

# Liquefied Natural Gas

Update

Improving macro environment

General industrials

The Magnolia development remains one of the most competitive LNG development projects (greenfield or brownfield) globally. Industry is starting to recognise that the current LNG oversupply will move towards undersupply within five years and there are few projects on track to fill the resulting gap. This should put Magnolia increasingly in the spotlight for buyers looking to fulfil demand in 2023 onwards. LNGL management has indicated it is in discussions with many companies across a diverse set of geographies and interests. We have adjusted our valuation to account for a delayed expectation of project FID, reducing it slightly to \$A1.25/share (US\$3.8/ADR).

Year end	Total revenues (A\$m)	Reported PBT (A\$m)	Cash from operations (CFO) (A\$m)	Net (debt)/cash (A\$m)	Capex (A\$m)
6/16	7.3	(115.1)	(117.1)	67.2	(0.1)
6/17	0.6	(29.2)	(25.5)	40.3	(0.4)
6/18e	0.0	(28.8)	(22.8)	10.9	(6.6)
6/19e	57.7	22.4	32.4	(956.2)	(999.5)

Note: Historical figures are as reported

## Market sentiment has improved

LNGL has suffered over the recent few years as a glut of spot LNG supply (and low spot crude prices) have cast shade on LNG markets. However, with spot prices (oil and LNG) improving and a consensus building that the oversupply will end in the early 2020s, we see much to be optimistic about. The Magnolia project is shovel ready (well ahead of many of its US peers) and continues to offer buyers a fast and cheaper alternative to other projects. The management continues to stress its marketing efforts and is discussing the project with many buyers including major oil companies and traders.

## Valuation has room to move with milestones

As and when the project gains binding tolling agreements and moves towards FID, we expect investors to de-risk their expectations for the company, pushing shares higher. Peer metrics suggest that once in production, Magnolia's substantial cashflow should generate share values significantly higher than the current price. In addition, Bear Head remains in a good position with all relevant permits/approvals allowing future design fine tuning and gas supply agreements to be sought before sanction (the company believes it is around a year behind Magnolia in terms of designs).

## Valuation: Value reduced slightly to \$A1.25/share

We have adjusted our valuation to account for actual cash balances and move our expectations of the timing for project FID and construction outwards given how long it has taken to move towards binding off-take agreements and management's current thoughts on when agreements will be signed. These changes result in a reduction in our risk-adjusted valuation to \$A1.25/share (US\$3.8/ADR), well above current share/ADR prices, while longer-term valuations are materially above these.

29 November 2017

**Price** **A\$0.49**
**Market cap** **A\$251m**

US\$/A\$1.3

Cash (A\$m) as of end September 2017 38.2

Shares in issue 513m

Free float 92%

Code LNGL

Primary exchange ASX

Secondary exchange OTX

### Share price performance



% 1m 3m 12m

Abs 14.0 (9.3) (25.2)

Rel (local) 12.1 (13.7) (31.8)

52-week high/low A\$1.0 A\$0.4

### Business description

Liquefied Natural Gas Ltd is an ASX-listed company devoted to the development of LNG export terminals in the US and Canada. It has traded ADRs.

### Next events

Binding offtake agreements signed 2018

Final investment decision 2018

### Analyst

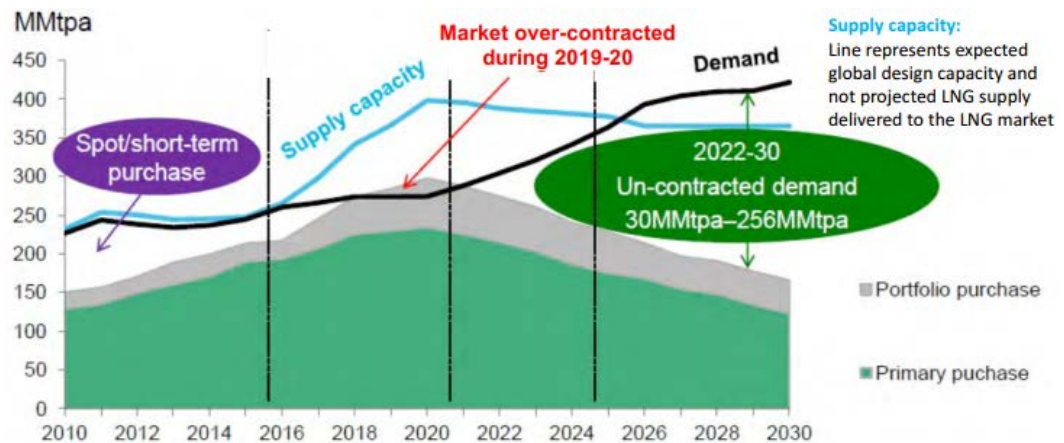
Will Forbes +44 (0)20 3077 5749

[industrials@edisongroup.com](mailto:industrials@edisongroup.com)
[Edison profile page](#)

**Liquefied Natural Gas is a  
research client of Edison  
Investment Research Limited**

## Macro environment has improved, as has the market sentiment over LNG

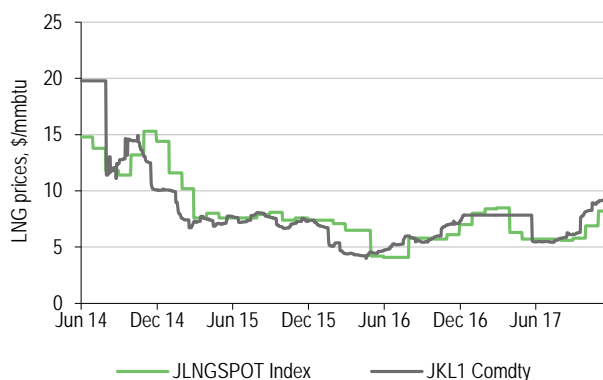
**Exhibit 1: LNG supply glut ending in early 2020s**



Source: Bloomberg New Energy Finance (2017) and LNGL

LNG prices have remained subdued in recent years as low Brent prices (upon which many LNG price contracts are based) combined with increasing supply. Using Japanese LNG prices as an example, realisations fell from around \$15/mmbtu in 2014 to below \$5 in 2016. Prices since then remained range bound below c \$7.5/mmbtu, which has meant that LNGL's negotiations with buyers for its Magnolia project did not progress as hoped. LNG buyers have been loath to contract long-term volumes at prices well above current spot prices, while low LNG prices do not generate high enough returns to motivate construction.

**Exhibit 2: Japanese spot LNG prices have recovered**



Source: Bloomberg

**Exhibit 3: Brent spot pricing has improved**



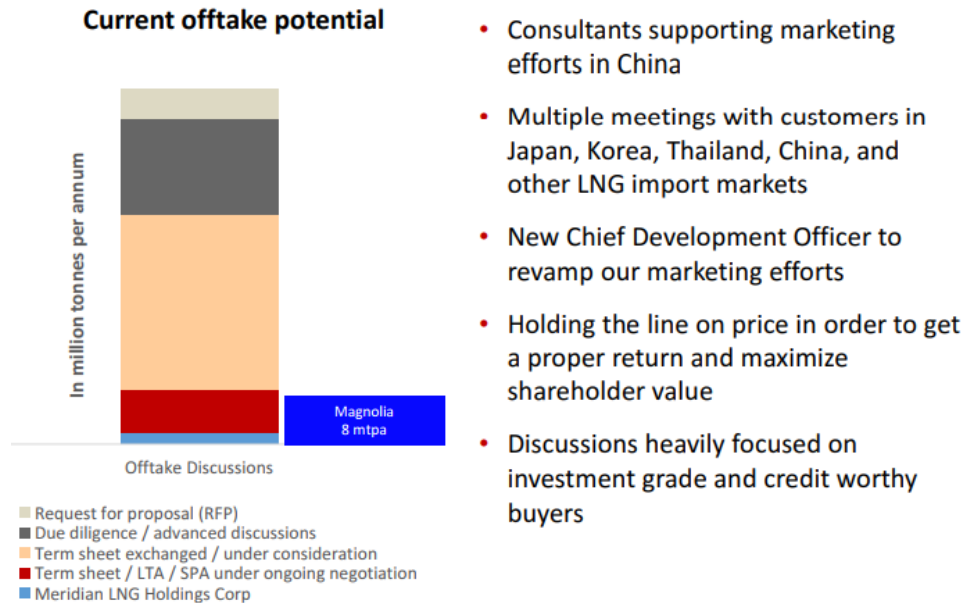
Source: Bloomberg

However, the recent pick up in oil prices has coincided with a growing acceptance that the supply glut will fade in the early 2020s, with few (if any) new projects coming online to fill the gap. As a result, the company has indicated its negotiations over tolling agreements cover many multiples of Magnolia's 8mtpa capacity (see Exhibit 4 below), and include a range of companies (international oil companies, utilities, traders etc). During the data room process, no companies have raised objections to the technical aspects of the project.

The time to build new facilities on greenfield or brownfield sites (around four to five years) implies a growing imperative for buyers to commit to contracts to allow facilities to be built in time. Magnolia has been rated (by World Gas Intelligence) as the second best positioned project (behind Corpus

Christi Train 3) in the US, and is well ahead of its greenfield peers in permitting and cost. We expect the company to execute binding agreements during 2018 (although an agreement in 2017 is not out of the question). Once the first 'anchor' agreement is signed, the company expects a number of others to come forward.

#### Exhibit 4: Volumes of offtake with potential customers far exceed Magnolia's capacity

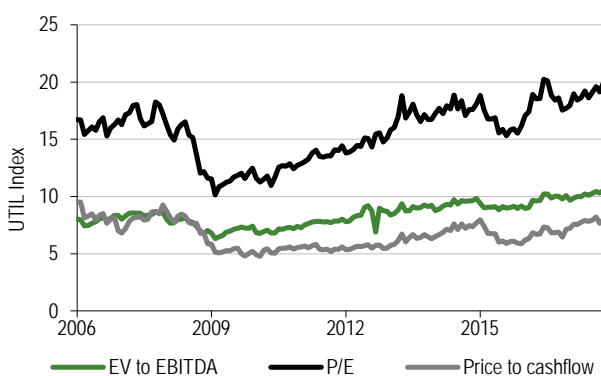


Source: LNGL

## Valuation

Longer-term valuation metrics for peers (utilities and pipeline companies in the US) remain strong, suggesting material upside for the shares as and when the project hits its milestones. We assume a tolling fee of \$2.4/mmbtu which would produce gross fees of around US\$900m. Cash flows of this magnitude would imply significant share price increases from current levels using cashflow metrics.

#### Exhibit 5: Multiples of US utilities are historically high

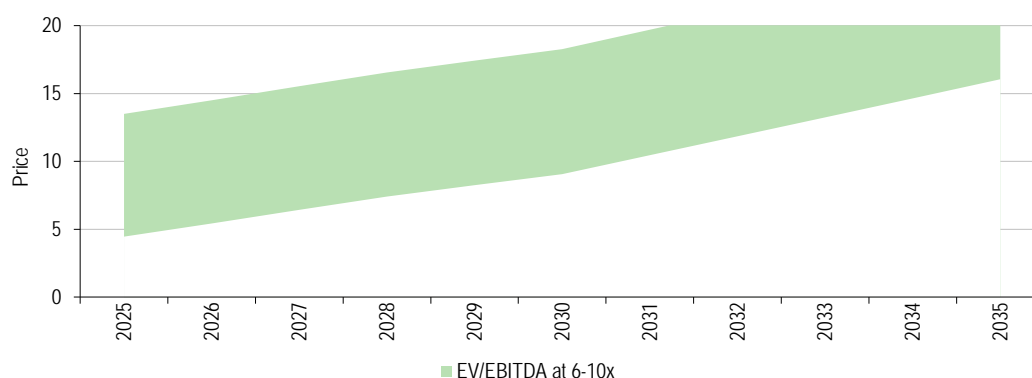


Source: Bloomberg

#### Exhibit 6: Dividend yields for US utilities are low



Source: Bloomberg

**Exhibit 7: Longer-term valuation expectations using EV/EBITDA multiples**


Source: Edison Investment Research. Note: Assumes 100% equity ownership of the project and includes only Magnolia project cashflows.

Given the uncertainty of timing on the project, we continue to use a risk-adjusted DCF approach. We have adjusted our modelling assumptions to account for a refreshed view on timings for Magnolia and reported cash figures. We model first LNG deliveries at Magnolia in H223, a delay from previous expectations (a few months' delay at Bear Head). This produces a slight reduction in our valuation from A\$1.37/share (US\$4.19/ADR) to A\$1.25/share (US\$3.79/ADR).

**Exhibit 8: Valuation summary**

Asset	Country	WI	CoS	Absolute	Riskd	Riskd
		%	%	US\$m	A\$/share	US\$/ADR
Net (debt)/cash (June 2017)				34	0.09	0.26
G&A (includes share based payments)				(49)	(0.13)	(0.38)
Project development costs July 2017 to June 2018				(5)	(0.01)	(0.04)
Magnolia Trains 1-4	United States	100%	60%	408	1.06	3.19
Bear Head Trains 1-4	United States	100%	15%	97	0.25	0.76
NAV				485	1.25	3.79

Source: Edison Investment Research

## Financials

The management continues to manage costs as far as possible, although cash needs to be spent on marketing the Magnolia project to achieve a binding tolling agreement and FID. Very little is required on project costs, as Magnolia's design is now ready and awaiting project progress on offtake and financing. Management has stated it expects the current cash reserves to last until the end of 2018. It is therefore possible that the company may need to return to the market over the next 12 months if the project does not develop as anticipated, which could see shareholder dilution.

BNP Paribas recently announced it would no longer support oil and gas developments and as a result, LNG will have to develop relationships with new lenders to provide debt financing. Given the project cashflows, and the investment quality of Magnolia's expected customers, management does not believe that it will encounter many difficulties in attracting another debt partner.

**Exhibit 9: Financial summary**

Accounts: IFRS, Yr end: June, AUD: Millions	2013	2014	2015	2016	2017	2018E	2019E
<b>Total revenues</b>	0	0	8	7	1	0	58
Cost of sales	0	0	0	0	0	0	(3)
<b>Gross profit</b>	0	0	8	7	1	0	55
SG&A (expenses)	(3)	(3)	(8)	(19)	(14)	(14)	(14)
R&D costs	0	0	0	0	0	0	0
Other income/(expense)	(11)	(20)	(72)	(89)	(14)	(9)	(9)
Exceptionals and adjustments	0	(1)	(15)	(14)	(3)	(6)	(10)
Depreciation and amortisation	(0)	(0)	(0)	(0)	(0)	(0)	(0)
<b>Reported EBIT</b>	<b>(14)</b>	<b>(24)</b>	<b>(87)</b>	<b>(116)</b>	<b>(30)</b>	<b>(29)</b>	<b>22</b>
Finance income/(expense)	0	(1)	1	1	0	0	0
Other income/(expense)	0	0	0	0	0	0	0
<b>Reported PBT</b>	<b>(13)</b>	<b>(25)</b>	<b>(86)</b>	<b>(115)</b>	<b>(29)</b>	<b>(29)</b>	<b>22</b>
Income tax expense (includes exceptionals)	0	0	(0)	0	(0)	0	0
<b>Reported net income</b>	<b>(13)</b>	<b>(25)</b>	<b>(86)</b>	<b>(115)</b>	<b>(29)</b>	<b>(29)</b>	<b>22</b>
Basic average number of shares, m	268	334	464	503	513	513	513
Basic EPS	(0.05)	0.00	(0.19)	(0.23)	(0.06)	(0.06)	0.04
<b>Balance sheet</b>							
Property, plant and equipment	0	0	12	12	12	18	968
Intangible assets	0	0	0	0	0	0	50
Other non-current assets	0	0	0	0	0	0	0
<b>Total non-current assets</b>	<b>1</b>	<b>0</b>	<b>12</b>	<b>12</b>	<b>12</b>	<b>19</b>	<b>1,018</b>
Cash and equivalents	2	48	47	67	40	11	145
Inventories	0	0	0	0	0	0	0
Trade and other receivables	0	0	2	1	0	0	0
Other current assets	1	3	135	5	5	5	5
<b>Total current assets</b>	<b>3</b>	<b>51</b>	<b>185</b>	<b>73</b>	<b>45</b>	<b>16</b>	<b>149</b>
Non-current loans and borrowings	0	0	0	0	0	0	1,101
Other non-current liabilities	0	0	0	0	0	0	0
<b>Total non-current liabilities</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>1,101</b>
Trade and other payables	1	3	14	3	2	2	2
Current loans and borrowings	0	1	0	0	0	0	0
Other current liabilities	0	0	1	1	0	0	0
<b>Total current liabilities</b>	<b>1</b>	<b>4</b>	<b>15</b>	<b>4</b>	<b>3</b>	<b>3</b>	<b>3</b>
Equity attributable to company	2	48	182	81	55	32	64
Non-controlling interest	(0)	(0)	(0)	(0)	(0)	(0)	(0)
<b>Cashflow statement</b>							
<b>Profit for the year</b>	<b>(13)</b>	<b>(25)</b>	<b>(86)</b>	<b>(115)</b>	<b>(29)</b>	<b>(29)</b>	<b>22</b>
Depreciation and amortisation	0	0	0	0	0	0	0
Share based payments	(0)	0	15	14	3	6	10
Other adjustments	5	1	(7)	(7)	2	0	0
Movements in working capital	0	2	9	(10)	(0)	0	0
Income taxes paid	0	0	0	0	0	0	0
<b>Cash from operations (CFO)</b>	<b>(8)</b>	<b>(22)</b>	<b>(70)</b>	<b>(117)</b>	<b>(25)</b>	<b>(23)</b>	<b>32</b>
Capex	(0)	(0)	(12)	(0)	(0)	(7)	(999)
Acquisitions & disposals net	0	0	0	0	0	0	0
Other investing activities	2	(2)	(132)	131	0	0	0
<b>Cash used in investing activities (CFIA)</b>	<b>2</b>	<b>(2)</b>	<b>(143)</b>	<b>130</b>	<b>(0)</b>	<b>(7)</b>	<b>(999)</b>
Net proceeds from issue of shares	0	70	205	0	1	0	0
Movements in debt	0	0	0	0	0	0	1,101
Other financing activities	(0)	(0)	(0)	(0)	(0)	(0)	(0)
<b>Cash from financing activities (CFF)</b>	<b>(0)</b>	<b>70</b>	<b>205</b>	<b>0</b>	<b>1</b>	<b>(0)</b>	<b>1,101</b>
Increase/(decrease) in cash and equivalents	(5)	46	(8)	14	(25)	(29)	134
Currency translation differences and other	0	(0)	7	7	(2)	0	0
<b>Cash and equivalents at end of period</b>	<b>2</b>	<b>48</b>	<b>47</b>	<b>67</b>	<b>40</b>	<b>11</b>	<b>145</b>
Net (debt) cash	2	47	47	67	40	11	(956)

Source: Company data, Edison Investment Research

Edison is an investment research and advisory company, with offices in North America, Europe, the Middle East and AsiaPac. The heart of Edison is our world-renowned equity research platform and deep multi-sector expertise. At Edison Investment Research, our research is widely read by international investors, advisers and stakeholders. Edison Advisors leverages our core research platform to provide differentiated services including investor relations and strategic consulting. Edison is authorised and regulated by the [Financial Conduct Authority](#). Edison Investment Research (NZ) Limited (Edison NZ) is the New Zealand subsidiary of Edison. Edison NZ is registered on the New Zealand Financial Service Providers Register (FSP number 247505) and is registered to provide wholesale and/or generic financial adviser services only. Edison Investment Research Inc (Edison US) is the US subsidiary of Edison and is regulated by the Securities and Exchange Commission. Edison Investment Research Pty Limited (Edison Aus) [46085869] is the Australian subsidiary of Edison. Edison Germany is a branch entity of Edison Investment Research Limited [4794244]. [www.edisongroup.com](http://www.edisongroup.com)

#### DISCLAIMER

Copyright 2017 Edison Investment Research Limited. All rights reserved. This report has been commissioned by Liquefied Natural Gas and prepared and issued by Edison for publication globally. All information used in the publication of this report has been compiled from publicly available sources that are believed to be reliable, however we do not guarantee the accuracy or completeness of this report. Opinions contained in this report represent those of the research department of Edison at the time of publication. The securities described in the Investment Research may not be eligible for sale in all jurisdictions or to certain categories of investors. This research is issued in Australia by Edison Investment Research Pty Ltd (Corporate Authorised Representative (1252501) of Myonlineadvisers Pty Ltd (AFSL: 427484)) and any access to it, is intended only for "wholesale clients" within the meaning of the Corporations Act 2001 of Australia. The Investment Research is distributed in the United States by Edison US to major US institutional investors only. Edison US is registered as an investment adviser with the Securities and Exchange Commission. Edison US relies upon the "publishers' exclusion" from the definition of investment adviser under Section 202(a)(11) of the Investment Advisers Act of 1940 and corresponding state securities laws. As such, Edison does not offer or provide personalised advice. We publish information about companies in which we believe our readers may be interested and this information reflects our sincere opinions. The information that we provide or that is derived from our website is not intended to be, and should not be construed in any manner whatsoever as, personalised advice. Also, our website and the information provided by us should not be construed by any subscriber or prospective subscriber as Edison's solicitation to effect, or attempt to effect, any transaction in a security. The research in this document is intended for New Zealand resident professional financial advisers or brokers (for use in their roles as financial advisers or brokers) and habitual investors who are "wholesale clients" for the purpose of the Financial Advisers Act 2008 (FAA) (as described in sections 5(c) (1)(a), (b) and (c) of the FAA). This is not a solicitation or inducement to buy, sell, subscribe, or underwrite any securities mentioned or in the topic of this document. This document is provided for information purposes only and should not be construed as an offer or solicitation for investment in any securities mentioned or in the topic of this document. A marketing communication under FCA Rules, this document has not been prepared in accordance with the legal requirements designed to promote the independence of investment research and is not subject to any prohibition on dealing ahead of the dissemination of investment research. Edison has a restrictive policy relating to personal dealing. Edison Group does not conduct any investment business and, accordingly, does not itself hold any positions in the securities mentioned in this report. However, the respective directors, officers, employees and contractors of Edison may have a position in any or related securities mentioned in this report. Edison or its affiliates may perform services or solicit business from any of the companies mentioned in this report. The value of securities mentioned in this report can fall as well as rise and are subject to large and sudden swings. In addition it may be difficult or not possible to buy, sell or obtain accurate information about the value of securities mentioned in this report. Past performance is not necessarily a guide to future performance. Forward-looking information or statements in this report contain information that is based on assumptions, forecasts of future results, estimates of amounts not yet determinable, and therefore involve known and unknown risks, uncertainties and other factors which may cause the actual results, performance or achievements of their subject matter to be materially different from current expectations. For the purpose of the FAA, the content of this report is of a general nature, is intended as a source of general information only and is not intended to constitute a recommendation or opinion in relation to acquiring or disposing (including refraining from acquiring or disposing) of securities. The distribution of this document is not a "personalised service" and, to the extent that it contains any financial advice, is intended only as a "class service" provided by Edison within the meaning of the FAA (ie without taking into account the particular financial situation or goals of any person). As such, it should not be relied upon in making an investment decision. To the maximum extent permitted by law, Edison, its affiliates and contractors, and their respective directors, officers and employees will not be liable for any loss or damage arising as a result of reliance being placed on any of the information contained in this report and do not guarantee the returns on investments in the products discussed in this publication. FTSE International Limited ("FTSE") © FTSE 2017. "FTSE®" is a trade mark of the London Stock Exchange Group companies and is used by FTSE International Limited under license. All rights in the FTSE indices and/or FTSE ratings vest in FTSE and/or its licensors. Neither FTSE nor its licensors accept any liability for any errors or omissions in the FTSE indices and/or FTSE ratings or underlying data. No further distribution of FTSE Data is permitted without FTSE's express written consent.