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 risked 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

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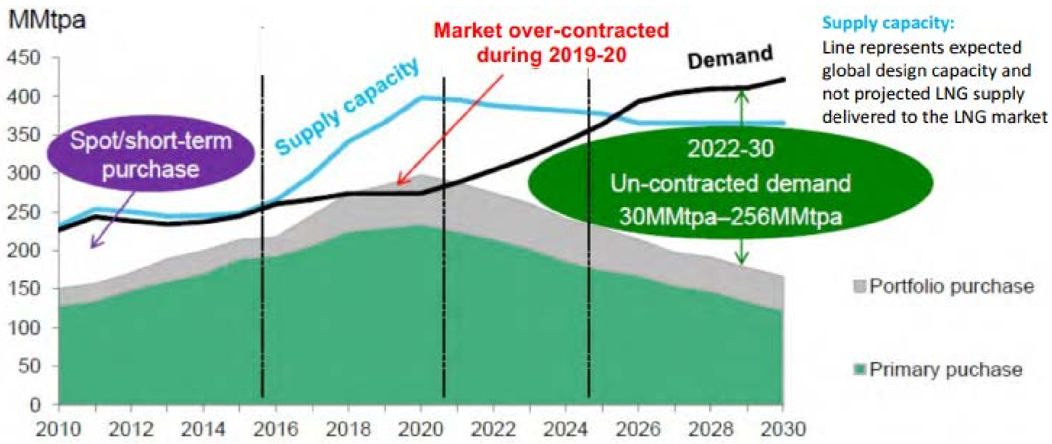
Macro environment has improved, as has the market sentiment over LNG

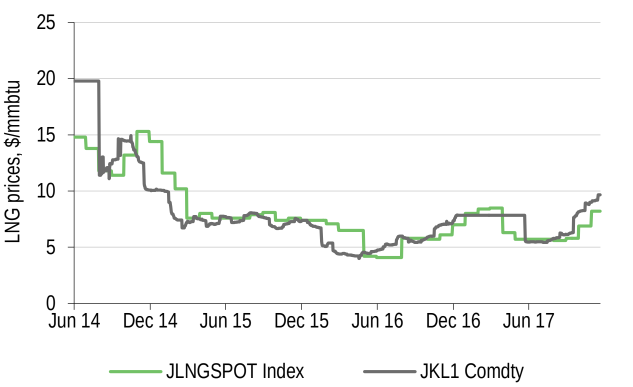
Exhibit 1: LNG supply glut ending in early 2020s



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

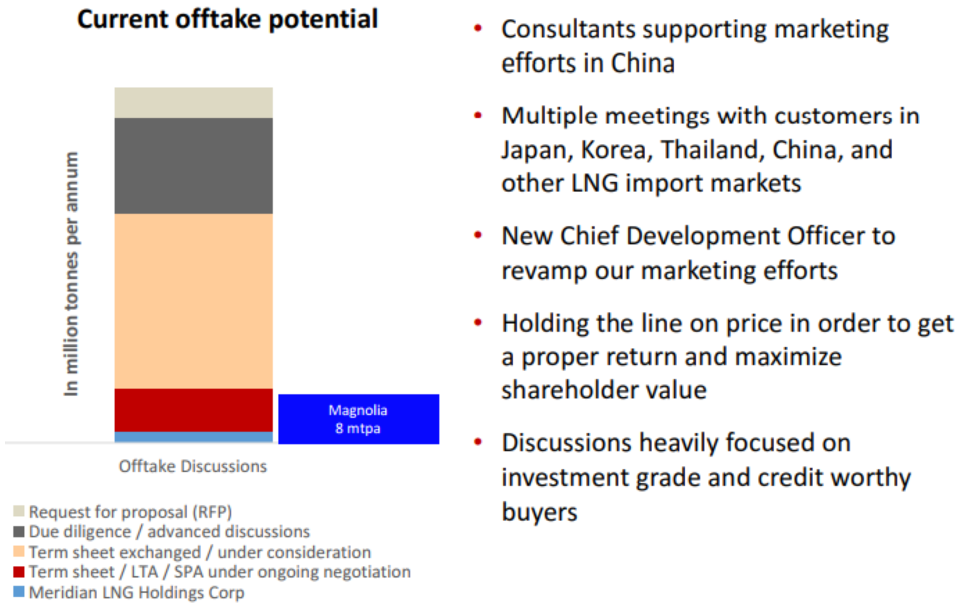
Source: Bloomberg

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

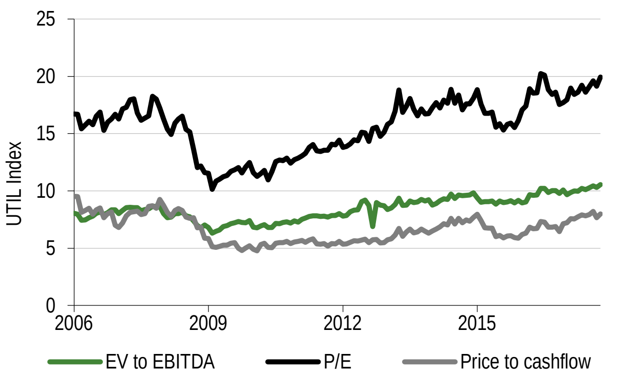


Source: LNGL

Valuation

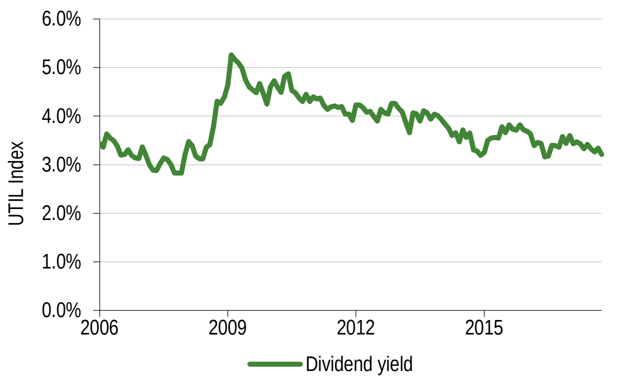
Longer-term valuation metrics for peers (utilities and pipeline companies in the US) remain strong, suggesting material upside for the shares as and when the project hits its milestones. We assume a tolling fee of $2.4/mmbtu which would produce gross fees of around US$900m. Cash flows of this magnitude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

Exhibit 5: Multiples of US utilities are historically high



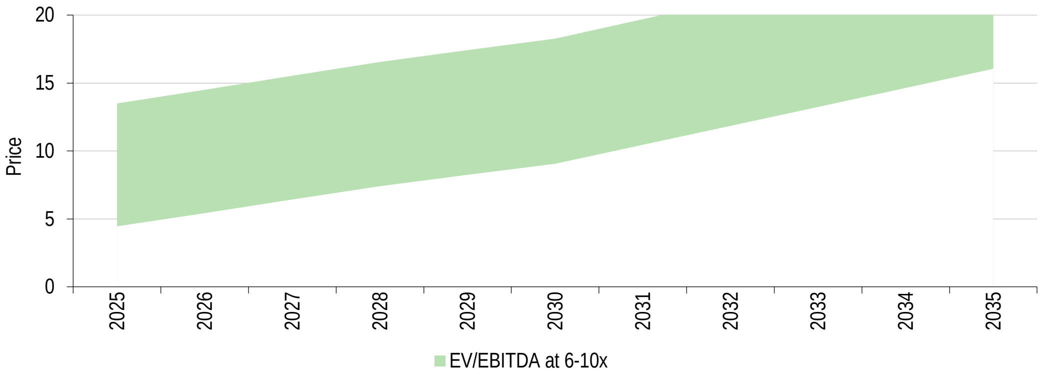
Source: Bloomberg

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 risked 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	Risked	Risked
		%	%	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, LNGL 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
Total revenues	0	0	8	7	1	0	58
Cost of sales	0	0	0	0	0	0	(3)
Gross profit	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)
Reported EBIT	(14)	(24)	(87)	(116)	(30)	(29)	22
Finance income/(expense)	0	(1)	1	1	0	0	0
Other income/(expense)	0	0	0	0	0	0	0
Reported PBT	(13)	(25)	(86)	(115)	(29)	(29)	22
Income tax expense (includes exceptionals)	0	0	(0)	0	(0)	0	0
Reported net income	(13)	(25)	(86)	(115)	(29)	(29)	22
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
Balance sheet							
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
Total non-current assets	1	0	12	12	12	19	1,018
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
Total current assets	3	51	185	73	45	16	149
Non-current loans and borrowings	0	0	0	0	0	0	1,101
Other non-current liabilities	0	0	0	0	0	0	0
Total non-current liabilities	0	0	0	0	0	0	1,101
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
Total current liabilities	1	4	15	4	3	3	3
Equity attributable to company	2	48	182	81	55	32	64
Non-controlling interest	(0)	(0)	(0)	(0)	(0)	(0)	(0)
Cashflow statement							
Profit for the year	(13)	(25)	(86)	(115)	(29)	(29)	22
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
Cash from operations (CFO)	(8)	(22)	(70)	(117)	(25)	(23)	32
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
Cash used in investing activities (CFIA)	2	(2)	(143)	130	(0)	(7)	(999)
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)
Cash from financing activities (CFF)	(0)	70	205	0	1	(0)	1,101
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
Cash and equivalents at end of period	2	48	47	67	40	11	145
Net (debt) cash	2	47	47	67	40	11	(956)

Source: Company data, Edison Investment Research

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