The 10-second briefing

## Petronet LNG
PLNG IN

Target (INR): **170.00 → 175.00**
Upside: **9.4%**
26 Dec price (INR): **160.00**

# 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

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

How do we justify our view?

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### ■ 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 547tbtus for FY13, 559tbtus for FY14, and 567tbtus 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

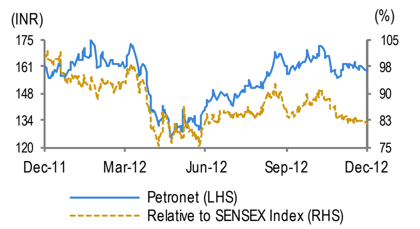
Our FY13-15E EPS are 4-23% below the Bloomberg-consensus forecasts, which could be due to our lower LNG-processing volume and marketing margin forecasts.

**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

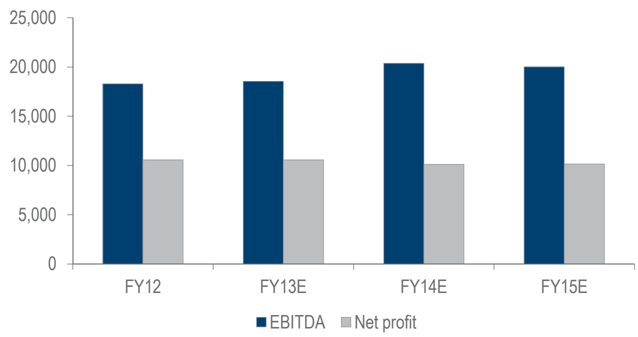
***How do we justify our view?***

- 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**

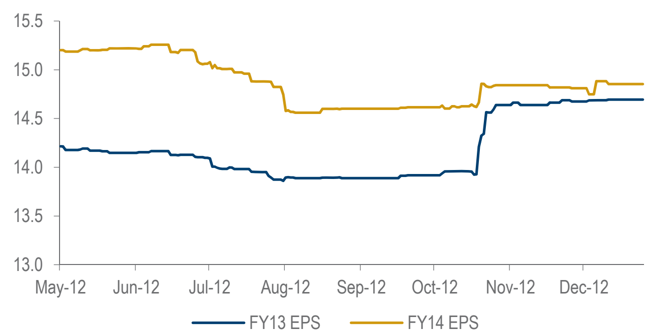
| Component | Unit | Output |
|---|---|---|
| WACC | % | 10.1 |
| Terminal growth rate | % | 1 |
| EV | INRm | 146,362 |
| Net debt | INRm | 14,961 |
| Equity value | INRm | 131,401 |
| No. of outstanding shares | m | 750 |
| Equity value per share | INR/share | 175 |

*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

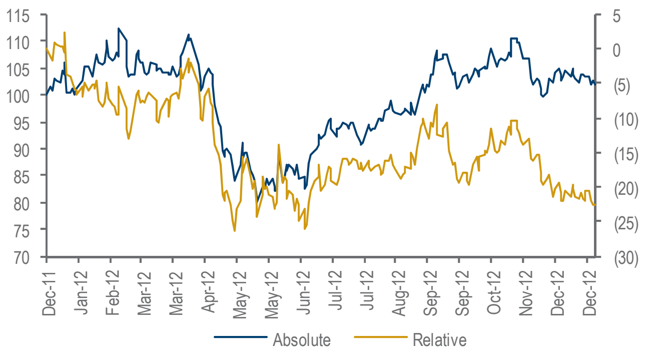
## Downgrading to Outperform

### 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

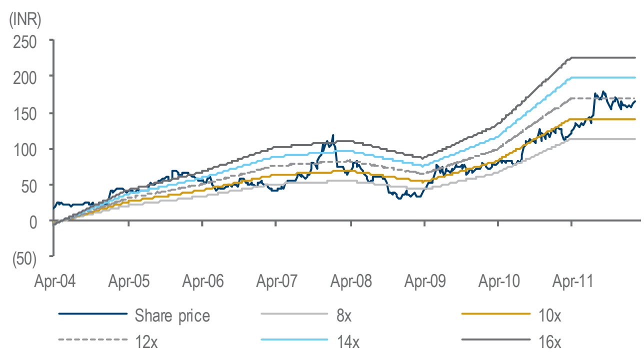
| | | |
|---|---|---|
| Pre-tax cost of debt | % | 9.0 |
| After-tax cost of debt | % | 5.9 |
| Risk-free rate | % | 8.0 |
| Risk premium | % | 5.0 |
| Beta | x | 1.0 |
| Cost of equity | % | 12.9 |
| Net debt to capital | % | 40.0 |
| WACC | % | 10.1 |

*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

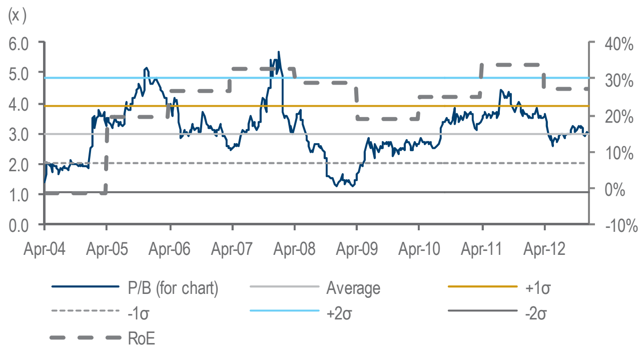



*Source: Bloomberg, Company, Daiwa estimates*

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 (%)




*Source: Bloomberg, Company, Daiwa estimates*

## 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.

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

| | | | Price | Mkt cap | EPS (INR) | | | PER (x) | | | PBR (x) | | | EV/EBITDA (x) | | | ROAE (%) | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Company | Ticker | Rating | (INR) | (USD m) | 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.

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

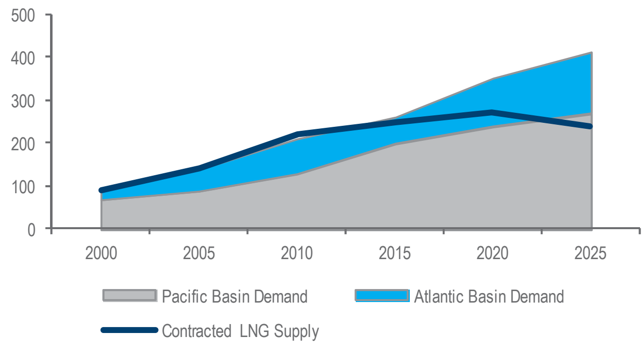
With demand for gas in the long term likely to increase and domestic gas production unlikely to fill the gap, imported gas could be an important filler. While the high price of imported LNG is a deterrent, we believe domestic gas prices in India are likely to move up over the next two years. This would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

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