E.L. & C. Baillieu Stockbroking Ltd
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Baillieu Research

Friday, 30 September 2011

Metgasco Limited (MEL)

In Brief

ERM Power takes a strategic stake

- Independent power generator and retailer ERM Power Ltd yesterday revealed that it had accumulated a six percent shareholding in coal seam gas developer Metgasco Ltd. The disclosure by ERM is a pointer to a largely hidden struggle among large gas buyers in Queensland and New South Wales to secure long-term low-coast gas supplies before LNG projects commence in Queensland, trebling industrial gas prices.
- ERM power has two large gas-fired power stations under consideration for development – Braemar III near Dalby in Queensland and Wellington I in central New South Wales – which will require secure gas supplies before a final investment decision can be made. ERM plans to sell down up to 50 percent of the equity in each power station, and to maximise shareholder value it will need gas supply arrangements in place.
- Metgasco remains in talks with several potential gas buyers, including parties that are developing LNG plants at Gladstone, Queensland. In recent presentations to investors, Metgasco managing director Mr Peter Henderson mentioned that an initial LNG supply deal would be likely to be around 30Pj of gas a year, a very large volume that would test Metgasco's ability to rapidly ramp up production. It is our belief that, in the short term at least, a supply deal with ERM and an LNG supply deal would be mutually exclusive.
- Recommendation: Metgasco is a deeply under-valued emerging gas producer with significant upside potential and wide corporate appeal. We rate the stock as a Speculative BUY. Due to the high risks entailed in early stage exploration companies, the stock is not recommended for investors with low risk tolerance.

Metgasco: Investment Summary

Year to June 30		2009	2010	2011	2012	2013
Revenue	$m		1	1	1	3
EBITDA	$m		-4.5	-4.6	-4.9	-3.6
EBIT	$m		-4.5	-4.7	-5.0	-3.7
Reported Profit	$m		-4.5	-4.7	-5.0	-3.7
Adjusted Profit	$m		-4.5	-4.7	-5.0	-3.7
EPS (reported)	¢	0.0	-1.8	-1.9	-1.4	-1.0
EPS (adjusted)	¢	0.0	-1.8	-1.9	-1.4	-1.0
EPS Growth	(%)	N/A	N/A	N/A	N/A	N/A
PER (reported)	(x)		N/A	N/A	N/A	N/A
PER (adjusted)	(x)		N/A	N/A	N/A	N/A
Dividend	¢					
Yield	%					
Franking	%	0	0	0	0	0

Recommendations

Short Term:	Spec. BUY
Long Term:	Spec. BUY
Risk:	High
Price:	**$0.36**
Price Target:	$0.65

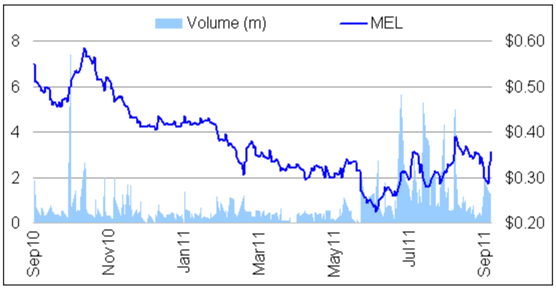
Snapshot

Monthly Turnover	$9.9m
Market Cap	$113m
Shares Issued	337.4m
52-Week High	$0.62
52-Week Low	$0.22
Sector	Energy

Business Description

Metgasco Limited (MEL) is an emerging gas producer that owns petroleum exploration and development rights to most of the Clarence-Moreton Basin in northern New South Wales. The company is likely to become an LNG producer.

12-Month Price and Volume



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Disclosure: The author owns no shares in MEL.

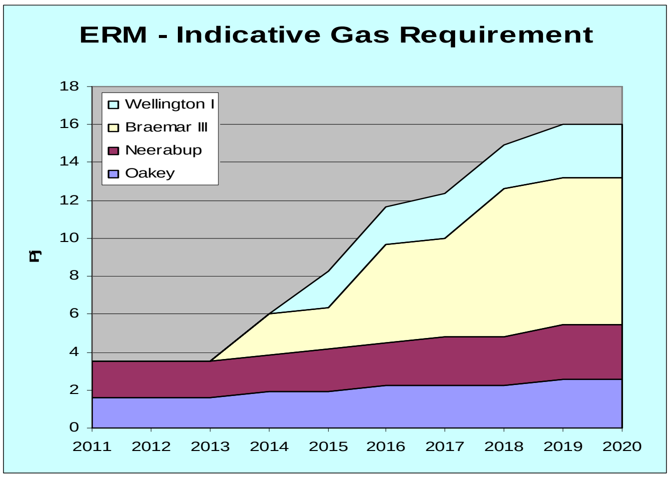
ERM acquires a strategic stake

- Independent power generator and retailer ERM Power Ltd yesterday revealed that it had accumulated a six percent shareholding in coal seam gas developer Metgasco Ltd. The disclosure by ERM is a pointer to a largely hidden struggle among large gas buyers in Queensland and New South Wales to secure long-term low-coast gas supplies before LNG projects commence in Queensland, trebling industrial gas prices.
- ERM power has two large gas-fired power stations under consideration for development – Braemar III near Dalby in Queensland and Wellington I in central New South Wales – which will require secure gas supplies before a final investment decision can be made. ERM plans to sell down up to 50 percent of the equity in each power station, and to maximise shareholder value it will need gas supply arrangements in place.
- Until recently ERM has pinned its gas supply hopes on a gas supply memorandum of understanding with Eastern Star Gas, which would have delivered 20Pj of gas a year over 25 years.
- However, following the Santos-TruEnergy takeover of Eastern Star, there is considerable doubt that Eastern Star will deliver any gas to ERM. While 20 percent of Eastern Star's gas output is to be made available to TruEnergy for domestic gas supplies and power generation, Santos will take the balance, most likely to supply its LNG project in Gladstone.
- Therefore ERM's move onto the Metgasco register may be seen as a pre-emptive move to put itself into a blocking position on the Metgasco register, giving it greater say over how Metgasco's reserves are finally carved up.
- The following chart shows our modelling of ERM's hypothetical gas requirement if the proposed Braemar III and Wellington I power stations were to commence construction within the next six months. Based on the assumption that Braemar III operates as a mixed peak and shoulder generator, ERM will require around 16 Pj of gas by 2019.
- Metgasco remains in talks with several potential gas buyers, including parties that are developing LNG plants at Gladstone, Queensland. In recent presentations to investors, Metgasco managing director Mr Peter Henderson mentioned that an initial LNG supply deal would be likely to be around 30Pj of gas a year, a very large volume that would test Metgasco's ability to rapidly ramp up production. It is our belief that, in the short term at least, a supply deal with ERM and an LNG supply deal would be mutually exclusive.
- Metgasco continues to trade at a deep discount to our valuation and to industry transaction yardsticks. In our view this discount will be removed as the company meets project delivery milestones, including connection of its first industrial gas customers and commencement of production from the Richmond Valley power Station.

Metgasco Indicative Valuation Summary

Permit/ Project	Gas In Place (PJ)	Low Value ($m)	High Value ($m)
PEL 16	3416	276	346
PEL 13	3231	102	646
PEL 426	1692	169	338
Conventional Gas		51	83
Total	$m	599	1413
ST Funding Requirement	$m	-60	-60
Net Enterprise Value	**$m**	539	1353
FD Capital **	mill	685	685
Indicative Value Per Share	**$/shr**	**0.79**	**1.98**

** Adjusted for future capital issues



E.L. & C. Baillieu Stockbroking Ltd

Metgasco Limited (MEL)

Analyst:	Ivor Ries
Date:	30 Sep 2011
Share Price: ($A)	$0.36
Issued Shares:	337.4m
Market Cap:	$113m

Recommendations:	
Short Term:	Spec.
Long Term:	Spec.
Valuation:	$1.16
Price Target	$0.65

Financial Performance ($m)

Year End: June 30	2010 (A)	2011 (E)	2012 (E)	2013 (E)
Sales Revenue	1.0	0.9	1.0	3.0
EBITDA	-4.5	-4.6	-4.9	-3.6
Depreciation	0.1	0.1	0.0	0.1
EBITA	-4.5	-4.7	-5.0	-3.7
Amortisation	0.0	0.0	0.0	0.0
EBIT	-4.5	-4.7	-5.0	-3.7
Net Interest	0.0	0.0	0.0	0.0
Other Non-Oper Inc/(Exp)				
Pre-tax Profit	-4.5	-4.7	-5.0	-3.7
Tax	0.0	0.0	0.0	0.0
Associates				
Outside Equity Int.				
Reported NPAT	-4.5	-4.7	-5.0	-3.7
Significant Items				
Discontinued Items				
Adjusted Profit	-4.5	-4.7	-5.0	-3.7

Cash Flow ($m)

Year End: June 30	2010 (A)	2011 (E)	2012 (E)	2013 (E)
Receipts from customers	0.0	0.0	0.4	3.8
Payments to suppliers	-4.9	-5.5	-6.0	-6.6
Other	1.0	0.9	0.6	0.8
Operating Cash Flow	-3.9	-4.6	-5.0	-2.0
Capital Expenditure	-22.6	-10.7	-15.8	-12.5
Other	0.4	0.0	0.0	0.0
Investing Cash Flow	-22.2	-10.7	-15.8	-12.5
Proceeds from Issues	28.9	0.0	34.0	0.0
Net Borrowings	0.1	0.1	0.0	0.0
Dividends				
Other	0.0	0.0	0.0	0.0
Financing Cash Flow	29.0	0.1	34.0	0.0
Net Change in Cash	2.8	-15.2	13.2	-14.5
Cash at Begin. of Year	17.3	20.1	4.9	18.1
Exchange Rate Adj.				
Cash at End of Year	20.1	4.9	18.1	3.7

Balance Sheet ($m)

Year End: June 30	2010 (A)	2011 (E)	2012 (E)	2013 (E)
Cash	20.1	4.9	18.1	3.7
Receivables	0.7	0.9	0.9	0.9
Inventories	1.2	1.4	1.4	1.4
Other	0.0	0.0	0.0	0.0
Current Assets	22.0	7.2	20.4	5.9
Investments				
Prop, Plant & Equip	4.3	4.5	12.0	12.5
Intangibles (net)	0.0	0.0	0.0	0.0
Other	48.5	59.3	67.6	79.5
Non-current Assets	52.8	63.8	79.6	92.0
Total Assets	74.8	71.0	100.0	97.9
Payables	1.5	1.7	1.4	4.2
Borrowings	0.1	0.2	0.2	0.3
Provisions & Other	0.1	0.1	0.1	0.1
Current Liabilities	1.7	2.0	1.7	4.6
Payables				
Borrowings	0.2	0.3	0.2	0.2
Provisions & Other	0.4	0.4	0.4	0.4
Non-current Liabilities	0.6	0.7	0.6	0.6
Total Liabilities	2.3	2.6	2.3	5.2
Share Capital	83.0	83.2	117.1	117.1
Reserves	3.8	4.1	4.1	4.1
Retained Profits	-14.3	-18.8	-23.5	-28.5
Shareholders Equity	72.5	68.4	97.7	92.7
Outside Equity Int.				
Total Equity	72.5	68.4	97.7	92.7
Total Funds Employed	72.8	68.8	98.1	93.2

Ratios

Year End: June 30	2010 (A)	2011 (E)	2012 (E)	2013 (E)
EBITDA Margin (%)	-455.0%	-520.9%	-476.5%	-118.6%
EBIT Margin (%)	-460.6%	-527.6%	-479.4%	-122.6%
NPAT Margin (%)	-462.7%	-528.9%	-479.4%	-122.6%
Return on Assets (%)	-6.0%	-6.6%	-5.0%	-3.8%
Return on Equity (%)	-6.3%	-6.8%	-5.1%	-4.0%
Net Debt to Equity (%)	-27.4%	-6.6%	-18.1%	-3.4%
Net Interest Cover (x)				
Fixed Charges Cover (x)				

Valuation

Year End: June 30	2010 (A)	2011 (E)	2012 (E)	2013 (E)
Basic EPS ¢	-1.8	-1.9	-1.4	-1.0
Adjusted EPS ¢	-1.8	-1.9	-1.4	-1.0
EPS Growth	N/A	N/A	N/A	N/A
P/E Ratio (x)	N/A	N/A	N/A	N/A
DPS ¢				
Yield (%)	%	%	%	%
Franking (%)				

Recommendations
Buy: Share price expected to appreciate by more than 10% during next 12 months.
Accumulate: Share price expected to appreciate by more than 10% during next 12 months. However, further short-term weakness possible.
Hold: Share price expected to trade between +10% and -10%.
Lighten: Share price expected to fall by more than 10% during next 12 months. However, share price may appreciate marginally in short term.
Sell: Share price expected to fall by more than 10% during next 12 months.

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