capital, we expect operating cash flows to improve going ahead on back of commissioning of new facilities & thereby improving utilization levels.

Improving Debt/Equity coupled with Higher return ratios provides greater comfort





Source: Company, Sushil Finance Research Estimates

The above diagram clearly depicts that the D/E of the company had always been in the comfortable zone in the past despite of huge capex. Better operating cash-flows going ahead would further help reduce the D/E to ~0.6x by FY14E. We expect operating cash-flows to be in the range of ~Rs.12-14 bn p.a. till FY15E. Also the Company has healthy return ratios with ROE & ROCE pegged at 34% and 27% respectively.

Scenario Analysis

Scenario	Target	Assumptions
Base	Rs.167	• Static Re-gas charges - Dahej at Rs.36.8/mmbtu (FY14 onwards) & for Kochi at Rs.55.1/mmbtu (FY16 onwards) • Capacity Ramp-up – Gradual ramp-up in utilization levels at Kochi (~90% in FY19). Also maximum capacity utilization assumed at 96% & 90% for Dahej & Kochi respectively. • Marketing margins assumed at 25 cents
Bull	Rs.216	• Increase in Re-gas charges by 5% every year till FY18 & then assumed to be constant going ahead • Faster capacity ramp-up & higher capacity utilization – Assumed full capacity utilization for both the terminals by FY16. • Marketing margins assumed at 25 cents
Bear	Rs.158	• Considering the base case assumptions & lowering marketing margins by ~50% to 12.5 cents

Risks & Concerns

Delays in commissioning of new facilities: The Company is expanding its capacities from 10 to 17.5 MMTPA over the next 3 years. However any delays in commissioning of facilities could hamper the volumes of the Company.

Increase in domestic gas supply: Any substantial increase in domestic gas supplies could result in lower demand for imported LNG, thus impacting the volumes of the Company. However considering the robust domestic demand & lack of new domestic supply sources in near future, the above situation seems unlikely.

Rise in International gas prices: Almost 20-30% of the total volumes are sourced through spot market. Hence any spike in international gas prices could lower the demand, thus affecting the spot volumes of the Company.

Regulatory intervention: Any regulatory intervention on marketing margins or re-gas charges of the Company could impact the financials of the Company. However management reiterates their view of marketing margins not falling under the purview of PNGRB.

OUTLOOK & VALUATION

PLL being the largest established player is well placed to capture the huge opportunity in the LNG space which has emerged due to strong domestic gas demand. Aggressive capex plan (10 to 17.5 MMTPA) to meet the increasing gas demand is likely to result in strong volume growth over the next few years. Also strong parental support coupled with capital cost advantage at Dahej provides competitive edge over its peers. Healthy balance-sheet along with strong operating cash-flows not only provides better financial stability but would also support huge expansion plan in future. At the CMP of Rs.147, the stock is quoting at 10.4x and 2.2x its FY14E EPS & BV of Rs.14.1 and Rs.67.6 respectively. Hence, considering the sound business model, huge capacity expansion coupled with strong financials, we maintain our positive outlook on the stock & recommend 'HOLD' with a DCF based price target of Rs.167.

PROFIT & LOSS STATEMENT

(Rs.mn)

Y/E Mar	FY11	FY12	FY13E	FY14E
Net Sales	**131973**	**226959**	**302394**	**354997**
Raw material Cost	118095	205932	281040	329471
Power & Fuel	651	1124	1270	1349
Employee Cost	285	298	345	426
SG&A Expenses	712	933	1089	1207
EBITDA	**12304**	**18292**	**18651**	**22544**
Interest Charges	1932	1774	2401	3255
Depreciation	1847	1842	2471	4227
Other Income	539	849	755	695
PBT	**9065**	**15525**	**14534**	**15757**
Tax	2868	4950	4796	5200
RPAT	**6196**	**10575**	**9738**	**10557**

BALANCE SHEET STATEMENT

(Rs.mn)

As on 31st Mar.	FY11	FY12	FY13E	FY14E
Share Capital	7500	7500	7500	7500
Reserves	19302	27698	35242	43166
Net worth	**26802**	**35198**	**42742**	**50666**
Total loans	29891	30340	35361	30686
Deferred tax liability	3480	3630	3921	4236
Capital Employed	**60173**	**69168**	**82024**	**85589**
Net block	27024	25215	66929	62702
CWIP	20122	32900	4516	9266
Investments	11649	1399	1399	1399
Sundry debtors	8472	12859	14913	17507
Inventories	2480	7124	6961	9064
Cash and bank	1575	9839	7884	9963
Loans and advances	3165	2689	2485	2918
Total Current Liab.	14439	22943	23063	27230
Net Current assets	1377	9654	9180	12222
Total Assets	**60173**	**69168**	**82024**	**85589**

FINANCIAL RATIO STATEMENT

Y/E Mar.	FY11	FY12	FY13E	FY14E
Growth (%)				
Net Sales	23.9	72.0	33.2	17.4
EBITDA	36.9	48.7	2.0	20.9
APAT	53.2	70.7	(7.9)	8.4
Profitability (%)				
EBITDA Margin	9.3	8.1	6.2	6.4
Net Profit Margin	4.7	4.7	3.2	3.0
ROCE	20.1	26.9	22.5	23.0
ROE	25.2	34.1	25.0	22.6
Per Share Data (Rs.)				
AEPS	8.3	14.1	13.0	14.1
Reported CEPS	11.0	16.8	16.7	20.1
BVPS	35.7	46.9	57.0	67.6
Valuation				
PER (x)	17.8	10.4	11.3	10.4
PEG (x)	0.3	0.1	(1.4)	1.2
P/BV (x)	4.1	3.1	2.6	2.2
EV/EBITDA (x)	11.3	7.6	7.7	6.2
EV/Net Sales (x)	1.1	0.6	0.5	0.4
Turnover				
Debtor Days	19	17	18	18
Creditor Days	18	16	18	19
Gearing Ratio				
D/E	1.1	0.9	0.8	0.6

CASH FLOW STATEMENT

(Rs.mn)

Y/E Mar.	FY11	FY12	FY13E	FY14E
PBT	9065	15525	14534	15757
Depreciation	1846	1840	2471	4227
Chgs. in W/Cap.	3	(12)	(1481)	(963)
Provision for Taxes	(2868)	(4950)	(4796)	(5200)
CF from Operations	**8263**	**12553**	**11018**	**14136**
Chgs. in Gross Block	(42)	(30)	(44185)	-
Chgs. in WIP	(6938)	(12778)	28384	(4750)
Chgs. in Investment	(6263)	10250	-	-
CF from Investing	**(13243)**	**(2558)**	**(15801)**	**(4750)**
Chgs. in Debt	4893	449	5022	(4675)
Dividend	(1743)	(2194)	(2194)	(2633)
CF from Financing	**3150**	**(1731)**	**2828**	**(7308)**
Cash at the End	**1575**	**9839**	**7884**	**9963**

Source: Company, Sushil Finance Research Estimates

Rating Scale

This is a guide to the rating system used by our Institutional Research Team. Our rating system comprises of six rating categories, with a corresponding risk rating.

Risk Rating

Risk Description	Predictability of Earnings / Dividends; Price Volatility
Low Risk	**High predictability / Low volatility**
Medium Risk	**Moderate predictability / volatility**
High Risk	**Low predictability / High volatility**

Total Expected Return Matrix

Rating	Low Risk	Medium Risk	High Risk
Buy	**Over 15 %**	**Over 20%**	**Over 25%**
Accumulate	**10 % to 15 %**	**15% to 20%**	**20% to 25%**
Hold	**0% to 10 %**	**0% to 15%**	**0% to 20%**
Sell	Negative Returns	Negative Returns	Negative Returns
Neutral	Not Applicable	Not Applicable	Not Applicable
Not Rated	Not Applicable	Not Applicable	Not Applicable

Please Note

- Recommendations with "Neutral" Rating imply reversal of our earlier opinion (i.e. Book Profits / Losses).
- ** Indicates that the stock is illiquid With a view to combat the higher acquisition cost for illiquid stocks, we have enhanced our return criteria for such stocks by five percentage points.
- **Stock Review Reports:** These are Soft coverage's on companies where Management access is difficult or Market capitalization is below Rs. 2000 mn. Views and recommendation on such companies may not necessarily be based on management meeting but may be based on the publicly available information and/or attending Company AGMs. Hence Stock Reviews may be just one-time coverage's with an occasional Update, wherever possible.