Prabhudas Lilladher

Petronet LNG

In a sweet spot

Q2FY12 Result Update

October 19, 2011

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Rating	**BUY**
Price	Rs161
Target Price	Rs200
Implied Upside	24.2%
Sensex	16,748

(Prices as on October 19, 2011)

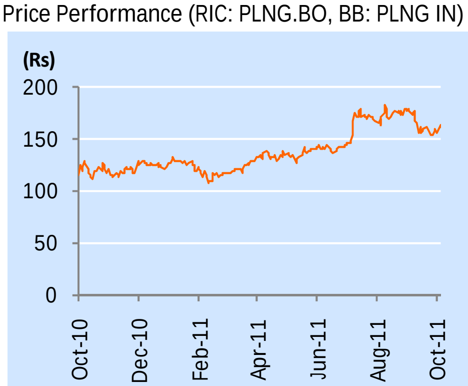
Trading data	
Market Cap. (Rs bn)	120.6
Shares o/s (m)	750.0
3M Avg. Daily value (Rs m)	693.7

Major shareholders	
Promoters	50.00%
Foreign	14.72%
Domestic Inst.	7.94%
Public & Other	27.34%

Stock Performance

(%)	**1M**	**6M**	**12M**
Absolute	(9.4)	20.3	29.0
Relative	(8.3)	32.6	46.0

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



Source: Bloomberg

Petronet LNG's (PLNG's) Q2FY12 result was significantly better than our expectation on the EBITDA and bottom-line front. Top-line registered a growth of 75.5% YoY to Rs53,669m (Rs30,577m) on account of 35.4% YoY growth in volumes, coupled with 29.7% YoY growth in realisations. EBITDA/TBTU witnessed an expansion, from Rs27.2/TBTU in Q2FY11 to Rs33.2/TBTU in Q2FY12. Bottom-line, during the quarter, stood at Rs2,603m (Rs1,311m), registering an increase of 98.5% YoY v/s our expectation of Rs2,210m during the quarter.

- **Performance led by spot marketing margins and higher tolling volumes:** During Q1FY12, net re-gasification margins rose by 21.5% YoY to Rs37.3/mmbtu (Rs30.7/mmbtu) because of higher margins on the spot volumes. Our calculation suggests that the company made a marketing EBITDA on spot volumes of Rs877m (20.0% of the overall EBITDA for the quarter). Volumes during Q1FY12 were at 133TBTU (95TBTU); the same were higher than our estimate of 128TBTU.

- **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 volumes throughput assumption for the Dahej terminal on account of strong volumes delivered during the quarter and optimistic management guidance of utilisation rate for Dahej terminal. 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 Rs200/share, implying a P/E of 14.3x and P/B of 3.5x FY13E.

Key financials (Y/e March)	**2010**	**2011**	**2012E**	**2013E**
Revenues (Rs m)	106,491	131,973	208,646	267,750
Growth (%)	*26.3*	*23.9*	*58.1*	*28.3*
EBITDA (Rs m)	8,465	12,163	18,274	19,853
PAT (Rs m)	4,045	6,196	10,176	10,409
EPS (Rs)	5.4	8.3	13.6	13.9
Growth (%)	*(22.0)*	*53.2*	*64.2*	*2.3*
Net DPS (Rs)	1.8	2.0	2.1	2.4

Source: Company Data; PL Research

Profitability & Valuation	**2010**	**2011**	**2012E**	**2013E**
EBITDA margin (%)	*7.9*	*9.2*	*8.8*	*7.4*
RoE (%)	*19.2*	*25.2*	*32.9*	*26.5*
RoCE (%)	*11.7*	*14.1*	*17.0*	*14.6*
EV / sales (x)	1.3	1.1	0.8	0.6
EV / EBITDA (x)	16.8	12.4	8.7	8.1
PE (x)	29.8	19.5	11.9	11.6
P / BV (x)	5.4	4.5	3.4	2.8
Net dividend yield (%)	*1.1*	*1.2*	*1.3*	*1.5*

Source: Company Data; PL Research

Exhibit 1:Q2FY12 Result Overview (Rs m)

Y/e March	Q2FY12	Q2FY11	YoY gr. (%)	Q1FY11	H1FY12	H1FY11	YoY gr. (%)
Net Sales	**53,669**	**30,577**	***75.5***	**46,233**	**99,902**	**55,837**	***78.9***
Expenditure							
Raw material	48,138	27,547	*74.7*	41,331	89,469	49,880	*79.4*
% of net sales	*89.7*	*90.1*		*89.4*	*89.6*	*89.3*	
Personnel cost	62	53	*16.4*	64	126	126	*(0.5)*
% of net sales	*0.1*	*0.2*		*0.1*	*0.1*	*0.2*	
Other operating expenses	986	261	*278.0*	457	1,443	637	*126.5*
% of net sales	*1.8*	*0.9*		*1.0*	*1.4*	*1.1*	
EBITDA	**4,484**	**2,716**	***65.1***	**4,381**	**8,865**	**5,194**	***70.7***
Margin (%)	*8.4*	*8.9*		*9.5*	*8.9*	*9.3*	
Depreciation	463	466	*(0.7)*	458	921	927	*(0.7)*
EBIT	**4,021**	**2,250**	***78.7***	**3,923**	**7,944**	**4,266**	***86.2***
Interest	458	495	*(7.4)*	464	922	993	*(7.1)*
Other Income	201	186	*8.2*	263	464	312	*48.7*
PBT	**3,763**	**1,941**	***93.9***	**3,722**	**7,485**	**3,585**	***108.8***
Total taxes	1,160	630	*84.1*	1,155	2,315	1,160	*99.6*
ETR (%)	*30.8*	*32.5*		*31.0*	*30.9*	*32.4*	
Rep. PAT	**2,603**	**1,311**	***98.5***	**2,567**	**5,170**	**2,425**	***113.2***
Exceptional Items	-	-		-	-	-	
Adj. PAT	**2,603**	**1,311**	***98.5***	**2,567**	**5,170**	**2,425**	***113.2***

Source: Company Data, PL Research

Exhibit 2:Operating Metrics

Y/e March	Q2FY12	Q2FY11	YoY gr. (%)	Q1FY11	H1FY12	H1FY11	YoY gr. (%)
Contracted Sales (TBTUs)	90.2	89.7	*0.5*	90.3	180.4	179.1	*0.7*
Spot Volumes (TBTUs)	27.7	9.8	*182.6*	24.4	52.1	9.8	*NA*
Tolling Volumes (TBTUs)	17.2	0.3	*NA*	18.7	36.0	6.0	*NA*
EBITDA/TBTU	33.2	27.2	*21.9*	32.9	33.0	26.6	*24.0*

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 90% 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 increase to 100% in the next 2-3 years from the commissioning year.

Impact of high cost of spot LNG: Against the current annualized run rate of 10.6MMT, company has around 9.0MMT of the term contract. Thus, the short-term volumes composed of the tolling volumes and re-gasification services stands at 1.6MMT (15% of the volumes processed). Management believes that selling around 1.6MMT of the volumes will be not a tough ask, given the strong demand potential in the Indian markets despite higher LNG prices. Moreover, for the course of Q3FY12, PLNG has already tied-up the required volumes with the customers, thus, believes the there is no risk to the volumes from the high LNG price scenario. Management expects spot LNG prices to come down from the current levels and believes that signs of the same are evident with some of the cargoes available at relatively lower prices. Commenting on the recent surge in the LNG prices, management believes the same is largely on account of seasonal demand factors in Japan.

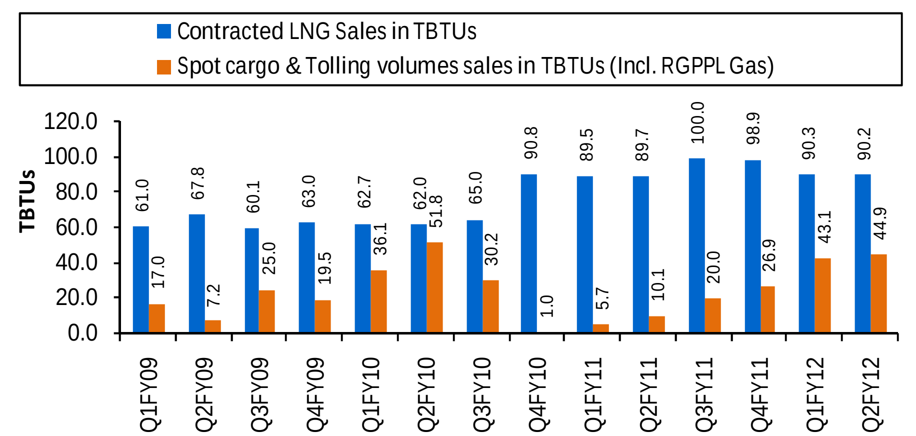
Additional Jetty at Dahej: Management expects the jetty to be operational from October-November 2012. Commenting on the possibilities of the delay of the same, management said, given the heavy penalties involved and timelines achieved till date, the chances of delay of the same is very slim. We believe, 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 utilisation of Dahej: While the management clearly highlighted the fact that there remains no risk on the downside regarding the utilisation of the Dahej terminal, guidance on the utilisation upsides was not provided by the management.

Quarterly Highlights

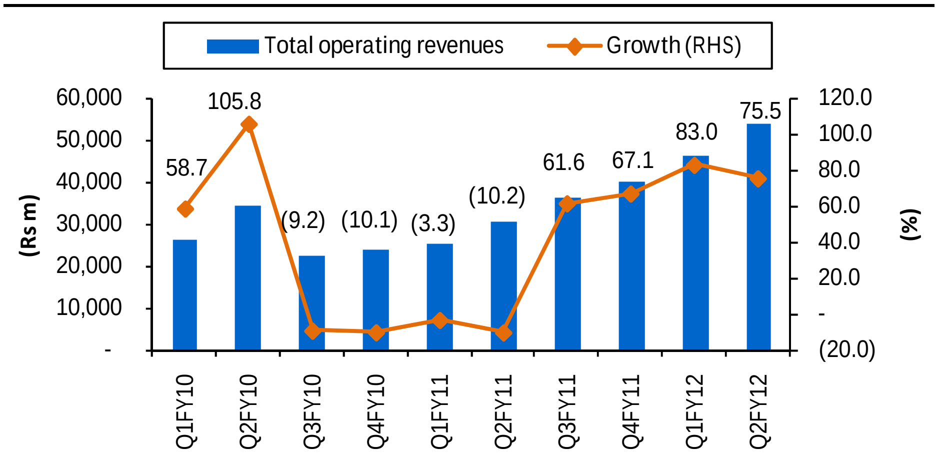
Volume and top-line increased YoY: For Q2FY12, PLNG's R-LNG volumes increased by 29.7% YoY, mainly on account of higher spot volumes. Volumes processed during the quarter stood at 135.1TBTU, higher than our expectation of 132.0TBTUs. Tolling volumes during the quarter stood at 17.2TBTU (0.3TBTU). Contractual volumes were almost flat on a YoY basis at 90.2TBTUs (89.7TBTUs). Spot volumes stood at 27.7TBTU against 9.8TBTU registered in Q2FY11. Capacity utilization during the quarter stood at 106.2% as against 78.4% in Q2FY11. On the revenue front, the company reported a 75.5% YoY increase in revenue to Rs53,669m (Rs30,557m), which was higher than our expectation of Rs52,066m. Realisation during the quarter registered 29.7% YoY growth on account of increased RasGas LNG and higher spot gas prices.

Exhibit 3: R-LNG Volumes



Source: Company Data, PL Research

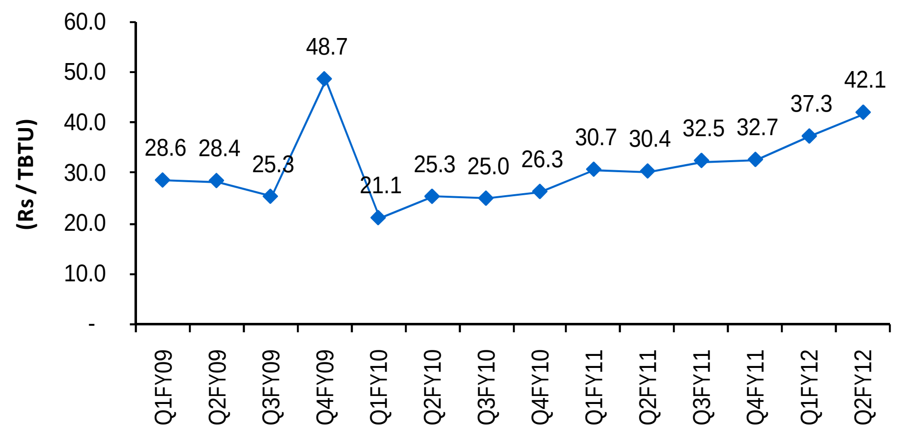
Exhibit 4: Operating revenue – Growth trend (YoY)



Source: Company Data, PL Research

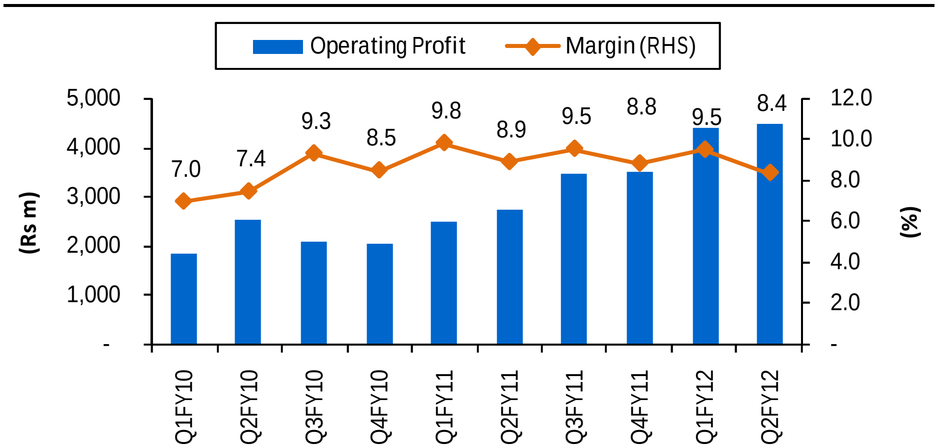
Better operating performance led by higher spot margins: Net re-gasification margins during the quarter rose by 38.5% YoY to Rs42.1/mmbtu (Rs30.4/mmbtu) on account of higher margins on the spot volumes. Moreover, the same was inflated to an extent as the impact of rupee depreciation on the cost of gas 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 (17.2TBTU), the company's tolling margins stood at Rs33.4/mmbtu during the quarter. Operating profit increased by 65.1% YoY to Rs4,484m (Rs2,716m) and was higher than our expectation of Rs4,026m on higher-than-anticipated margins on the spot volumes.

Exhibit 5: Netback margin trend



Source: Company Data, PL Research

Exhibit 6: Operating performance trend

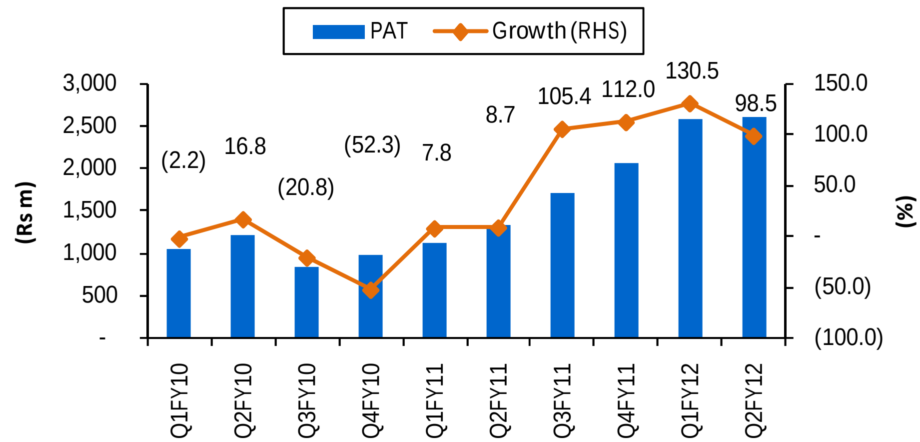


Source: Company Data, PL Research

Depreciation, interest in-line with expectation: Depreciation cost during Q3FY11 was flattish at Rs463m (Rs466m). Interest expenditure declined by 7.4% YoY to Rs458m (Rs495m).

PAT increases 98.5% 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 98.5% YoY to Rs2,603m (Rs1,311m) and was higher than our expectation of Rs2,210m.

Exhibit 7: PAT – Growth trend (YoY)



Source: Company Data, PL Research

Key Stock Price Catalyst

Further upside to Dahej capacity Utilisation: PLNG has operated its Dahej terminal at 106% utilisation in the current quarter. This is a commendable task, given the fact that during the quarter, Dahej terminal has been operating at 50% utilisation for the period of three days due to hooking activity for ONGC project (forming almost 1.6% quarter time). Also, as this was a monsoon quarter, flexibility to use the jetty would have been limited. Thus in H2FY12, jetty flexibility is bound to increase the volumes. Thus, there is an upside risk to our estimates in terms of utilisation of the Dahej terminal for H2FY12.

Timely completion of Dahej Jetty: Additional jetty at Dahej is likely to provide the required operational freedom to PLNG to operate beyond its nameplate capacity. Management has highlighted that once the jetty comes on stream the effective available capacity could rise to around 12.5MMT. Recent update from the management on the execution front suggests that Jetty is likely to be completed in Sept-2012. We believe timely completion of the jetty in an environment of the dwindling domestic production is likely to be beneficial for PLNG.

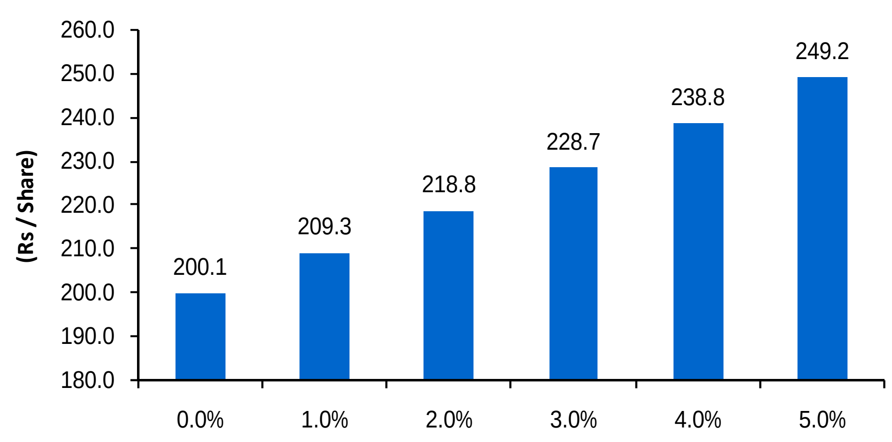
Volumes tie-up for Kochi terminal: PLNG management continues to provide positive commentary on the Kochi terminal utilisation prospects. Management believes that the terminal is likely to see 100% utilisation from 2-3 years of commissioning against our estimates of 90% utilisation from 6th year of operation. According to the management, there is a demand for the tune of around 35mmscmd (around 9MMTPA) in the southern markets, thus demand is not an issue. Given the fact that Kochi terminal is likely to be mechanically complete in Q3FY13 and commercial operations are likely to start from Q4FY13, we believe company would be aggressively looking for the tie-up of the gas for the remaining (3.5 MMTPA of the capacity). We believe as the terminal approaches mechanical completion, management would be proactive would becomes increasing proactive to tie-up the volumes for the same.

According to our understanding, if Kochi terminal could see 100% utilisation from 4th year of operation i.e.FY2016 onwards, our fair value estimate would increase from current level of Rs200/share to Rs215/share.

Reduction in spot LNG prices: Key rationale attributed to correction in PLNG's stock price over the last one month is attributed to the spurt in the International spot LNG prices. We believe fears of spot LNG prices exceeding the crude index prices and significant increase in the slope of the spot LNG to international crude oil prices is unlikely. PLNG management also expects spot LNG prices to come down from the current levels and believes that signs of the same are evident with some of the cargoes available at relatively lower prices. Moreover, the recent spurt is largely a function of seasonality; so prices are bound to correct. Any meaningful price correction would further put to rest PLNG's ability to place spot volumes in the domestic markets and would act as a positive catalyst.

Continuation of the annual escalation in Dahej re-gasification charges: Re-gasification margins are one of the major variables that will determine the profitability of PLNG. We have assumed a freeze on the re-gasification margins for PLNG's Dahej Terminal from FY11 onwards. However, if the company is allowed escalation in the re-gasification margins till perpetuity, its target price would be favourably impacted. We continue to remain concerned over the base re-gasification margins, apart from the annual escalation. As per the terms of contract signed between PLNG and various off-takers, PLNG is entitled for an annual escalation of 5% in Dahej re-gasification charges. Given the high RoE generated by the Dahej terminal, we assume a freeze on the re-gasification charges from CY2014 onwards. However, management has repeatedly said that the re-gasification charges are bound to increase by 5% on an annual basis. We believe if the same turns out to be true, the stock could see a significant upside from our target price.

Exhibit 8: Target Price sensitivity with Re-gasification margins at Dahej



Source: 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 Rs200/share, implying a P/E of 14.3x and P/B of 3.5x FY13E.

Exhibit 9: Key Assumptions

Y/e March	FY12E	FY13E
Installed capacity (TBTU)	586	586
Total volumes processed (TBTU)	538	573
Fixed contract (Rasgas)	252	252
Fixed contract (Rasgas Tranche 'A')	125	125
Spot/medium term contracts	118	153
Tolling Volumes	40.0	40.0
Total Volumes processed (MMTPA)	10.6	11.2
Effective capacity utilisation	*91.8*	*97.7*
Regasification charges (Rs per mmbtu)	33.8	35.5
EBITDA per TBTU (Rs)	34.1	33.3

Source: Company Data, PL Research

Income Statement (Rs m)

Y/e March	2010	2011	2012E	2013E
Net Revenue	**106,491**	**131,973**	**208,646**	**267,750**
Raw Material Expenses	96,648	118,012	188,293	244,880
Gross Profit	9,843	13,961	20,352	22,870
Employee Cost	204	306	325	519
Other Expenses	1,174	1,493	1,754	2,499
EBITDA	**8,465**	**12,163**	**18,274**	**19,853**
Depr. & Amortization	1,609	1,847	1,848	2,758
Net Interest	1,839	1,931	1,888	2,557
Other Income	978	680	700	1,050
Profit before Tax	**5,995**	**9,064**	**15,238**	**15,587**
Total Tax	1,950	2,868	5,062	5,178
Profit after Tax	**4,045**	**6,196**	**10,176**	**10,409**
Ex-Od items / Min. Int.	—	—	—	—
Adj. PAT	**4,045**	**6,196**	**10,176**	**10,409**
Avg. Shares O/S (m)	**750.0**	**750.0**	**750.0**	**750.0**
EPS (Rs.)	**5.4**	**8.3**	**13.6**	**13.9**

Cash Flow Abstract (Rs m)

Y/e March	2010	2011	2012E	2013E
C/F from Operations	10,279	9,075	11,683	14,713
C/F from Investing	(12,358)	(14,766)	(15,550)	(12,220)
C/F from Financing	(1,094)	3,826	4,769	1,926
Inc. / Dec. in Cash	(3,173)	(1,865)	902	4,419
Opening Cash	6,578	3,405	1,540	2,442
Closing Cash	3,405	1,540	2,442	6,861
FCFF	(7,302)	7,606	10,481	(28,948)
FCFE	(5,121)	14,769	18,881	(22,634)

Key Financial Metrics

Y/e March	2010	2011	2012E	2013E
Growth				
Revenue (%)	26.3	23.9	58.1	28.3
EBITDA (%)	(6.1)	43.7	50.2	8.6
PAT (%)	(22.0)	53.2	64.2	2.3
EPS (%)	(22.0)	53.2	64.2	2.3
Profitability				
EBITDA Margin (%)	7.9	9.2	8.8	7.4
PAT Margin (%)	3.8	4.7	4.9	3.9
RoCE (%)	11.7	14.1	17.0	14.6
RoE (%)	19.2	25.2	32.9	26.5
Balance Sheet				
Net Debt : Equity	1.0	1.1	1.1	0.9
Net Wrkng Cap. (days)	(2)	(1)	2	2
Valuation				
PER (x)	29.8	19.5	11.9	11.6
P / B (x)	5.4	4.5	3.4	2.8
EV / EBITDA (x)	16.8	12.4	8.7	8.1
EV / Sales (x)	1.3	1.1	0.8	0.6
Earnings Quality				
Eff. Tax Rate	32.5	31.6	33.2	33.2
Other Inc / PBT	16.3	7.5	4.6	6.7
Eff. Depr. Rate (%)	4.5	5.2	5.2	3.6
FCFE / PAT	(126.6)	238.4	185.5	(217.4)

Source: Company Data, PL Research.

Balance Sheet Abstract (Rs m)

Y/e March	2010	2011	2012E	2013E
Shareholder's Funds	22,349	26,802	35,147	43,452
Total Debt	24,998	32,161	40,561	46,875
Other Liabilities	3,262	3,480	3,581	3,995
Total Liabilities	**50,609**	**62,443**	**79,290**	**94,322**
Net Fixed Assets	42,012	49,053	63,455	73,452
Goodwill	—	—	—	—
Investments	5,386	11,649	11,649	11,649
Net Current Assets	3,211	1,741	4,186	8,707
Cash & Equivalents	*3,405*	*1,540*	*2,442*	*6,861*
Other Current Assets	*8,811*	*12,334*	*20,125*	*25,462*
Current Liabilities	*9,006*	*12,134*	*18,381*	*23,616*
Other Assets	—	—	—	—
Total Assets	**50,609**	**62,443**	**79,290**	**93,807**

Quarterly Financials (Rs m)

Y/e March	Q3FY11	Q4FY11	Q1FY12	Q2FY12
Net Revenue	**36,276**	**39,860**	**46,233**	**53,669**
EBITDA	**3,456**	**3,513**	**4,381**	**4,484**
% of revenue	*9.5*	*8.8*	*9.5*	*8.4*
Depr. & Amortization	465	455	458	463
Net Interest	507	431	464	458
Other Income	54	314	263	201
Profit before Tax	**2,538**	**2,941**	**3,722**	**3,763**
Total Tax	830	878	1,155	1,160
Profit after Tax	**1,708**	**2,063**	**2,567**	**2,603**
Adj. PAT	**1,708**	**2,063**	**2,567**	**2,603**

Key Operating Metrics

Y/e March	2010	2011	2012E	2013E
Contracted Sales (TBTUs)	281	379	377	377
Spot LNG (TBTUs)	104	36	118	153
EBITDA/MMBTU	21	28	34	33

Source: Company Data, PL Research.

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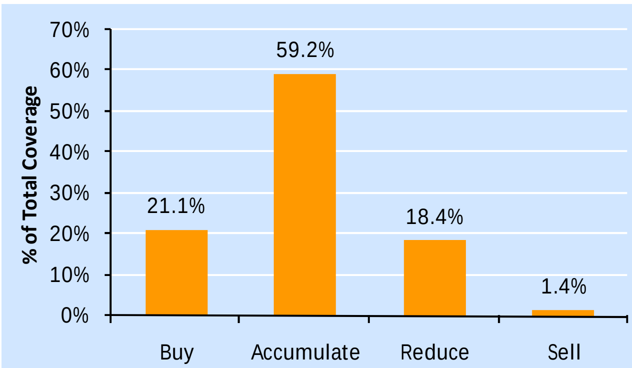

PL's Recommendation Nomenclature

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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