

BULLETIN # 45 – FEBRUARY 9 2011

GOLAR LNG – GLNG-NASD

To me, the best stocks have a story so compelling and simple that I don't have to spend huge amounts of time analyzing its performance. **GasFrac** is the perfect example of that kind of stock. Its propane fracking is unique to them and it works so much better than other methods the customer gets it for free.

This next stock pick of mine – **Golar LNG (GLNG-NASD)** is that type of stock. It's simple, it's unique, its management has a remarkable track record in creating shareholder wealth and it's the world leader of a big trend that should last for a decade or more – the increasing use of natural gas as an energy source by the developing world. (LNG=Liquid Natural Gas)

Golar is more than an LNG shipping company, but some investors may visualize it as a pipeline company – the lower the cost of gas, the more economical it is to ship/transport. Supply from countries like Qatar is increasing dramatically, and usage by countries like Korea, Japan, China and Brazil is also increasing dramatically. The global LNG fleet – including Golar - is the pipeline.

For the first time ever, there is a real GLOBAL spot market in LNG as supply, demand and the cost and technology of logistically moving it and docking have improved. It is projected to increase from 210 billion cubic metres (bcm) in 2008 to 500 bcm in 2035. The share of LNG in total natural gas trade versus pipelines is projected to grow from 31% in 2008 to 42% in 2035.

Golar's BIG edge is that it is the first company in the world to have successfully retrofitted a LNG tanker to a vessel called an FSRU – Floating Storage and Regasification Unit. This is where the compressed LNG is put back into usable form, out in the ocean, and pumped into gas lines onshore. I'll explain the power and profitability of being the world leader in this.

Management here is also a very clear bonus. John Fredriksen is worth billions, and made almost all of it from shipping. He owns 46% of Golar stock and intends to increase dividends as fast and as much as he can. He has a great track record in doing this.

Consider these two news items just from **TODAY** – New Jersey governor vetoes a huge, 65 acre offshore LNG terminal, and Israel announces it is building a new LNG import facility using FSRU. <http://www.platts.com/RSSFeedDetailedNews/RSSFeed/Oil/7055279>.

Trading Symbols:	GLNG-NASD
Share Price:	\$18.39 (my price \$15.42)
Basic Shares Outstanding:	67.58 million
Mgmt Ownership	46.18 %
Market Cap (Basic):	\$1.242 billion
Net DEBT	\$412 million
Enterprise Value (EV):	\$1.6 billion

THE LNG SHIPPING BUSINESS (abbreviated version)

(most of this info comes from the website of Golar's competitor Teekay LNG Partners (TGP-NYSE) – I have paraphrased most of it)

Liquefied Natural Gas

Liquefied natural gas (LNG) is a cheap way of moving natural gas overseas by super-cooling it to a liquid form, reducing its volume by *1/600th* of its gaseous state. The LNG shipping industry is growing rapidly with global demand for LNG expected to increase by more than 50% by 2030.

Shipping Natural Gas

Shipping natural gas includes the following three key stages:

Liquefaction

To transform natural gas into a liquid state, it is super-cooled to a temperature of approximately -260 degrees Fahrenheit (-163 degrees Celsius). This process takes place at a liquefaction facility.

This super-reduced volume allows LNG to be transported around the world economically, particularly to areas that don't have modern pipeline infrastructure.

Shipping

LNG is shipped in double-hulled ships. LNG carriers transport LNG between liquefaction facilities and import terminals - which cost \$1.5 Billion at least - or floating storage regasification units (FSRU) - which can cost \$265 million. (*starting to get the idea...???*)

The double-hulled ships insulates the LNG so it stays in liquid form. LNG that evaporates during the voyage and converts to natural gas (called *boil-off*) is used as fuel to help propel the carrier.

Regasification

At regasification facilities, the LNG is returned to its gaseous state. Such facilities have been located on shore for many years but *more recently there has been a growing demand for floating regasification units (FSRUs) on which the LNG can be regasified.*

- Floating regasification allows countries who want to import LNG to gain fast and relatively cheap access to global LNG supply. Its advantages include:
 - Ability to fast track regasification access for new LNG importers
 - (*Dramatically-ks*) Lower upfront capital investment compared to onshore facilities
 - Can be relocated if demand is short term and/or seasonal
 - Allows customers in new markets to gain confidence in LNG
 - Good solution for when availability of land is limited
 - Large pool of potential FSRU conversion candidates in the fleet (*these are old LNG carriers that can be retrofitted into FSRUs very cheaply-ks*)

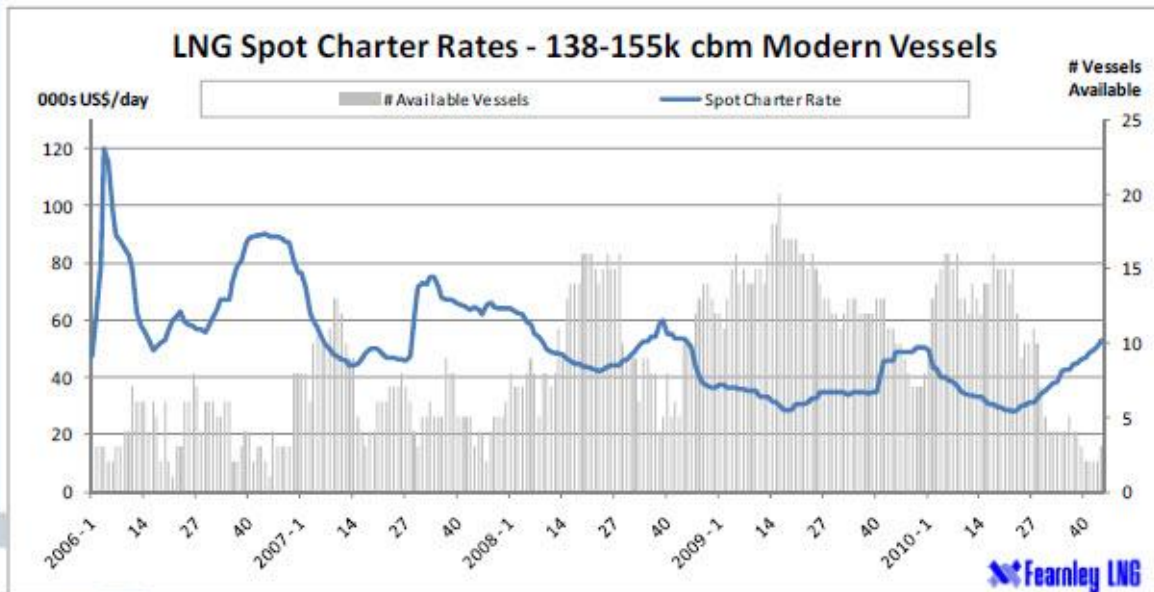
A Growing Global Market

- Total demand for natural gas is projected to increase from 3,149 billion cubic meters (bcm) in 2008 to 4,535 bcm in 2035. This is a 44% increase over the period at an average annual growth rate of 1.4%.
- Inter-regional natural gas trade is projected to increase from 670 bcm in 2008 to 1,187 bcm in 2035. This is a 77% increase over the period at an annual average rate of 2.1%. Trade rises much faster than demand due to the pronounced geographical mismatch between regions of production and consumption.
- Japan, Korea and India are the biggest Asian importers. In 2009 these countries received about 55 percent of total global LNG trade. Spain, France and the US are the Atlantic Basin's biggest importers closely followed by the UK. China is currently the world's ninth largest LNG importer and is expected to become a major buyer of LNG in the future.
- Qatar, Malaysia and Indonesia are the biggest producers accounting for 44% of all LNG exports in 2009. Other major producers include Nigeria, Algeria, Australia and Trinidad & Tobago.
- The pattern of global LNG trade is expected to change in the future. Up to now LNG trade has been concentrated in the Asia-Pacific region with gas sourced from Asia and the Middle East. Although this market will continue to expand, LNG demand from the Atlantic basin is also expected to increase.
- As of June 2010 global liquefaction capacity totaled around 360 bcm per year. An additional 77 bcm per year is under construction while a further 500 bcm per year is currently in the planning stage. Australia, Nigeria, Iran and Russia account for 77% of the planned new production capacity, though not all of these projects are expected to come online due to political and economic barriers.
- The global LNG fleet is growing rapidly to meet this increasing supply and demand. As of November 2010 there were 360 LNG vessels in service with a further 24 vessels on order.

OK, there you go – a bit of history and industry trends, major players etc. - LNG Shipping 101. The only other important item to know is that historically, LNG trades at 13% of Brent Crude.

Where the industry is at right now is...that every single LNG ship in the world that can be working, is now working. So what that means is that the “day rate” for these ships is now going up.

Back in 2007 day rates for LNG tankers were as high as USD\$110,000 a day; they went down to \$30,000 after the crash of 2008, and up until late this summer were sitting at USD\$47,000 – then the market for LNG tankers got tight and have since shot up to \$70,000. Golar estimates they need a day rate of \$33,000 to break even.



This chart from last November (their latest; overall info on the Golar website of the company and the industry is not good) shows two things – the axis on the left is the day rate in thousands of dollars per day, which is the blue line that is now on the rise and has broken a steady four year downtrend.

The right axis is the number of vessels available for hire to transport LNG – see all those vertical lines disappearing into the bottom right of the chart – that means there are almost none left. That’s why day rates are now moving up sharply.

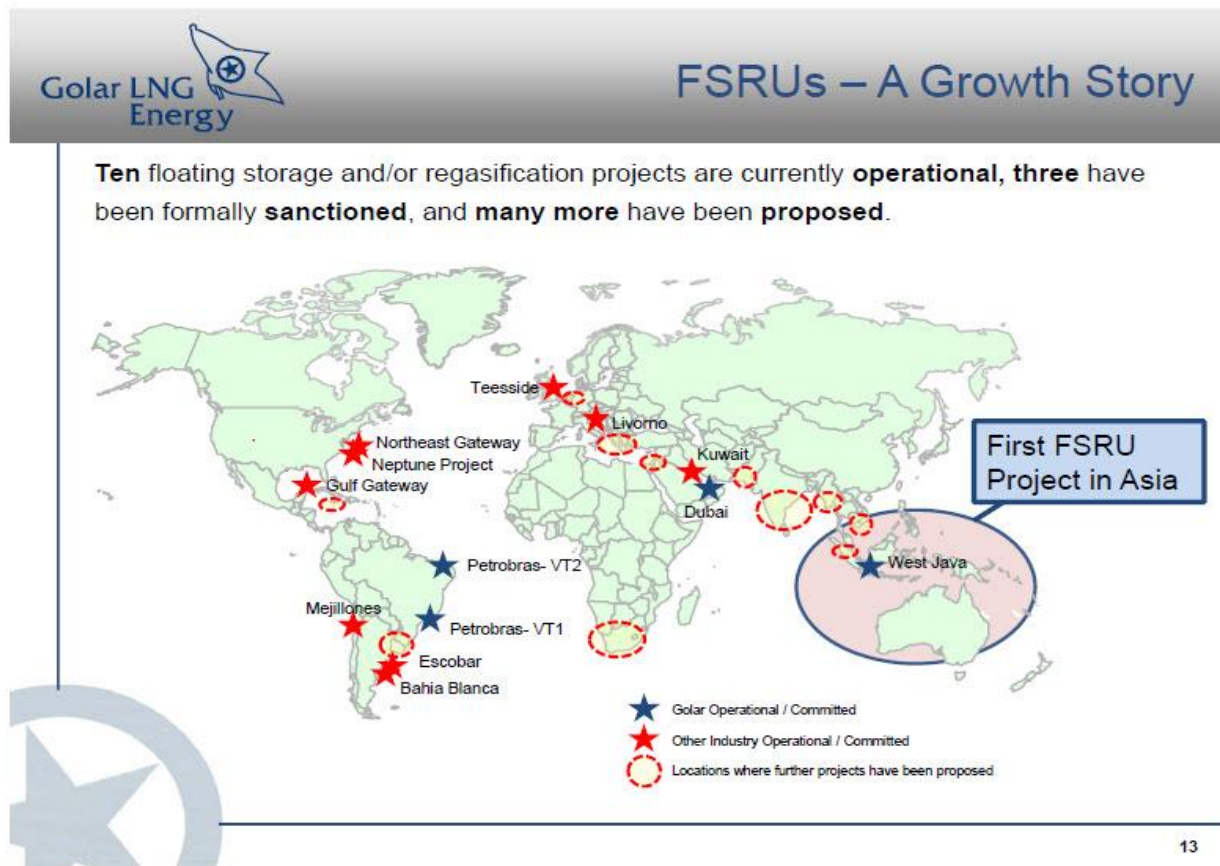
This is a major trend that should last for many years. Global LNG demand is expected to increase 44% in the next 25 years. The percentage of shipping LNG vs pipeline is expected to increase. With all the shale gas being discovered in the world, the price of natural gas may well stay low enough compared to oil that will make LNG shipping economic for a long time. So day rates for LNG carriers should continue to be highly profitable. Golar has 7.5 LNG tankers in its fleet.

The world is just in the infancy of a truly global LNG market with a big increase in long term contracts and active spot markets – thanks to low gas prices and new technology. Nobody knows now what the nuances of this market will be in the future that will create big opportunities for investors, but the trend of a sustained and active LNG shipping market for the next decade or so seems assured – to me. I’m willing to put my money into that trade.

THE COMPETITIVE EDGE - FSRU

But like any energy services company, I want to find a company with a big competitive edge, and I think Golar has that. They are the world leader in FSRU projects – **Floating Storage and Regasification Units**.

Golar can retrofit an old LNG tanker into an FSRU for anything between \$85 to \$125 million. **NOBODY ELSE HAS DONE THIS**. Other companies have built FSRUs from scratch, which can cost up to \$300 million. This compares to a price tag of more than \$1.5 billion for an onshore LNG import terminal. For developing nations who don't have the cash, FSRUs are an obvious, cheap and safe way to get gas infrastructure built for the cleanest burning hydrocarbon money can buy.



For the developed world, FSRUs get rid of the NIMBY syndrome – NotInMyBackYard. Who wants an LNG terminal beside them that could, if it explodes (terrorism), flatten the earth for a mile or two? These ships sit 10-12 miles offshore just over the horizon and send the gas onshore via a flexible underwater pipe.

The other big plus for developed countries is that FSRUs can be **Moved**. Countries like Brazil that see themselves significantly growing natural gas production over the next decade love

FSRUs because they can lease them to someone else at any time, or simply hand the keys back to Golar later.

The FSRU industry is just in its infancy and I expect it to grow substantially over the coming 20 years for the reasons I just outlined.

Golar now has three FSRUs that are operational – two in Brazil and one in Dubai. The cash flow from these ships, along with two of their ships that are in long-term charter contracts, covers 100% of the current \$1/share annual dividend, which is paid 25 cents quarterly.

These ships have 10 year contracts which guarantee this dividend. And Golar has just won a bid to do an FSRU in Indonesia (*the first FSRU in South-east Asia, where most global interest is centred for FSRUs*), which will be operational by year end 2011. This is a significant contract to Golar because majority of FSRU interests come from that region.

Each ship will create about 30 cents a share in dividends, which at the current 6% yield is good for \$5 per share on the stock (0.3 / 0.06). A 4% yield – which is where I think this dividend is going - would imply a stock price increase of \$7.50/share. So the market knows, or strongly believes assuming that the ship is operational on time, that an extra 30 cents a year is coming in 2012 dividends.

GOLAR HAS NEVER LOST A BID ON AN FSRU CONTRACT that made it into production. They are the acknowledged world leader in this.

One of my favourite lines for subscribers is that when making financial projections, I like to keep one foot firmly planted in the air. So, Golar is now working on 10-12 FSRU bids around the world. *If* they win half, or six, that would add \$1.80 in dividends, which in addition to the \$1.30 the company will have in 2012, gives investors a total of \$3.10 in 3 years or so, and at a 4% yield I get a \$77.50 stock price. That's a big IF, but very possible.

MANAGEMENT

To appreciate this company subscribers should understand what CEO and Chairman John Fredriksen has done in the past. First off, remember he owns 46% of the stock and his partners own more, to the point of just being under 50% in total. So this team is more than committed.

He is a rags to riches, Horatio Alger story. Born to a working class family in Norway, he started off as a trainee in a ship brokering company. But he had gumption, and chartered ships to transport oil in the Middle East during the Iran-Iraq wars.

Fredriksen has built up the world's largest oil tanker company - Frontline (FRO-NYSE, \$2.2 billion market cap). He has a major stake in SeaDrill (SDRL-NASD; \$36) an offshore drilling company. He is worth an estimated \$7 billion - \$11 billion, give or take.

And he loves dividends. He has shown that he is good at managing companies and increasing their dividends. And as long as he owns 46% of GLNG, I'm assuming he will continue his policy.

FINANCIALS

In the first nine months of 2010 Golar has revenue of \$180 million, EBITDA of \$45 million and just returned to profitability in Q3 with 6 cents a share earnings. For the 9 months of 2010 the loss is 7 cents. The stock has had a good run lately as Q4 is expected to be very strong with the increase in day rates for shipping.

There are a couple items here that investors should take note of:

Investors should understand this company uses a lot of debt to finance these ships, but that is against a 10 year contract, AND they must put up restricted cash against each ship – so this is not a speculative debt instrument. The financials will show \$821 million in debt, but once you subtract the restricted cash against that, (\$554 million), there is really only \$267 million in net debt (plus there is equity of \$1.6 billion in the current ships).

This is one of the key pieces of the puzzle that makes GLNG so profitable – debt is cheap right now (Golar pays an average 4.89% on its debt) and will create a great ROI from the ships' cash flow.

One analyst estimated an FSRU will create 4.5x its cost in EBITDA (Earnings Before Interest, Tax, Depreciation and Amortization—this is roughly equivalent to cash flow) over a 10 year life – and when that cost is debt against restricted cash that just gets recycled, the profits are even more lucrative.

The second thing is that Golar LNG owns 63% of an Oslo-listed company called Golar Energy (GOLE-Oslo). Golar Energy is more involved in straight LNG spot market. They do short term LNG shipping contracts and act as a feeder for Golar LNG – any shorter term contract that turns into a long term one will get sold up to Golar LNG.

Fredriksen has said that Golar Energy will need to get financing for its projects on its own, so at one point in the near to medium future its revenue will not be consolidated.

Lastly, Golar Energy has a commodity division, Golar Commodities (of course) which is into trading LNG. While this is not core business, they see an opportunity where, when they own the ships, and can have a stronger negotiating position in dealing with customers and contracts.

This new part of the business does involve derivative trading and the company did have a loss in this segment in the last quarter.

VALUATION

The market sees Golar LNG as a dividend play, given Fredriksen's background. Every bit of research I read on Golar said that new FSRU contracts would be the main driver for the stock price, with increasing LNG shipping rates being second. As such, analysts are looking for new FSRU contracts to be won, and dividends to be increased, which will increase the stock price.

As I mentioned earlier, each ship will create about 30 cents a share in dividends, which at the current 6% yield is good for \$5 per share on the stock ($0.3 / 0.06$). A 4% yield – which is where I think this dividend is going, as the market gains more faith in the business - would imply a stock price increase of \$7.50/share. So the market knows, or strongly believes assuming that the ship is operational on time, that an extra 30 cents a year is coming in 2012 dividends.

If they can win six new FSRU contracts in the next three years, that would add \$1.80 in dividends, which in addition to the \$1.30 the company will have in 2012, gives investors a total of \$3.10 in 3 years or so, and at a 4% yield I get a \$77.50 stock price in 2014. A 6% yield = \$51.67/share – a triple from my \$15.42 cost.

CONCLUSION

A true, liquid spot market in LNG is now emerging, due to low gas prices and new technology such as FSRUs. Golar LNG is THE world leader in FSRUs, and a (but not THE) leader in LNG transport with 7.5 ships. Management knows the shipping business inside out, as John Fredriksen owns Frontline, the world's largest oil tanker company. Management also owns 46% + of Golar LNG.

This is the right team at the right time. As the rest of the world's shipping is slowing down (those charts aren't pretty), LNG shipping analysts are forecasting a very tight market for several years. Day rates are high and rising.

For those investors who want a natural gas play, this is it. It's also a China play, an India play, and a non-US play. And it's a play for those who believe natural gas will stay cheaper than oil – which at a 6:1 ratio is \$16.67/mmcf on \$100 oil.

The only real negative here is that analysts are calling for the major growth to happen in 2013 and 2014. The stock has had a great run, and once it hits an implied 6% yield on 2012 dividends of \$1.30 – which is \$21.67 – the stock could easily stall until they win a new FSRU contract, or LNG shipping rates get and stay over \$90,000 a day. **I own 2000 shares of Golar at \$15.12.**

STOCK CHARTS (there are 2 this time...)





The end

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