PetroVietnam Southern Gas (PGS – HNX)

2015 – A year of challenge

Particulars (VND bn)	3QFY14	2QFY14	% (qoq)	3QFY13	% (yoy)
Net Revenues	1,961.9	1,927.0	2%	1,815.1	8%
PAT	56.7	48.8	16%	53.5	6%
EBIT	101.7	73.8	38%	87.6	16%
EBIT margin (%)	5.2%	3.8%	136bps	4.8%	36bps

Source: PGS

- 3Q2014 earnings improved slightly
- LPG business prospect dims as price continues to falter
- CNG input price will be imposed a 8-percent increase in 2015
- 2015 business prospect: a challenging year

Outlook and Valuation:

In this update, we also utilize the DCF method, which suggests a per-share price for PGS of about VND39,100/share. Combining this with the result of the P/E method, we estimate the reasonable price for PGS at **VND37,800/share**, 9% higher than the closing price on 24/11/2014. With numerous challenges to overcome in the coming years, we rate the stock as **NEUTRAL** in the **LONG-TERM.**

In the beginning of 2015, PGS expect to pay a share dividend at 3:1 ratio, which information may affect the stock's price movements in the short-run. However, this factor should have no direct impact on the firm's business efficiency. Instead, the Company's efforts to control costs and increase output are essential to minimize the risks from (1) the volatility of world's gas price; (2) the increase of CNG input gas price.

Key financials

Y/E Dec (VND bn)	FY2012	FY2013	9M/FY2014	FY2014E	FY2015F
Net Revenues	6,374.9	6,902.0	5,591.7	7,171.6	7,122.9
% chg	10.6%	8.3%	15.6%	3.9%	-0.7%
PAT	151.3	179.0	133.4	165.3	154.0
% chg	-36.6%	18.3%	-11.4%	-7.7%	-6.9%
EBIT margin (%)	2.4%	2.6%	2.4%	2.3%	2.2%
ROA (%)	4.9%	6.0%		5.5%	5.3%
ROE (%)	19.5%	20.8%		17.1%	14.4%
EPS (VND)	3,981	4,711		4,350	4,052
Adjusted EPS (VND)	1,403	4,711		4,350	4,052
Book value (VND)	21,325	24,040		26,945	29,670
Cash dividend (VND)	1,200	1,500		1,500	1,500
P/E (x)	4.3	6.0		8.0*	9.0*
P/BV (x)	0.8	1.2		1.3*	1.2*

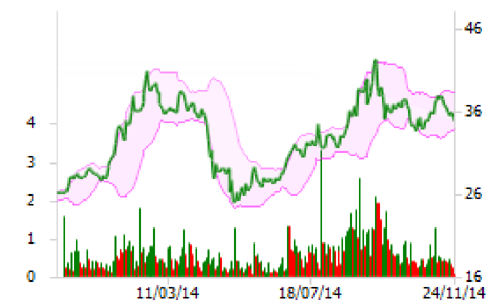
Sources: RongViet Research, (*) PGS Stock price as of 24/11/2014

NEUTRAL

PGS (VND)	34,700
Target Price (VND)	37,800
Investment Period	Long-term

Stock Info

Sector	Oil & Gas
Market Cap (VND bn)	1,345
Current Shares O/S	38,000,000
Beta	1.55
Free float (%)	55.3
52 weeks High	42,400
52 weeks Low	23,900
Avg. Daily Volume (in 20 sessions)	589,559



Performance (%)

	3M	1Y	3Y
PGS	-2.5	38.8	82.6
Oil&Gas	-17.0	58.9	N/A
HN30 Index	0.6	44.3	N/A
HNX Index	2.7	35.8	43.9

Major Shareholders (%)

PV-Gas	35.26
Halley Sicav-Halley Asian Property	9.46
Dai A Bank	4.56
Foreign Investors' Room (%)	27.29

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Exhibit 1: 3QFY2014 and YTD Results

Particulars (VND bn)	3QFY14	2QFY14	% chg (qoq)	3QFY13	% chg (yoy)	9M/FY14	% chg (yoy)
Net Revenues	1,961.9	1,927.0	1.8	1,815.1	8.1	5,591.7	*15.6*
Gross profits	320.1	287.5	11.3	297.0	7.8	869.0	*1.8*
SG&AC	223.4	219.0	2.0	212.3	5.2	655.0	*12.4*
Operating Income	96.7	68.5	41.2	84.7	14.2	214.0	*-3.9*
EBITDA	170.7	143.0	19.4	164.3	3.9	439.6	*-14.3*
EBIT	101.7	73.8	37.9	87.6	16.1	230.0	*-17.4*
Financial expenses	7.4	9.1	-18.4	13.4	-44.3	26.4	*-62.4*
- Interest Expenses	7.3	8.8	-16.7	9.4	-22.2	25.9	*-42.9*
Dep. and amortization	-69.0	-69.2	-0.3	-76.6	-10.0	-209.6	*-10.8*
Non-recurring Items (*)							
Extraordinary Items (*)	0.5	0.0	1306.8	0.5	2.5		
PBT	94.4	64.9	45.3	78.2	20.7	204.1	*-12.4*
PAT	56.7	48.8	16.1	53.5	6.0	133.4	*-11.4*
(*) Adjusted PAT	56.2	48.8	15.3	53.0	6.1	133.4	

Sources: PGS, RongViet Research

Exhibit 2: 3QFY2014 performance analysis

Particulars	3QFY14	2QFY14	*% Chg. (qoq)*	3QFY13	*% Chg.(yoy)*
Profitability Ratios (%)					
Gross Margin	16.3	14.9	140bps	16.4	-5bps
EBITDA Margin	8.7	7.4	128bps	9.0	-35bps
EBIT Margin	5.2	3.8	136bps	4.8	36bps
Net Margin	2.9	2.5	36bps	2.9	-6bps
Adjusted Net Margin	2.9	2.5	34bps	2.9	-5bps
Turnover *(x)					
-Inventories	40.5	33.3	7.2	59.0	-18.5
-Receivables	9.8	10.1	-0.3	10.5	-0.7
-Payables	4.4	4.7	-0.3	5.6	-1.2
Leverage (%)					
Total Debt/ Equity	2.0	2.3	-0.3	2.1	-0.1

Sources: RongViet Research , (*) Annualized turnover

3Q2014 earnings improved slightly

Improved business result in 3Q2014 partly covered the decline in profit in the first half of the year. Last quarter, PGS reported VND1,962 of revenue, about the same as in the previous quarter and up 8.1% over the same period last year and VND56.7 billon of net profit, up 16.1% from Q2 and 6% over the one-year period. Notably, gross profit margin increased from an average 15.12% in 1H2014 to 16.3% in the third quarter.

Since the beginning of this year, the Company has witnessed a fairly good increase of output in all of its business segments. In particular, LPG sale volume reached 209,000 tons, a 10-percent increase from a year earlier while CNG volume was 117 million m^3, up 12.5%. However, the gross profit margin of both segments fall because of (1) an extended slide of LPG price since earlier this year and(2) a 5-percentincrease of CNG input price in 1Q2014. Besides, though interest expense was reduced, administration expense rose significantly (+37.5%), causing accumulative net profit by the end of September 2014 to fall 17.8% over the 9M2013 to VND133.38 billion. According to PGS, G&A expenses rose because the Company has proceeded to purchase a cylinder factory and the remaining free floats of one of its subsidiary, VT-Gas, which negatively affected the overall efficiency of the business.

In the last quarter of 2014, LPG price is expected to continue its tumble to about $650/ton, down 18% as compared to Q3. Meanwhile, the CNG segment should remain stable. On the other hand, the receipt of VND6 billion of tax reimbursement of about will also contribute to improve net income. For the whole-year period, we estimate PGS' revenue at VND7,171 billion (+3.9% yoy), and net profit for parent shareholders at VND165 billion (-7.6% yoy).

Exhibit 3: 4QFY2014 Forecast

Particulars (VND bn)	4QFY14	%chg (qoq)	%chg (yoy)
Net Revenues	1,580	-19.5%	*-24.8%*
Gross profits	233	-27%	*-9.5%*
EBIT	42.3	-56%	*0.1%*
PAT	31.9	-43.6%	*14.6%*

Source: RongViet Research estimates

LPG business prospect dims as price continues to falter

In contrast with our earlier expectations, the downtrend of LPG price has stretched on and even as winter approaches, world's LPG price (CP) has dropped further to $605/ton at the start of November, 2014, the lowest level since July, 2012. As the largest LPG distributor with 30% of market share in the South, an unceasing downtrend of LPG price may make the profit margin of PGS' LPG segment to grow even narrower. We estimate the gross profit margin of this segment in 2014 to shrink to around 9.3%, well below the level of 10.9% in 2013. This, however, cannot deny the fact that, PGS is still one of the most efficient gas distributors, advantaged by its lion share in the market as well as its established brand and distribution channel.

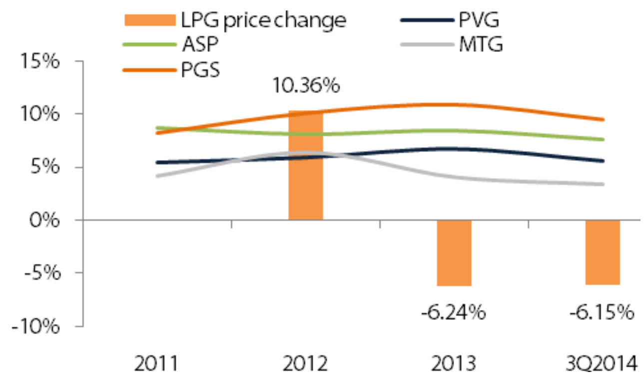
The prospect of the LPG business is defined by two main factors:

(1) Output growth: According to PVGas, the average growth rate of LPG consumption in the period 2004-2013 was approximately 6% with most of the consumption going to industrial clients and households. In 2013-2014, LPG output growth is in line with GDP growth rate at about 5.43%. Thus, we maintain the assumption that LPG output in the period 2015-2018 with continue growing at the same pace as the economy at an average 6%/year.

(2) World LPG price trend: In light of the recent slump of crude oil, we have noticed strong positive correlation between oil price and LPG price. A research* showed that 74% of the changes in propane price and up to 90% of the changes in butane price can be explained by crude oil price volatility. Most recently, the US Energy Information Administration (EIA) has revised its forecast for oil price in 2015 to $77.75/barrel for WTI and $83.42/barrel for Brent crude oil. Up to now, oil price has fallen below that forecasts. In our best-case scenario, oil price will be stable at the current level next year. Worse, oil price will continue to drop and adversely affect the prospect of LPG segment.

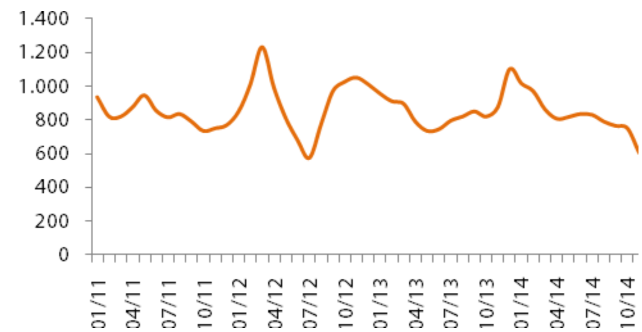
** Source: SSRN, Shale Gas and the Relationship between the U.S. Natural Gas, Liquefied Petroleum Gases and Oil Markets, 07/2013*

Graph: Gross profit margin of selected LPG vendors



Source: RongViet Research

Graph: LPG price movement

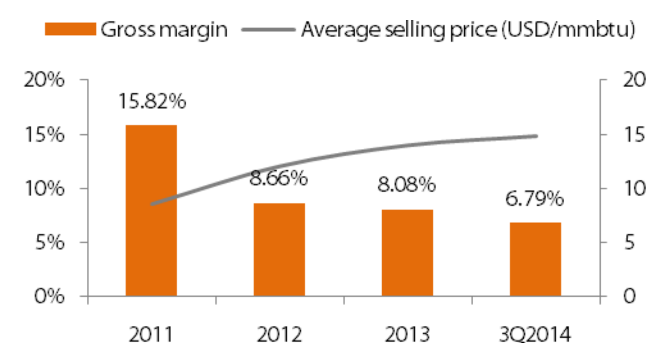


Source: Aramco

CNG input price will be imposed a 8-percent increase in 2015

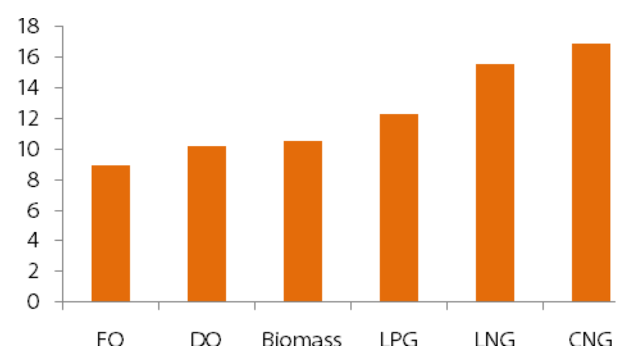
Apart from LPG segment, CNG is also a core business of PGS; however, the segment has faced some difficulties recently. In the previous report, we mentioned about the risk of losing major clients at the parent company due to competition against such alternative fuels as biomass. This time, we will give a closer look at the risk of input price increase. CNG input price is determined by two key factors: (1) the level of competition against other alternatives and (2) the schedule convergence to world's prices. According to PGS, from 2016 onward, CNG price for the industrial sector will be calculated on the selling gas price of Thien Ung field (Nam Con Son basin), around $12/MMBTU, 40% higher than the current input price. Following that schedule, input gas price will increase at a maximum of 20% in 2015. Nevertheless, because world gas price has still tumbled, we assume that input gas price will add only 8% for the whole year.

Graph: The average selling price and gross margin of PGD



Source: PGD, RongViet Research

Graph: CNG and other alternative fuels prices ($/mmbtu)



Source: RongViet Research

Given PGS's bargaining power, we see it unlikely that the Company will be able to pass on the increased cost to its customers. First, the CNG customer portfolios at the parent company PGS and its subsidiary CNG Vietnam are tilted towards steel and building material manufacturers. Considering the fact that the construction material industry relies largely on the wellbeing of the real estate market, we do not think there is much to hope for CNG consumption growth in 2015. Second, alternative fuels with their increasing competitiveness (see below table) affect PGS's ability to not only expand its customer base but also to maintain its relationship with existing customers. The Company said that it found a new way to distribute CNG in 2014, i.e. through intermediaries, which allows a monthly distribution volume of up to 1.8 million cubic meter. This is good news but it also implies that the possibility of adding new large customers in the CNG segment is shrinking. A combination of all those factors will have a negative effect on PGS's profit, a situation PGD has been dealing with this whole time.

Exhibit 4: Fuels comparison

	Thermal Value	Toxic components	Consumption rate (kg/h)	Main constituents
DO	11,000	S: 0.05-0.25%	360	Hydro Carbons
FO	9,500	S: 2-3.5%	417	
Coal	5,500-7,800	S: 0.5-0.8%	660	C, H_2, S
Wood	1,400-4,200		1,240	Mix
LPG	11,300-12,000 26,000 (kcal/m3)	S: low	336	C_3H_8; C_4H_{10}
CNG	13,400	H_2S: 0-3%	304	CH_4: 70-92%
Biomass	1,140-1,760 (kcal/m3)	S: low <0.08%	2,640	CO; H_2
Electric	1kWh = 860 Kcal		4,250	
Wood pellets	3,600-4,200	S: low <0.08%	990	Mix

Source: khihoa

2015 business prospect: a challenging year

From above analysis, we realize that 2015 will be a challenging year for PGS given: (1) LPG price risk; (2) the likely increase of CNG input gas price; (3) difficulty in transferring incremental costs to buyers and expanding customer base in the CNG segment; (4) the ending of the period of preferential income tax for the CNG segment. Next year, the capacity of CNG Vietnam, PGS' subsidiary will be upgraded to 80 million m3 at the arrivals of some new customers, causing depreciation expense to increase slightly as compared to 2014.

We establish a base-case scenario for 2015 where (1) LPG price will be reduced by 10% from 2014's average price; (2) the CNG input price will pick up 8% in 2015; (3) the Company may not transfer the gas price increase to its customers. Accordingly, revenue in 2015 is estimated at VND7,122 billion and net profit for the parent company's shareholders at VND154 billion, or VND4,052/share.

Outlook and valuation

In this update, we also utilize the DCF method, which suggests a per-share price for PGS of about VND39,100/share. Combining this with the result of the P/E method, we estimate the reasonable price for PGS at **VND37,800/share**, 9% higher than the closing price on 24/11/2014. With numerous challenges to overcome in the coming years, we rate the stock as **NEUTRAL** in the **LONG-TERM**.

In the beginning of 2015, PGS expect to pay a share dividend at 3:1 ratio, which information may affect the stock's price movements in the short-run. However, this factor should have no direct impact on the firm's business efficiency. Instead, the Company's efforts to control costs and increase output are essential to minimize the risks from (1) the volatility of world's gas price; (2) the increase of CNG input gas price.

Exhibit 5: Key Assumptions

Particular	Earlier Estimates		Revised Estimates	
	FY2014E	FY2015F	FY2014E	FY2015F
Revenue growth (%)	-	-	3.9	-0.7
LPG volume (%)	-	-	5.0	6.2
CNG volume (%)	-	-	6.0	6.5
Gross margin (%)	-	-	15.4	14.8
EBIT margin (%)	-	-	4.0	4.0

Source: RongViet Research estimates

VND Billion

INCOME STATEMENT	FY2012	FY2013	FY2014E	FY2015F
Revenue	6,374.9	6,902.0	7,171.6	7,122.9
COGS	5,390.9	5,806.0	6,069.3	6,066.3
Gross profit	**984.1**	**1,096.0**	**1,102.3**	**1,056.6**
Selling Expense	509.0	623.2	652.3	641.1
G&A Expense	133.5	169.1	193.6	178.1
Finance Income	40.3	34.8	19.6	22.8
Finance Expense	145.4	81.0	29.9	12.9
Other profits	18.4	20.5	11.2	22.6
PBT	**255.1**	**278.1**	**257.2**	**269.9**
Prov. of Tax	43.3	40.4	30.3	51.3
Minority's Interest	60.5	58.6	61.6	64.7
PAT to Equity Shareholder	**151.3**	**179.0**	**165.3**	**154.0**
EBIT	**372.6**	**339.0**	**286.6**	**281.6**
EBITDA	635.7	655.5	564.6	560.9

%

FINANCIAL RATIO	2011A	2012A	2013E	2014F
Growth				
Revenue	10.6	8.3	3.9	-0.7
Operating Income	-26.7	-11.1	-15.6	-7.4
EBITDA	-10.0	3.1	-13.9	-0.7
EBIT	-27.7	-9.0	-15.4	-1.8
PAT	-36.6	18.3	-7.7	-6.9
Total Assets	-10.8	5.1	-2.9	-6.1
Equity	9.9	12.7	12.1	8.2
Internal growth rate	13.7	14.2	11.2	9.1
Profitability				
Gross profit/Revenue	15.4	15.9	15.4	14.8
Operating profit/ Revenue	5.4	4.4	3.6	3.3
EBITDA/ Revenue	10.0	9.5	7.9	7.9
EBITDA/ Revenue	5.8	4.9	4.0	4.0
Net margin	2.4	2.6	2.3	2.2
ROAA	4.9	6.0	5.5	5.3
ROIC or RONA	22.9	22.8	20.1	20.1
ROAE	19.5	20.8	17.1	14.4
Efficiency				
Receivable Turnover	11.0	10.2	8.8	8.8
Inventory Turnover	54.2	35.4	34.1	40.0
Payable Turnover	5.1	5.3	4.7	4.5
Liquidity				
Current	0.9	1.1	1.1	1.2
Quick	0.8	0.9	1.0	1.1
Solvency				
Total Debt/Equity	233.0	208.9	173.1	137.7
Current Debt/Equity	55.7	42.6	21.0	6.4
Long-term Debt/ Equity	40.1	16.2	8.7	1.2

VND Billion

BALANCE SHEET	2011A	2012A	2013E	2014F
Cash and equivalents	443.0	593.8	724.4	660.9
Short-term investment	68.9	68.1	0.1	0.1
Receivables	529.0	818.6	815.8	810.3
Inventories	123.5	204.1	151.7	151.7
Other current assets	25.3	54.7	70.8	74.3
Total Current Asset	**1,189.8**	**1,739.4**	**1,762.8**	**1,697.3**
Tangible Fixed Assets	839.9	657.6	608.3	522.3
Intangible Fixed Assets	33.7	33.2	33.5	32.8
Construction in Progress	29.1	39.7	40.0	40.0
Investment Property	0.8	0.0	0.0	0.0
Long-term Investment	93.8	0.0	0.0	0.0
Other long-term assets	716.4	587.4	535.5	507.2
Goodwill	17.9	12.4	30.9	30.9
Long-term Asset	**1,731.5**	**1,330.3**	**1,217.3**	**1,102.2**
Total Asset	**2,921.3**	**3,069.7**	**2,980.1**	**2,799.5**
Payables	840.7	1,134.5	1,200.8	1,200.2
Other current liabilities	104.9	103.0	154.2	138.9
Current Debt	451.3	388.8	215.1	71.2
Long-term Debt	324.8	148.4	88.7	13.3
Other long-term liabilities	166.7	133.7	113.2	101.9
Total Liability	**1,888.4**	**1,908.5**	**1,772.0**	**1,525.5**
Owner's Equity	**810.4**	**913.5**	**1,023.9**	**1,127.5**
Capital	380.0	380.0	380.0	380.0
Retained Earnings	165.6	166.4	178.8	186.5
Funds & Reverses	218.6	321.0	419.0	514.9
Others	**0.0**	**0.0**	**0.0**	**0.0**
Total Equity	**810.4**	**913.5**	**1,023.9**	**1,108.2**
Minority's Interest	222.6	247.7	184.1	165.7
TOTAL RESOURCES	**2,921.3**	**3,069.7**	**2,980.1**	**2,799.5**

CASH FLOW STATEMENT	2011A	2012A	2013E	2014F
Profit before tax	255.1	278.1	257.2	269.9
-Depreciation	263.1	316.6	278.0	279.3
-Adjustments	*107.1*	*-61.5*	*29.8*	*-11.1*
+/- Working capital	-347.1	-6.8	76.4	-88.1
Net Operating CFs	**278.1**	**526.3**	**641.4**	**450.0**
+/- Fixed Asset	-106.6	-105.7	-217.7	-139.7
+/- Deposit, equity investment	20.2	16.1	3.9	-22.3
Interest, dividend, cash profit received	45.8	28.1	17.7	20.5
Net Investing CFs	**-40.6**	**-61.5**	**-196.2**	**-141.5**
+/- Capital	0.0	10.7	0.0	0.0
+/- Debt	-205.0	-238.8	-233.4	-219.3
Dividend and others paid	-175.8	-86.0	-81.2	-152.7
Net Financing CFs	**-380.7**	**-314.1**	**-314.6**	**-372.0**
+/- cash & equivalents	-143.2	150.8	130.6	-63.5
Beginning cash & equivalents	**586.3**	**443.0**	**593.8**	**724.4**
Impact of exchange rate	0.0	0.0	0.0	0.0
Ending cash & equivalents	**443.0**	**593.8**	**724.4**	**660.9**

RESULT UPDATE

This report is created for the purpose of providing investors with an insight into the discussed company that may assist them in the decision-making process. The report comprises analyses and projections that are based on the most up-to-date information with the objective which is to determine the reasonable value of the stock at the time such analyses are performed. Through this report, we strive to convey the complete assessment and opinions of the analyst relevant to the discussed company. To send us feedbacks and/or receive more information, investors may contact the assigned analyst or our client support department.

RATING GUIDANCE

Ratings / Return Potential	BUY	ACCUMULATE	NEUTRAL	REDUCE	SELL
Intermediate- term (up to 6 months)	>20%	10% to 20%	-5% to10%	-15% to- 5%	<-15%
Long-term (over 6 months)	>30%	15% to 30%	-10% to 15%	-15% to -10%	<-15%

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