CONTRARIAN RESEARCH REPORT

The Contrarian Series

April 28, 2021

Cheniere Energy, Inc.

(Update and Recommendation)

Price (close):	$74.51	**Ticker:**	LNG
52-Week Range:	$39.51 - $77.11	**Dividend:**	n/a
Shares Outstanding:	253.5 million	**Yield:**	n/a
Market Capitalization:	$18.88 billion		

Data as of April 27, 2021

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Exclusive Marketers of The Contrarian Report

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Summary

Founded in 1996, Cheniere Energy is a liquified natural gas ("LNG") company that owns and operates LNG terminals in the U.S. that process and export liquified natural gas. In 2016, it became the first company to export LNG.

On January 30, 2019, Cheniere Energy was recommended for purchase at a price of $66.50 per share. The investment thesis at the time was based on the observation that, after several years of construction (financed primarily with debt capital), the company's operations had expanded to a point at which it had reached meaningful profitability, and thus established a path to higher earnings and cash flow. After all, the company was still only partway through the completion of its development plan; with all of its facilities operational, higher earnings would be virtually assured.

Since the initial report, the company has indeed made progress on its development plans. As opposed to four terminals (or trains, in industry parlance) in operation in early 2019, the company now has seven trains constructed and operational, with an additional train substantially completed at the end of March and another scheduled to be online in the second half of 2022. At that time, the company's initial development plans will be complete.

Although the stock has risen to a recent price of approximately $74.50 per share (+12%), it still does not approach the fair value estimate based on a conservative earnings scenario ($106 per share). There is no doubt that the intervening coronavirus pandemic had a large impact on the company's share price. During the height of the crisis last year, its market capitalization was cut in half, but has since recovered. When the pandemic ends, which appears will be soon, given the mass vaccination programs put in place, one could expect a normalization of the equity value and recognition of the appreciation potential. Allowing for a more generous but still reasonable earnings figure, fair value could approach $140 per share, which would be a doubling from the current level. As a result, the recommendation to purchase Cheniere Energy is reiterated.

Brief Company Description

Cheniere Energy is the leading producer of liquified natural gas in the United States; it is the second largest LNG operator in the world and the fourth largest supplier globally. The company owns and operates two LNG plants on the Gulf Coast.

The first is the Sabine Pass Liquefaction terminal in Louisiana. Sabine Pass is one of the largest LNG production facilities in the world and is owned through a publicly traded limited partnership, Cheniere Energy Partners, L.P. (NYSE: CQP). Sabine Pass currently has five terminals, or trains, in operation. A sixth train is under construction and is expected to be completed in the latter half of 2022. At that time, the total production capacity will be 30 million tonnes per annum ("mtpa"). Along with the liquefaction plant (which converts natural gas in the gaseous form to liquid natural gas, hence the term LNG), Sabine Pass also has two marine berths (and one under construction) that can accommodate shipping vessels that transport the LNG to its final destination, usually overseas, particularly Asia.

The other facility is the Corpus Christi LNG terminal located in Texas. This facility operates two trains, with a third that was recently completed and will soon be put into production. The Corpus Christi terminal has a 15 mtpa total production capacity. It also owns a 23-mile natural gas supply pipeline that interconnects the Corpus Christi LNG terminal with several interstate and intrastate natural gas pipelines, as well as two marine berths that can each accommodate vessels with nominal capacity of up to 266,000 cubic meters.

In principle, the business of producing LNG is fairly simple. Cheniere receives natural gas through purchase agreements with a variety of pipeline companies. The gas is liquified through a procedure called liquefaction that cools the gas to a temperature of -260°F, wherein it transforms into a liquid. This is done because the process shrinks the volume of natural gas by 600 times, allowing it to be efficiently held and transported in LNG tanker carriers. The LNG is then loaded onto the ships at Cheniere's Gulf locations and ultimately transported to the end customer, where the LNG is converted back to gaseous form for use.

Rather, the principal obstacle is the ability to raise the capital necessary to construct the facilities. Being the first in the U.S., Cheniere Energy secured an early mover advantage and was able to raise the funds necessary to accomplish its plan. To date, it has approximately $30.4 billion invested in its property, plant and equipment, net of depreciation. Given that all but one terminal has been completed, the capital requirements for construction purposes is nearing an end. Thus far, the majority of the funds have been raised through debt issuance. As of December 31st, 2020, the company had total debt of $30.8 billion.

In order to reduce its financial risk, Cheniere Energy requires its customers to enter into long-term contracts that typically lasts 20 years and involve two forms of payment (currently, the average remaining life of its contracts is 18 years). The first is a fixed component that must be paid regardless of whether the customer cancels future deliveries.

This is referred to as a take-or-pay provision. Essentially, it guarantees or holds the customer's portion of Cheniere's capacity will be available to it. Presently, Cheniere Energy has approximately 85% of its platform contracted on a long-term basis, providing over $5.5 billion in run-rate annual take-or-pay revenues from long-term contracts.

The second is a variable component that is based on the amount of LNG delivered to customers. Effectively, customers pay 115% of the Henry Hub spot price per MMBtu (million BTU) delivered, which ensures Cheniere Energy a 15% margin over the market price of natural gas. In this way, the company is not exposed to the fluctuations in the commodity and ensures that it does not deliver LNG at a loss. These provisions provide a more steady and dependable revenue stream compared to the typical company operating in the oil and gas industry.

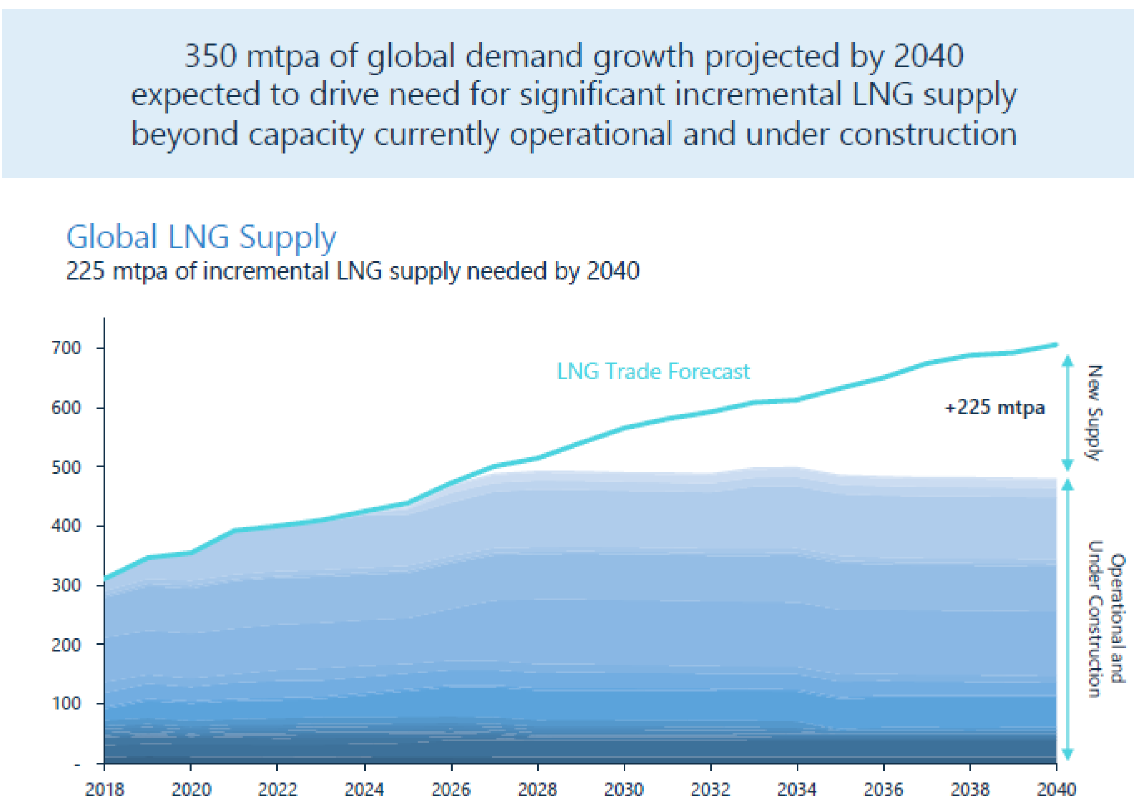
However, the company did experience a very modest revenue decline last year resulting from the economic effects of the worldwide COVID-19 pandemic lockdowns. During the year, LNG prices dropped to a record low and experienced some customer cancellations, although it did receive compensation in the form of the take-or-pay payments. In these instances, the customer elects to postpone or cancel the LNG gas delivery from Cheniere, but is still contractually obligated to purchase LNG in future periods. Usually, the notice to cancel must be communicated within a specific timeframe (e.g., 60 days before scheduled loading), which allows Cheniere to manage its raw materials cost; the company can reduce the purchase of natural gas and avoid holding unsold LNG. In 2020, the company recognized just under $1 billion of revenues associated with LNG cargoes that customers elected to not take delivery of. Accordingly, notwithstanding the cancellations, the revenue decline was less than 4% year-over-year (from $9.7 billion in 2019 to $9.3 billion in 2020). To put that in perspective, the 2020 revenue figure was still 17% higher than the level achieved in 2018.

Despite improving its gross margins and greater operating efficiency, the company recorded a fairly small GAAP loss of $85 million for the year (versus net income of $648 million in the prior year). However, this is attributable to $515 million of non-cash changes to commodity derivatives related to long-term marketing agreements for the purchase of natural gas and certain gas supply agreements, which require mark-to-market accounting, which is an annually fluctuating non-cash figure. Moreover, Cheniere recorded $217 million of losses resulting from the extinguishment of debt.

On a cash basis, Cheniere Energy remained very profitable. For the year, the company produced $1.2 billion in operating cash flow on $9.3 billion of revenue. Although it is down from the prior year's $1.83 billion, it is quite an achievement considering the economic disruptions that transpired in 2020. The financials appear even more favorable on an adjusted EBITDA basis. The company calculates that adjusted EBITDA reached $3.96 billion last year, which is a considerable increase from 2019's EBITDA figure of $2.94 billion. The primary difference between the two years is attributable to the previously mentioned mark-to-market adjustments.

Looking forward, Cheniere Energy expects adjusted EBITDA to rise further, with a range of $4.1 billion to $4.4 billion this year. It should be noted that this is a slight increase in its forecast, from a range of $3.9 billion to $4.2 billion previously. Additionally, the company forecasts distributable cash flow[1] to be in a range of $1.4 billion to $1.7 billion. Overall, this suggests that its business continues to expand, as the LNG market is expected to double between 2018 and 2040, courtesy of a growing worldwide population as well as a shift from legacy fossil fuels (coal and oil) to cleaner energy sources, which include natural gas. Indeed, natural gas is sometimes referred to as a "bridge fuel" because it is recognized that "clean" electricity production methods such as from solar and wind are unable to fully support the current amount of electric consumption. Natural gas is viewed as an acceptable substitute because it produces less emissions than coal and oil, but is also in plentiful supply and can be used to produce electricity on demand. This is critical to renewable energy installations, because they produce interruptible power due to the vicissitudes of weather conditions, and require an 'always-on' source of back-up power.

Exhibit 1: Global LNG Supply Forecast



Source: Company presentation dated March 2021

[1] Distributable cash flow is defined as cash received less interest, taxes and maintenance capital expenditures; essentially, discretionary free cash flow.

Valuation

Considering that Cheniere Energy produced EBITDA of $3.9 billion in the crisis-stricken year of 2020 and forecasts EBITDA of $4.3 billion this year, it could be reasonably estimated that when the pandemic has subsided and its remaining train is completed, EBITDA of $5.0 to $5.5 billion could be achieved. Notably, it will be increasing from seven trains in operation to nine, an almost one-third capacity increase, crudely speaking.

In terms of valuation, large oil and gas pipeline companies could be used as a basis. Similarities between the group and Cheniere include operating in the oil and gas sector, as well as the production of revenue based on throughput. However, there are also differences that could be regarded in favor of Cheniere. For example, some of these peers are structured as limited partnerships, such that their income must be distributed to unitholders and thus require new capital raises in order to expand facilities or to expend maintenance capital. In comparison, Cheniere Energy can utilize its cash flow for any number of endeavors, including further plant expansion, debt repayments, dividends, etc. In that case, Cheniere embodies a growth potential that the pipeline partnerships lack.

At present, the oil and gas pipeline companies, including Plains All American (PAA), Williams Companies (WMB), Enterprise Products Partners (EPD), Magellan Midstream Partners (MMP) and Enbridge Inc. (ENB), trade in a range of approximately 8.8x to 12.2x EBITDA.

Exhibit 2: Peer Group Valuations

Ticker	Company	EV/EBITDA
PAA	Plains All American Pipeline, L.P.	8.8x
WMB	The Williams Companies, Inc.	10.2x
EPD	Enterprise Products Partners L.P.	9.9x
MMP	Magellan Midstream Partners, L.P.	11.3x
ENB	Enbridge Inc.	12.2x
		10.5x

Source: Bloomberg

Were Cheniere Energy's normalized EBITDA of $5.3 billion valued at the average Enterprise Value-to-EBITDA multiple of 10.5x, it would have an enterprise value of $55.65 billion. Deducting $28.77 billion of net debt would result in an equity value of $26.88 billion, or $106.00 per share. This would represent a gain of roughly 42% from the current price level. Even if this were to take two years to achieve, it would translate into a compound return of 19% per annum.

If one were more optimistic of Cheniere Energy's prospects, a multiple of 12.2x, which is the upper end of the peer range, could be applied. In that case, one would arrive at an enterprise value of $64.66 billion. Deducting the net debt would lead to a fair value of $141.58 per share, which would represent an almost doubling of the share price. On the other end, a valuation at the low end of the range—8.8x—results in a share price of $70.49, which is about 5% below the current level. This implies that the shares are fairly valued, at worst, and undervalued by roughly half at the high end.

It should be noted that the company is sufficiently confident of its future cash flow that it intends to begin reducing debt this year by committing to pay down $500 million of outstanding borrowings. This would serve as an additional support to a higher share price in that the company will become a less leveraged entity (and thus a reduced perceived financial risk).

As one exercise to determine the financial value of that cash flow, one could imagine that the company applies all of its free cash flow to the repayment of debt. Based on the expected EBITDA of $5.3 billion when the final two trains are completed, Cheniere Energy might have free cash flow of roughly $1.9 billion. If it could be assumed that the earnings remained static at this level and the resulting cash flow were only used to repay its debt, all of the $28.77 billion debt could be effaced in a little more than 11 years.

This assumes that the interest expense saved during the year is utilized as additional debt repayment in the following year. For example, if the company repaid $1.9 billion in the first year, it would reduce interest expense by roughly $102 million, based on an average interest rate of 5.3%. If those funds were redirected towards additional debt repayment, then in year 2, the total debt repaid would be $2.03 billion ($1.93 billion + $102 million). And so on.

Exhibit 3: Hypothetical Debt Repayment/Equity Value Schedule

	Beginning Net Debt	-	Repayment	=	Ending Net Debt	Interest Saved	Enterprise Value	-	Ending Net Debt	=	Equity Value
Year 1	$ 28,766	-	$ 1,933	=	$ 26,833	$ 102.5	$ 55,650	-	$ 26,833	=	$ 28,817
Year 2	26,833	-	2,035	=	24,798	107.9	55,650	-	24,798	=	30,852
Year 3	24,798	-	2,143	=	22,654	113.6	55,650	-	22,654	=	32,996
Year 4	22,654	-	2,257	=	20,398	119.6	55,650	-	20,398	=	35,252
Year 5	20,398	-	2,377	=	18,021	126.0	55,650	-	18,021	=	37,629
Year 6	18,021	-	2,503	=	15,518	132.7	55,650	-	15,518	=	40,132
Year 7	15,518	-	2,635	=	12,883	139.7	55,650	-	12,883	=	42,767
Year 8	12,883	-	2,775	=	10,108	147.1	55,650	-	10,108	=	45,542
Year 9	10,108	-	2,922	=	7,186	154.9	55,650	-	7,186	=	48,464
Year 10	7,186	-	3,077	=	4,109	163.1	55,650	-	4,109	=	51,541
Year 11	4,109	-	3,240	=	869	171.8	55,650	-	869	=	54,781

($ in millions)

Source: Company reports, Horizon Research

Maintaining the same pipeline group valuation multiple of 10.5x EBITDA (i.e., no increase in the valuation multiple), if the enterprise value in Year 12 is the same, but the $28 billion of debt has been repaid, then the equity value would be yet higher by the $28.7 billion (or effectively an equity market capitalization of $55.6 billion subsequent to year 11). This is because any amount of debt repayment should, all else equal, result in a commensurate increase in the total market capitalization; that is, debt + equity market value = enterprise value. Otherwise, a company that repays debt would bizarrely experience a decrease in its enterprise value even as it is improving its balance sheet and net earnings.

Consequently, one could expect an annualized share price appreciation of approximately 10% per annum. Expressed differently, if Cheniere Energy chose to apply its cash flow to only repay its debt, one could expect a compound annual rate of return of 10%, even absent any improvements in revenues, operating cash flow, or valuation multiples.

Summary and Recommendation

In January 2019, purchase of Cheniere Energy was recommended based on the potential earnings it would generate once its development plans were completed. Since that time, the company has followed through and has nearly completed all of the construction, even through the disruption caused by the coronavirus pandemic. When the company embarks upon the next phase of its business plan, its normalized earnings should increase further from the current level, so that the generation of EBITDA in excess of $5 billion per year could be expected. Thus, were the company to merely trade at a valuation in line with oil and gas pipelines, a price of $106 per share could be envisage, which would imply a return of 42% could be achieved. If a more optimistic, yet still reasonable, valuation multiple is applied, one could experience returns of up to 90%. Consequently, the purchase of Cheniere Energy is reiterated.

CHENIERE ENERGY, INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS
(in millions, except share data)

	December 31, 2020	December 31, 2019
ASSETS		
Current assets		
Cash and cash equivalents	$ 1,628	$ 2,474
Restricted cash	449	520
Accounts and other receivables, net	647	491
Inventory	292	312
Derivative assets	32	323
Other current assets	121	92
Total current assets	3,169	4,212
Property, plant and equipment, net	30,421	29,673
Operating lease assets, net	759	439
Non-current derivative assets	376	174
Goodwill	77	77
Deferred tax assets	489	529
Other non-current assets, net	406	388
Total assets	$ 35,697	$ 35,492
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities		
Accounts payable	$ 35	$ 66
Accrued liabilities	1,175	1,281
Current debt	372	—
Deferred revenue	138	161
Current operating lease liabilities	161	236
Derivative liabilities	313	117
Other current liabilities	2	13
Total current liabilities	2,196	1,874
Long-term debt, net	30,471	30,774
Non-current operating lease liabilities	597	189
Non-current finance lease liabilities	57	58
Non-current derivative liabilities	151	151
Other non-current liabilities	7	11
Commitments and contingencies (see Note 20)		
Stockholders' equity		
Preferred stock, $0.0001 par value, 5.0 million shares authorized, none issued	—	—
Common stock, $0.003 par value, 480.0 million shares authorized		
Issued: 273.1 million shares and 270.7 million shares at December 31, 2020 and 2019, respectively		
Outstanding: 252.3 million shares and 253.6 million shares at December 31, 2020 and 2019, respectively	1	1
Treasury stock: 20.8 million shares and 17.1 million shares at December 31, 2020 and 2019, respectively, at cost	(872)	(674)
Additional paid-in-capital	4,273	4,167
Accumulated deficit	(3,593)	(3,508)
Total stockholders' deficit	(191)	(14)
Non-controlling interest	2,409	2,449
Total equity	2,218	2,435
Total liabilities and stockholders' equity	$ 35,697	$ 35,492

CHENIERE ENERGY, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS
(in millions, except per share data)

	Year Ended December 31,		
	2020	2019	2018
Revenues			
LNG revenues	$ 8,924	$ 9,246	$ 7,572
Regasification revenues	269	266	261
Other revenues	165	218	154
Total revenues	9,358	9,730	7,987
Operating costs and expenses			
Cost of sales (excluding items shown separately below)	4,161	5,079	4,597
Operating and maintenance expense	1,320	1,154	613
Development expense	6	9	7
Selling, general and administrative expense	302	310	289
Depreciation and amortization expense	932	794	449
Impairment expense and loss on disposal of assets	6	23	8
Total operating costs and expenses	6,727	7,369	5,963
Income from operations	2,631	2,361	2,024
Other income (expense)			
Interest expense, net of capitalized interest	(1,525)	(1,432)	(875)
Loss on modification or extinguishment of debt	(217)	(55)	(27)
Interest rate derivative gain (loss), net	(233)	(134)	57
Other income (expense), net	(112)	(25)	48
Total other expense	(2,087)	(1,646)	(797)
Income before income taxes and non-controlling interest	544	715	1,227
Income tax benefit (provision)	(43)	517	(27)
Net income	501	1,232	1,200
Less: net income attributable to non-controlling interest	586	584	729
Net income (loss) attributable to common stockholders	$ (85)	$ 648	$ 471
Net income (loss) per share attributable to common stockholders—basic	$ (0.34)	$ 2.53	$ 1.92
Net income (loss) per share attributable to common stockholders—diluted	$ (0.34)	$ 2.51	$ 1.90
Weighted average number of common shares outstanding—basic	252.4	256.2	245.6
Weighted average number of common shares outstanding—diluted	252.4	258.1	248.0

CHENIERE ENERGY, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
(in millions)

	Year Ended December 31,		
	2020	2019	2018
Cash flows from operating activities			
Net income	$ 501	$ 1,232	$ 1,200
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization expense	932	794	449
Share-based compensation expense	110	131	113
Non-cash interest expense	51	143	74
Amortization of debt issuance costs, premium and discount	114	103	69
Non-cash operating lease costs	291	350	—
Loss on modification or extinguishment of debt	217	55	27
Total losses (gains) on derivatives, net	211	(400)	51
Net cash provided by settlement of derivative instruments	74	138	17
Impairment expense and loss on disposal of assets	6	23	8
Impairment or loss on equity method investments	126	88	—
Deferred taxes	40	(521)	(5)
Repayment of paid-in-kind interest related to repurchase of convertible notes	(911)	—	—
Other	2	—	(5)
Changes in operating assets and liabilities:			
Accounts and other receivables, net	(154)	1	(133)
Inventory	21	11	(73)
Other current assets	(27)	(18)	(15)
Accounts payable and accrued liabilities	54	52	188
Deferred revenue	(23)	22	26
Operating lease liabilities	(277)	(366)	—
Finance lease liabilities	—	1	—
Other, net	(93)	(6)	(1)
Net cash provided by operating activities	1,265	1,833	1,990
Cash flows from investing activities			
Property, plant and equipment, net	(1,839)	(3,056)	(3,643)
Investment in equity method investment	(100)	(105)	(25)
Other	(8)	(2)	14
Net cash used in investing activities	(1,947)	(3,163)	(3,654)
Cash flows from financing activities			
Proceeds from issuances of debt	7,823	6,434	4,285
Repayments of debt	(6,940)	(4,346)	(1,391)
Debt issuance and other financing costs	(125)	(51)	(66)
Debt modification or extinguishment costs	(172)	(15)	(17)
Distributions and dividends to non-controlling interest	(626)	(590)	(576)
Payments related to tax withholdings for share-based compensation	(43)	(19)	(20)
Repurchase of common stock	(155)	(249)	—
Other	3	4	(8)
Net cash provided by (used in) financing activities	(235)	1,168	2,207
Net decrease in cash, cash equivalents and restricted cash	(917)	(162)	543
Cash, cash equivalents and restricted cash—beginning of period	2,994	3,156	2,613
Cash, cash equivalents and restricted cash—end of period	$ 2,077	$ 2,994	$ 3,156

Balances per Consolidated Balance Sheets:

	December 31,	
	2020	2019
Cash and cash equivalents	$ 1,628	$ 2,474
Restricted cash	449	520
Total cash, cash equivalents and restricted cash	$ 2,077	$ 2,994

This report was produced by Horizon Kinetics ("HK"). The following persons employed by HK contributed to this report: Murray Stahl, Chairman, Steven Bregman, President, and Peter Doyle, Managing Director. HK is located at 470 Park Avenue South, New York, NY 10016. At the time of this report, there are no planned updates to the recommendations. To the extend HK has provided previous recommendations concerning the same issuer(s) during the preceding 12-month period, such recommendations do not differ from the recommendations contained here.

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