Gasol

LNG project

Edison investment research

Build it and they will come

Oil & gas

We believe Gasol could be close to its first liquefied natural gas (LNG) re-gasification project. As stated in a recent media report, the company has signed Memorandums of Understanding (MoU) to provide gas to a Middle Eastern country and Benin and Togo (it continues negotiations elsewhere). We have therefore explored what a potential smaller-scale project could look like and examined the main drivers to value creation. Our illustrative, theoretical modelling indicates that a project in a benign marine environment close to existing gas infrastructure (possible in the Middle East) could generate value well above Gasol's market cap for a restricted initial capital outlay. First revenues could come in 2014 and would be the first step in Gasol's larger strategy of supplying gas to gas-hungry West African markets.

Year end	Revenue (£m)	EBITDA* (£m)	PBT* (£m)	Debt (£m)	Net (debt) cash (£m)	Capex (£m)
02/11	0.1	(2.1)	(2.4)	(2.8)	(2.6)	0
02/12	0.1	(1.7)	(2.0)	(2.1)	(1.9)	0
02/13e	0.1	(2.5)	(2.8)	(4.1)	(4.2)	0

Note: *PBT and EPS are normalised, excluding intangible amortisation and exceptional items.

First LNG project could be close, demand is strong

Gasol recently acquired the option for a number of gas development projects in West Africa and elsewhere. Recent strengthening of its management team and press reports indicate that the company is willing and able to launch its first project. Margins between LNG and other energy sources such as diesel are such that provision of LNG would be beneficial to West African markets, which are forecast to continue to grow strongly in coming years.

Valuation creation with restricted capital outlay

Our illustrative project has low capex requirements; floating storage and regasification units (FSRUs) would be leased, while initial capital requirements would be determined by proximity to gas infrastructure and harbour requirements, but could be low (we tentatively estimate $10-15m). By entering long-term contracts with large or government-backed gas companies (with additional credit enhancement if necessary), Gasol will be able to reduce risk and attract financing that could cover the majority of initial capital requirements, leaving only perhaps 20% of cash needed from equity.

Valuation: First project could be strongly positive

Our analysis is a first look at possible drivers for a project and we will have to wait until a deal is announced for further details. However, it is clear that overall market pricing and demand are not impediments to these projects and that the company could create significant value by supplying LNG to gas-starved markets. Our first blush analysis indicates that an NPV@15% of over $15m is possible, with an equity contribution of as little as $1-3m, with first revenues possible in 2014 if a deal is announced soon (as the company is hoping). We look forward to the company announcing a first deal, but until this is done we do not ascribe any value. We leave our forecasts and valuation unchanged.

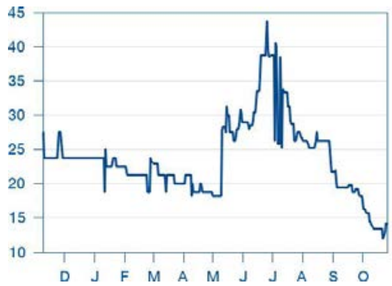
Gasol is a research client of Edison Investment Research Limited

29 October 2012

Price	14.25p
Market cap	£5m

Shares in issue	32.4m
Free float	N/A
Code	GAS
Primary exchange	AIM
Other exchanges	N/A

Share price performance



%	1m	3m	12m
Abs	(31.7)	(56.8)	(55.0)
Rel (local)	(32.3)	(58.8)	(59.4)
52-week high/low		43.75p	13.5p

Business description

Gasol seeks to source and provide gas to West Africa through LNG projects or gas developments. It also plans to invest in infrastructure and power generation plants.

Next events

Project announcement	2012/2013

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Investment summary

Company description: Looking forward to a first project

In recent months, the company has taken a number of steps towards rolling out its strategy to supply gas to African markets in need. While its long-term goal of supplying gas from its own assets is still a long way off, a look at recent newsflow indicates that an intermediate project of LNG supply could be near.

Exhibit 1: Recent Gasol events

Date	Notes
29 Oct 2012	Company announces signing of MoU for COGAZ to supply gas to the electric authority of Benin and Togo via a FSRU.
16 Oct 2012	Article in media about possible LNG projects in West Africa and Middle East (www.proactiveinvestors.com) gives details on potential scenarios and costs.
12 Sep 2012	50:1 reverse share split
03 Sep 2012	Contract with Benin (see our note "On your marks, get set…"). Gasol formed JV with BenGaz to develop gas infrastructure and gas supply in Benin. All gas sold by the JV will be provided by Gasol (or affiliate). Gasol will provide management assistance in BenGaz's stake in the West African Gas Pipeline (WAGP).
28 Aug 2012	Gasol agree to option to acquire African Power Generation Limited, which is developing a number of gas projects in Africa and elsewhere.
28 Aug 2012	£2.5m convertible loan facility.
26 Jul 2012	New Chairman appointed.

Source: Gasol, Edison Investment Research

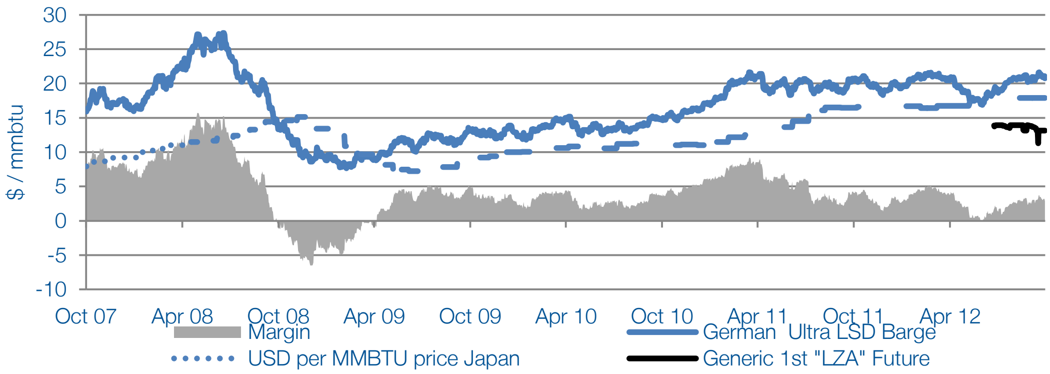
As a result, we believe it would be useful to flesh out a theoretical model on what a potential FSRU project would look like. How much value could investors expect Gasol to create, and for what outlay?

Margins to be made in LNG markets in gas-starved markets

As we made note of in our last note on Gasol (*On your marks, get set…* 5 September 2012), the company is targeting a number of markets which would benefit from the supply of gas via regasification of LNG (re-gas). Benin, Togo and Ghana are all countries experiencing significant growth in GDP and where gas demand is significant.

Gasol will be able to generate value when the gas can be supplied at a lower price than the existing energy supply – in this case liquid fuels such as diesel. Exhibit 2, below, illustrates that the margin between LNG and diesel prices is wide. Under this scenario, gas is both cheaper and cleaner for the industrial and power customers and has other advantages such as lower maintenance costs; as long as the infrastructure is in place customers will demand the gas. Build it, and they will come.

Exhibit 2: Prices of diesel and LNG with resulting margin between ($/mcf basis)



Source: Bloomberg. Note: The Japanese LNG pricing is one of few long term LNG prices generally available. A comparison with the Generic LZA future (LNG future), indicates that there is a larger delta between diesel equivalent prices and LZA than the margin between Japanese LNG import and diesel equivalent prices, giving extra potential for pricing headroom when Gasol is supplying customers.

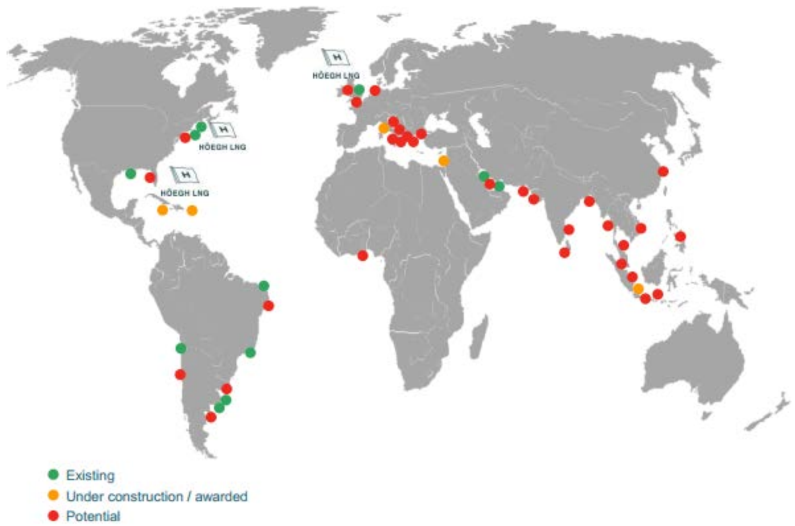
FSRUs and re-gasification

FSRUs provide a quick and flexible solution to gas supply needs. A typical project takes 12 months from final investment decision (FID) to operation according to Excelerate, far quicker than a land-based alternative. As such, Gasol could have a real chance of first revenues from a project in early 2014 should a deal be announced in Q412. Company statements in proactiveinvestors.com indicate that they are hopeful of similar timing.

FSRUs are generally older LNG supply ships that have been converted to add a regasification unit, although new builds are an increasing part of the picture. Companies such as Golar, Excelerate and Höegh can all supply FSRUs for lease.

FSRUs are moored in a still deepwater port or river during their contract term and connected to a country's infrastructure to supply regasified natural gas into the network. LNG is supplied periodically to the FSRU by LNG supply ships (for a video of this process please see the video on Excelerate Energy's Escobar project), with LNG deliveries occurring as often as necessary. The offloading capacity of FSRUs can vary significantly – Excelerate Energy's ships range from 50-800mmscf/d for example.

Exhibit 3: Global FSRU projects, June 2011



Source: Höegh

Project considerations and indicative assumptions

The main points that we have assumed are:

- Gasol will source LNG from a global trading house and sell to a country gas supplier.
- It will be leasing an FSRU, rather than buying it. This will lead to relatively lower capital costs but higher operating costs. For our modelling, we assume a relatively small FSRU with flow rates of 150mmscfd. We note that press reports (Jakarta Globe, August 2012) indicate that the Nusantara Regas (capacity 400mmscfd) will have a day rate of $190k.
- Capex will be limited to costs outside of the FSRU, including the setting-up of jetty facilities, breakwaters, pipelines, dredging, environmental studies and control systems. Capex will therefore vary depending on the level and complexity of the construction of these facilities. In benign environments, where waters are generally calm (or harbour facilities already exist) and an existing gas pipeline to customers is nearby, the capex will be low. We believe approvals and permits on any necessary work will be approved relatively quickly given the government involvement in approving the LNG regasification project in the first place.
- We have assumed a 10-year contract term – a standard duration within the industry. Save from extreme cases, FSRUs are not the cheapest long-term solution. If countries require gas supply without the possibility of native gas supplies or imported piped gas, onshore facilities will likely be cheaper over multi-decade timescales. Contracts can always be renewed if required, although we have not assumed this in our modelling.
- Gasol will buy LNG in the market, the price of which is assumed to be linked to the prevailing oil price (in this case Brent). Sales prices will be negotiated, but are likely to be constrained by prices of alternatives (in the case of West Africa, fuel oil/petrol/diesel) and competitive pressures. As discussed above, this current price margin is significant and opens the opportunity for LNG re-gas projects. The company has said it will not take pricing risk on the LNG, so we would expect it would enter long-term contracts for the supply of the LNG too, at a discount to the prevailing spot market.
- Gasol was reported in Proactive Investors that a potential deal is open within the Middle East. It has signed an MoU "with a national government to begin providing gas in the first quarter of 2014". The company also stated that it is in advanced negotiations with an African government to

supply 150-400mmscf/d of gas. The company has worked hard to develop relationships with suppliers and traders for sourcing LNG, according to the article in Proactive Investors.

Valuation

The analysis presented here is an illustration of potential value that could be created by a small-scale LNG project, such as one we believe that Gasol may execute. As such, until a deal is announced and further detail given to the market on volumes, prices and financing arrangements, we leave our company valuation unchanged, albeit with the view that value could be created and included in our NAV in the future.

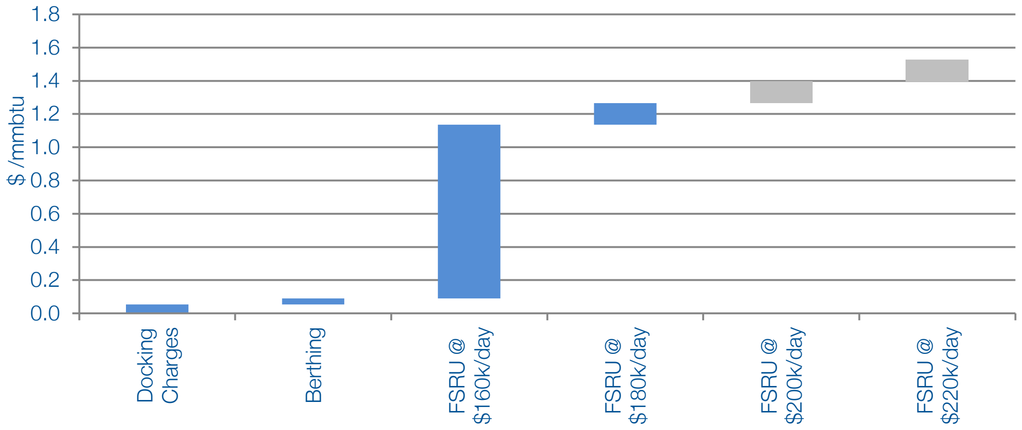
We examine such a theoretical project on a bottom-up basis, assuming costs and deriving a required margin to pass benchmarks and create value. Our analysis indicates that the over-arching supply and demand of gas in Africa and elsewhere will enable Gasol to sell gas at a profit and make good returns. We believe that the delta between the latent gas demand and current supply is not the main driver to determine returns – the gap between LNG prices and diesel is very wide. Instead, competitive pressures from other companies will determine returns.

We tentatively believe that Gasol could generate an NPV@15% for a project of between $15-25m, based on an initial capital requirement of $10-15m, of which Gasol could contribute $1-3m (assuming financing from development banks), though this is sensitive to small changes in achieved margins.

Project costs and margins

The company indicated in the Proactive Investors article that it expects a day rate of $180k/day for the FSRU. In the article, it also indicates that it is in advanced negotiations to supply an African country with between 150-400mmscf/d of gas. Our indicative project modelling assumes a throughput of 150mmscfd. Other opex costs are smaller – docking charges for LNG transfer are assumed at $150k/day (typical LNG tanker rates), while we estimate berthing costs for the FSRU run to $2m per year. Based on a 150mmscf/d throughput of gas the following opex base can be generated (on a per mmbtu basis). Gasol thus needs to charge a margin of between $1.1-1.5/mmbtu to reach cashflow breakeven in our 2014 snapshot scenario (depending on the FSRU day rates). We ignore the minimal capex costs of around $10-15m in this analysis; capex accounts for less than 1.5% of the overall opex bill of over $800m. The ability of Gasol to source the gas on a long-term basis will be key.

Exhibit 4: Opex build up

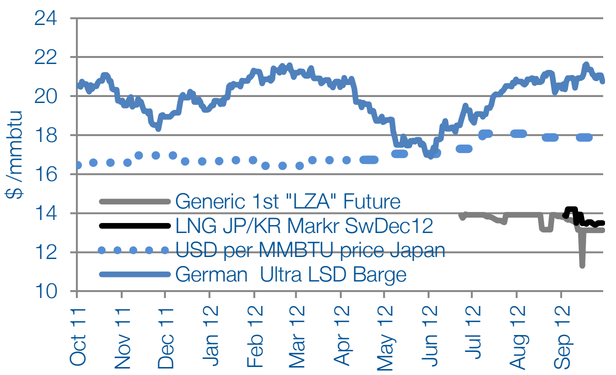


Source: Edison Investment Research

Long-term pricing and margin achievements

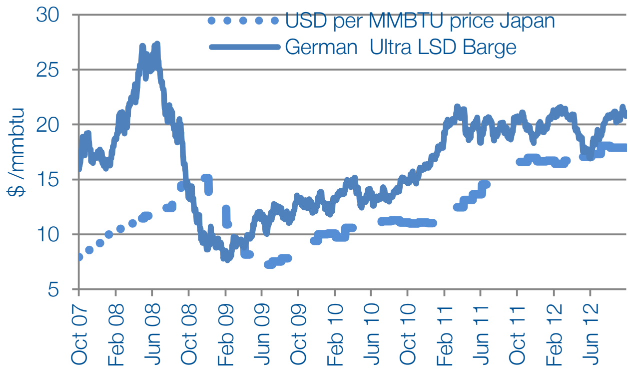
The value due to Gasol will therefore be a function of the pricing it is able to demand above this figure. An initial look at the diesel equivalent pricing indicates that the company has headroom for strong negotiation with customers if the only alternative fuel is diesel and prices remain where they are currently – there is more than a $6/mcf delta between diesel equivalent prices and Asia LNG prices (closest listed LNG pricing). However, projects are not sanctioned on current selling prices and will likely be negotiated based on a conservative view of future prices and the returns that projects would achieve. As is illustrated by Exhibit 7, the gas equivalent price for diesel has fallen below $10/mcf within the last four years, although the lowest price seen in the last 18 months was $17/mcf. We believe a deal would be signed at a notable discount to this figure – indeed with 30-40 projects in the pipeline in 2011 (according to Höegh) the competitive pressures would mean that margins will be lower. To determine a possible marketing margin that Gasol could achieve we ultimately have to refer to project NPV sensitivities to examine where others may be bidding.

Exhibit 5: Prices of LNG in Asia , one year



Source: Bloomberg, Edison Investment Research

Exhibit 6: Prices of LNG in Asia , five year



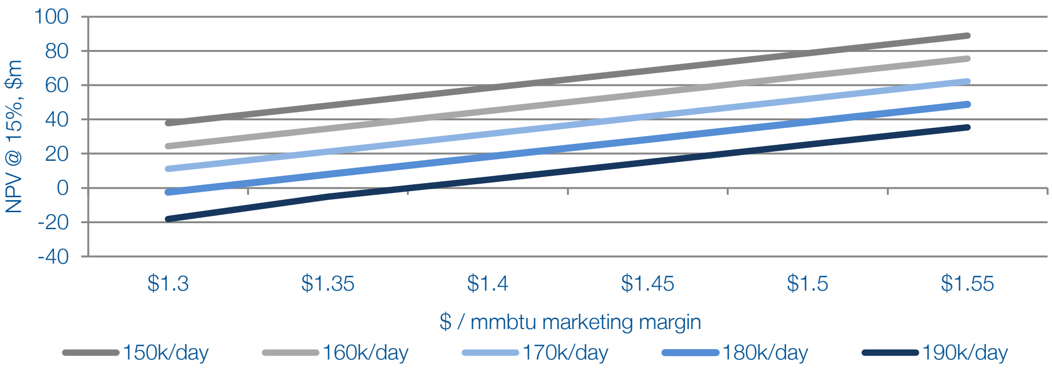
Source: Bloomberg, Edison Investment Research

Sensitivities

According to the Proactive Investors article the company said, “We are not going to take any price risk on the LNG. We will put our margin on top of the LNG cost. There is the cost of leasing the vessel, which we pass through. And then the only final bit is the infrastructure charge”. Based on these comments, we believe the company would be essentially taking the part of a (necessary) facilitating middleman and not a trader.

In our illustrative modelling, it is clear that the largest factor in generating returns is the marketing margin the company is able to achieve on gas sold. As shown below, an increase in prices of just $0.075/mmbtu can increase the NPV@15% by around $15m.

Exhibit 7: NPV@15% based on different marketing margins and day rates



Source: Edison Investment Research

The analysis indicates that a project has the potential to create significant value for Gasol. The emphasis on opex vs capex means Gasol can create significant value with a low initial contribution. As a relatively small company, we therefore have to look at how Gasol may raise enough capital to fund such a project.

Financing and funding options

Even a small initial capex bill of $10-15m is more than Gasol's current market cap. However, we believe most of the funds can be obtained through debt financing. The clarity of future revenues, derived from long-term contracts with government agencies or large gas companies provide surety that will enable banks to provide finance. We believe the financing will be provided by development banks, leaving the equity funding requirements to be as low as perhaps 10-20% of total capital demands.

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Exhibit 8: Financial summary

£'000s	2011	2012	2013e
February	IFRS	IFRS	IFRS
PROFIT & LOSS			
Revenue	68	68	68
Cost of Sales	0	0	0
Gross Profit	68	68	68
EBITDA	(2,100)	(1,719)	(2,532)
Operating Profit (before amort. and except.)	(2,016)	(1,711)	(2,532)
Intangible Amortisation	0	0	0
Exceptionals	0	0	0
Other	0	0	0
Operating Profit	(2,016)	(1,711)	(2,532)
Net Interest	(364)	(281)	(245)
Profit Before Tax (norm)	(2,379)	(1,992)	(2,777)
Profit Before Tax (FRS 3)	(2,379)	(1,992)	(2,777)
Tax	0	0	0
Profit After Tax (norm)	(2,379)	(1,992)	(2,777)
Profit After Tax (FRS 3)	(2,379)	(1,992)	(2,777)
Average Number of Shares Outstanding (m)	1,104.9	1,248.8	32.4
EPS - normalised (p)	(0.2)	(0.2)	(8.6)
EPS - normalised and fully diluted (p)	(0.2)	(0.2)	(8.6)
EPS - (IFRS) (p)	(0.2)	(0.2)	(8.6)
Dividend per share (p)	0.0	0.0	0.0
BALANCE SHEET			
Fixed Assets	3,008	3,003	3,003
Intangible Assets	3,000	3,000	3,000
Tangible Assets	8	3	3
Investments	0	0	0
Current Assets	319	383	177
Stocks	0	0	0
Debtors	144	177	177
Cash	175	206	0
Other	0	0	0
Current Liabilities	(3,190)	(2,676)	(2,676)
Creditors	(426)	(561)	(561)
Short term borrowings	(2,763)	(2,115)	(2,115)
Long Term Liabilities	0	0	(2,071)
Long term borrowings	0	0	(2,071)
Other long term liabilities	0	0	0
Net Assets	137	709	(1,568)
CASH FLOW			
Operating Cash Flow	(1,726)	(1,482)	(2,777)
Net Interest	0	0	0
Tax	0	0	0
Capex	0.0	(3.1)	0.0
Acquisitions/disposals	0	0	0
Financing	23	(4)	500
Dividends	0	0	0
Net Cash Flow	(1,704)	(1,489)	(2,277)
Opening net debt/(cash)	952	2,588	1,909
HP finance leases initiated	0	0	0
Other	69	2,168	0
Closing net debt/(cash)	2,587	1,909	4,186

Source: Edison Investment Research, Company accounts

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