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## Petronet LNG – (Buy) Update

Fair disclosure – the analyst, his family and investment company have exposure to this Company's equity shares and therefore have a vested interest in this recommendation. Please use your discretion before initiating purchases on this recommendation.

The facts so far – we had recommended this stock last year in the second half of the calendar year based on the out-performance of the broader markets, technical outlook, management buying and the fundamental reasons outlined in the in-house reports. The reason for this update is the results and dividends announced along with the corporate vision statement by the CMD.

The Company has managed to record net profits of Rs 518 Crs vis-à-vis Rs 474 Crs last year. Sales have crossed Rs 8000 Crs and the capacity expansion by 100 % has not even started showing up in the numbers! The actual implementation of the expansion will kick off in May 2009 and the benefits will accrue in FY 09-10, as expected. Also noteworthy is the point that we had brought our investors attention to – there was an automatic hike in the re-gassification charges by 5 cents per unit from Jan 2009 onwards. This will result in addition of over Rs 0.50 EPS in the current year. The management has indicated a probable topline of Rs 16,000 Crs (*source – media interviews*) in the ongoing year. The company has already contracted 116 cargoes of 63,000 tonnes each of the 142 cargoes of it's annual capacity. To this extent, the Company has already tied up 82 % of it's raw material requirements for the year ahead. Dividend of Rs 1.75 per share has been declared versus Rs 1.50 per share last year. Since the Company receives it's re-gassification commission in USD, the falling Rupee has helped it's bottomline. Last year, there was a breakdown in the centrifugal motor at it's Dahej plant in the capacity expansion process, which resulted in the Company buying LNG spot cargoes to fulfill it's contractual obligations, in the process incurring losses of Rs 90 crs which are non-recurring in nature. At current prices, the market capitalization is under 0.5 times of annual sales.

The following are the open market purchases by the management (primarily Mr P Dasgupta, who now holds 2,50,000 shares total) –

Date	Quantity
Jul 02 2008	15000 shares
Jan 21 2008	20000 shares
Nov 08 & 22 2007	10000 shares
Oct 11 2007	10000 shares
Oct 31 2007	10000 shares
Aug 23 2007	10000 shares
Jun 25 & Jul 24 2007	20000 shares
Jun 12 & 14 2007	10000 shares
Jun 5 & 8 2007	10000 shares

Our investors will recollect the significant emphasis that we place upon the insider activity (open market acquisitions) by the management, who are known to make sizable profits from their proximity to the corporate fundamentals. Recent examples of L&T and Marico where we pointed out big ticket management buying and the subsequent sharp rallies in stock prices that followed.

**Our view of the nuts and bolts of the company** – we view the Company's prospects in light of the following broad based metrics –

- The Country's requirement of natural gas is over 1,80,000 MMSCD
- RIL will be unable to contribute more than 85,000 MMSCD at peak output rates, to be achieved next year at best.
- 100 % capacity expansion (May 09) will bolster topline and bottomline sharply.
- 82 % of the annual supply of LNG tied up, 5 cent increase in per unit of re-gassification fee wef Jan 09.
- Any revival of economic activity in China, India, Japan and Europe will see a big demand increase for LNG / CNG / LPG.
- Official estimates of 8 % annual demand increase for LNG / CNG per annum in India. The same maybe surpassed when UMPP's (ultra mega power generation projects) / fertiliser company demand rallies.
- Kochi LNG terminal to be commissioned in 2011 with capacity of 2.5 MT to further boost topline / bottomline.

**Our fundamental projection metrics** –

Topline and bottomline boosters will be seen till 2010, thereafter, operational efficiency will be a driver for NPM's (net profit margins). The market senses this and therefore discounts PLNG in single digits. We assume that the PE discounting will remain in this band and project forward on a conservative basis, though the stock was quoting at 20x in January 2008.

We assume the FY 2010 topline at Rs 14,500 crs (vis-à-vis Mr P Dasgupta's projection at Rs 16,000 Crs) and NPM at 6.6 %, yielding a net profit of Rs 957 Crs. This translates to an EPS of 12.75 on a conservative basis, all things remaining equal.

**Metric # 1** –

Assuming a NP growth of 6 - 7 % and a dividend yield of 2 % (current yield 3.3 %) on an average basis for the next 3 – 5 years (barring 2010 where 100 % capacity increase will cause a major upthrust), the PE multiple is likely to be ranged at an equilibrium of 7.5 – 9 times. For FY 2010, that means a projected price band of 95 – 115, in case the market sentiments are conducive. A bull market will see even more upsides from this band.

**Metric # 2** –

Assuming we can sell the stock for atleast Rs 90 in 2011 and an average return of 20 – 25 % from equities p.a; the recommended buy price for PLNG is around Rs 50 for the long term investor with a minimum 24 month perspective.

### Metric # 3 –

We assume FD yields at 10 % (risk free) p.a. and an EPS of 14 in 2011 and an inflation rate of over 3 % p.a. (which is not difficult in emerging market economies), the market should discount the stock at Rs 130 + levels in 2011. This methodology is used by astute investors like Warren Buffet. This metric assumes a free and fair market without wars, terror attacks and recessions.

### Metric # 4 –

We have used this metric ourself in allocating capital on this counter. This metric is based on Kelly's formula for capital allocation, based on threat / profit projections. This formula suggests upto 30 % of your capital being invested in this stock. The word "invested" is underlined to emphasise patience and "don't call up Vijay if the price declines" aspects.

### Technical analysis –

The chart shows a saucer formation in progress on the weekly compression presentation. The display is in logarithmic scale and the rally appears slightly muted in the end. This is in line with our conservative approach. A few pointers to the rationale behind the buy recommendation – note the high relative strength comparative vis-avis the Nifty 50 at 174 (where 100 = base), which makes this counter a strong market out performer. Also note the strong intraday gains recorded by this counter in the last 4 weeks relative to the broader markets. The RoC and MACD are in the buy zone and the traded volumes are perking higher since January 2009, inline with the price appreciation, indicating an improved buying interest.

In qualitative terms, the ticket size per trade in the period has spiked over 50 %, indicating bigger chunks being purchased per trade. However, the ticket size per trade remains (naturally) below the July – Dec 2007 levels, when the market was in a runaway mode. The moving averages are indicating an optimistic scenario as well, the short term moving average (13 weeks) has cut the medium term moving average (30 weeks) and the price is trading above it's 52 week simple moving average. Since the short & medium term moving averages still remain below the long term (52 week SMA), the possibility of a pullback below cannot be ruled out. That indicates a staggered buying approach for the discerning investor, who must space out purchases so as to achieve a lower average price of acquisition on this counter.

The weekly chart shows a decline in a staircase like formation and the last base in March 2009 is higher than the previous one in December 2008, which is indicating a higher bottom formation. The double bottom formation so indicated was the first alert that the stock might rally. A confirmation was received above the 48 levels and we have been recommending purchases since, especially for the momentum / swing traders.

We now recommend a buy fresh buy for the long term investors, in addition to holding the existing stock acquired earlier. The buying strategy is elaborated below the graphic on the next page. We emphasise the relaxed approach to buying this stock as the perspective is that of long term buy-and-hold strategy.



**Your call of action** – Purchases must be initiated in small lots (nibble on a chocolate) and buy bigger lots on the way down in pyramid fashion where the base size increases at lower levels. Incremental purchases maybe spaced at Rs 2.50 – 3 per share declines. Leave room for averaging till the 35 levels (if needed) and a stop loss be maintained below the 28 mark (previous significant low). We suggest profit sales at the triple digit levels in the absolute long term.

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