

# Agreement on LT LNG deferment a positive Quick Note

### RasGas has agreed to defer 10% of LT LNG supplies this year

In a major positive for GAIL (GAIL IN, Buy) and Petronet LNG (PLNG IN, Buy), Indian LNG buyers have reached an agreement with RasGas to defer about 10% of this year's annual LNG deliveries, as per Petrowatch. The deferred quantity of 0.75mmt (10% of 7.5mmtpa annual supplies, 12-13 cargos), will be spread over next five years. In our 15 January 2015 *note on GAIL*, we indicated that Indian LNG buyers would approach RasGas for some cutback in off-take in the near term.

- This agreement is a positive in our view, as it should ease the current operational challenges caused by high stock levels and weaker demand for higher priced LT LNG. To ease the current situation, we think benefit of majority of reduced 12-13 cargos will be taken in next few months.
- Also, as flexibility improves, Indian buyers will be able to take advantage of the currently weak spot LNG prices. So, while the long-term LNG volume will likely be lower, we do not think the over-all utilisation level of Petronet LNG's Dahej terminal will be impacted.

### LNG import environment has been challenging recently

As we noted last week (*LNG sales further decline*), the operating environment for LNG imports has been challenging. The off-take of LNG has been weak due to reduced competitiveness with liquid fuels due to their sharp price declines. The situation was exacerbated by the wider price gap between RasGas long-term LNG prices (current FOB price of USD13/mmbtu) and spot LNG (currently below USD7/mmbtu). Due to weak off-take, the stock levels at LNG import terminals have likely increased sharply, and this in our view has resulted in less flexibility to import cheaply available spot cargoes.

- India's LNG sales and import volumes further declined in January by 9% and 5%, respectively, from December 2014 levels.
- From the recent high in October 2014, LNG imports declined 18% in January 2015.
- Regasified LNG (R-LNG) sale declines have steepened. RLNG sales declined 9% m-m in January. R-LNG sales have declined for five consecutive months and are down nearly 30% from the recent peak in August 2014.

### Near-term operational challenges will likely ease; startup of few gas based power plants will be the next trigger

While the agreement to defer supplies should certainly ease the situation, we highlight that the situation currently remains challenging. In our view, LNG demand has further weakened recently due to lower off-take by fertiliser plants. We think an early revival in demand, particularly from the power sector, will be the next trigger.

As we highlighted in our note last week, GAIL along with the power and fertilizer ministry is evaluating a gas swapping mechanism to enable supply

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of gas-based power to Telangana. An agreement would facilitate the currently stranded gas-based power plants in Andhra Pradesh to re-start and supply power to Telangana. Similarly, an early agreement to re-start Dabhol power plant would be positive, in our view.

**While 4Q will likely stay weak for GAIL/PLNG, the situation will likely ease from 1QFY16F, in our view**

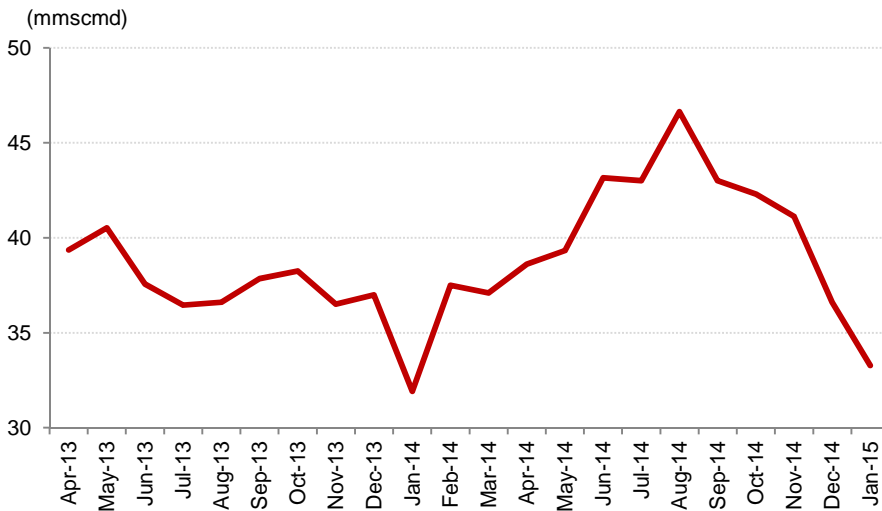
Both GAIL and PLNG reported weak marketing earnings in 3QFY15. (Please see our notes: *GAIL* and *Petronet LNG*). For GAIL, which reports marketing segment earnings separately, segment earnings declined 89% q-q. For Petronet LNG, reported EBITDA declined 34% q-q.

As LNG demand has remained weak in January and February, and the price gap between LT LNG and spot LNG has further widened, we think similar to 3Q, the current quarter will likely be weak for both GAIL and PLNG.

However, as operational flexibility increases with lower LT LNG volumes, we expect that the ability to make marketing margins will return from 1QFY16, for both GAIL and PLNG.

**Fig. 1: India R-LNG sales volumes**

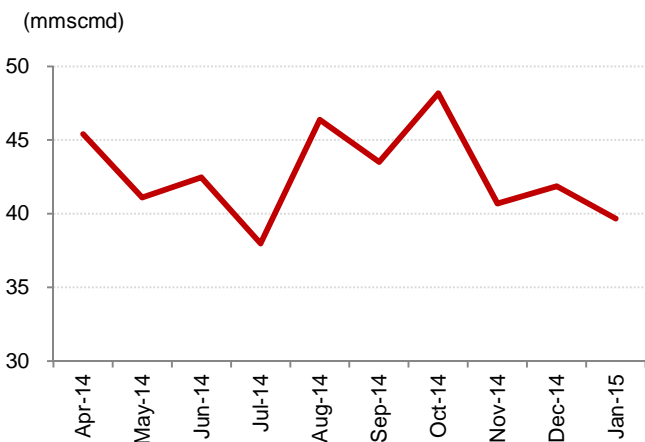
R-LNG sales declined for 5th consecutive months - down 9% m-m in Jan, down 30% from peak in Aug-14



Source: PPAC, Nomura research

**Fig. 2: India R-LNG import volumes**

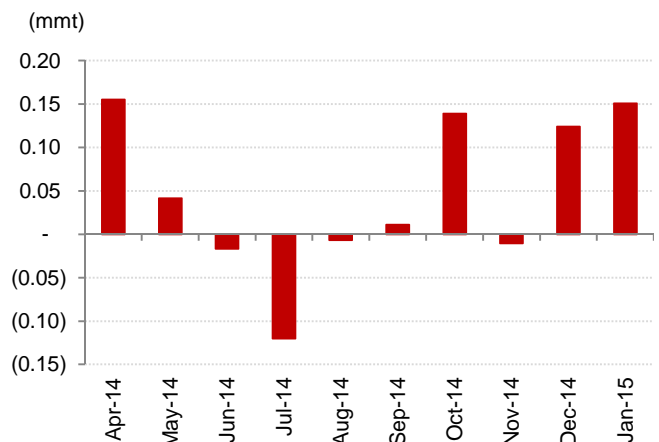
R-LNG import volumes declined 5% m-m in Jan



Source: PPAC, Nomura research

**Fig. 3: India LNG imports less RLNG sale**

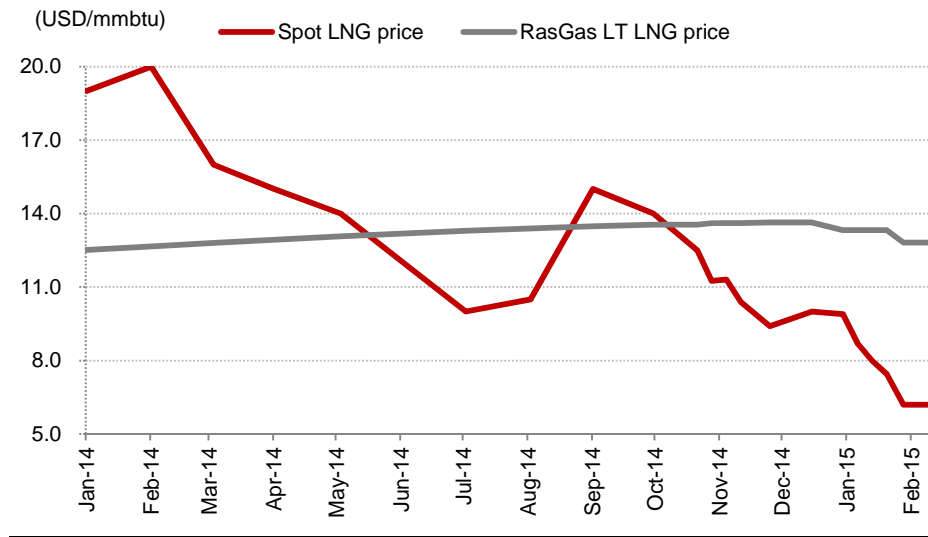
As sales have been lower, stock levels at import terminals have increased



Source: PPAC, Nomura research

**Fig. 4: RasGas LT LNG price vs. spot LNG prices**

The price gap between LT RasGas and spot LNG has further widened in 4Q



Source: ICIS, Nomura estimates

# Appendix A-1

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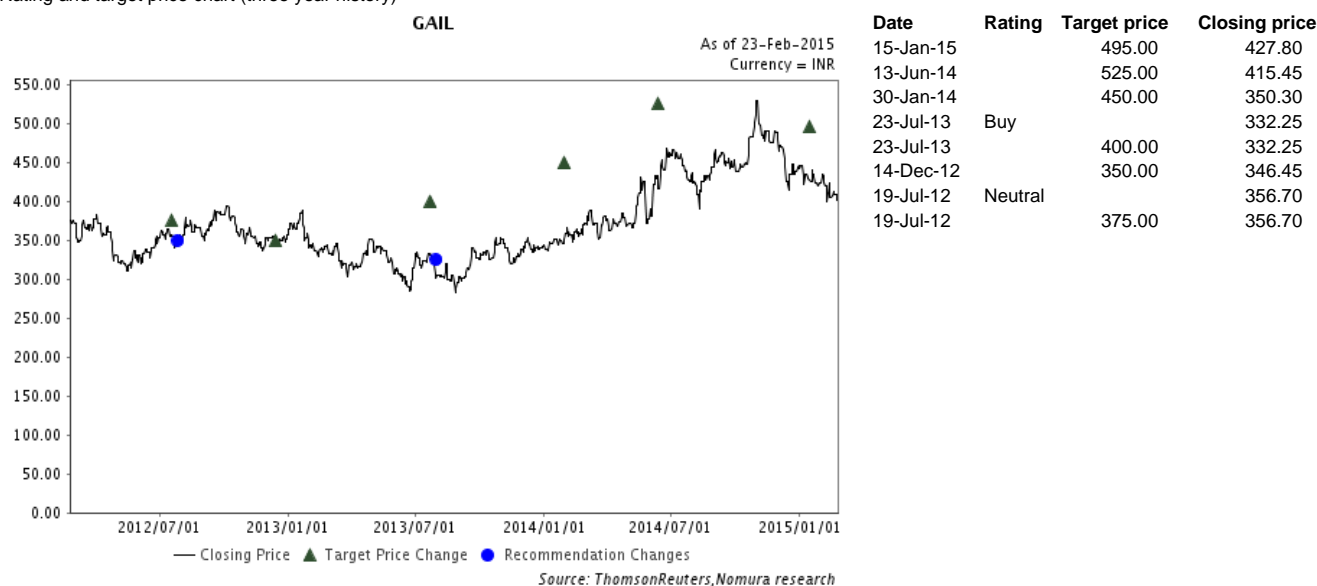
## Materially mentioned issuers

Issuer	Ticker	Price	Price date	Stock rating	Sector rating	Disclosures
GAIL	GAIL IN	INR 411	26-Feb-2015	Buy	N/A	
Petronet LNG	PLNG IN	INR 179	26-Feb-2015	Buy	N/A	

### GAIL (GAIL IN)

INR 411 (26-Feb-2015) Buy (Sector rating: N/A)

Rating and target price chart (three year history)



For explanation of ratings refer to the stock rating keys located after chart(s)

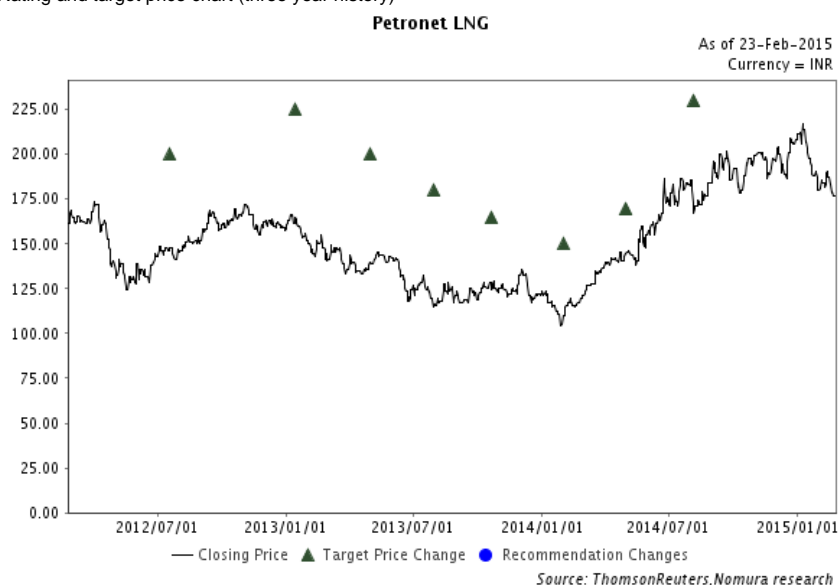
**Valuation Methodology** We use a sum-of-the-parts valuation method as our primary tool in valuing GAIL's diversified business. We value the gas transmission business at 8x FY17F EBITDA. We use a lower 4x FY17F EBITDA for gas trading. We assign 6x FY17F EBITDA for petrochemical and 5x FY17F EBITDA for LPG. We value E&P upside at INR23/share. Our target price is INR495. The benchmark index for this stock is MSCI India.

**Risks that may impede the achievement of the target price** Key downside risks include lower transmission volumes, a sharper decline in polymer prices, and higher subsidy burden than our assumptions.

**Petronet LNG (PLNG IN)**

INR 179 (26-Feb-2015) Buy (Sector rating: N/A)

Rating and target price chart (three year history)



Date	Rating	Target price	Closing price
06-Aug-14		230.00	167.20
01-May-14		170.00	144.80
01-Feb-14		150.00	110.00
21-Oct-13		165.00	124.20
31-Jul-13		180.00	115.75
01-May-13		200.00	139.55
14-Jan-13		225.00	164.90
19-Jul-12		200.00	147.70

For explanation of ratings refer to the stock rating keys located after chart(s)

**Valuation Methodology** We use a DCF methodology to value Petronet LNG (PLNG). Based on a WACC of 10.9% and terminal growth of 1%, our DCF-based target price is INR230. Cash flows are discounted back to FY16F. The benchmark index for this stock is MSCI India.

**Risks that may impede the achievement of the target price** Key downside risks include 1) lower-than-expected spot volumes resulting in downside to our numbers; 2) delays in ramp-up of Dahej capacity; 3) the Dahej offtake agreements providing for 5% annual rises in the re-gasification charges (conservatively, we assume a 5% tariff hike only for five years; lower than our assumed tariff increase would be a negative); and 4) a slower ramp-up at Kochi terminal.

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