

LNG, Yeh You Know Me

The last time we wrote about liquefied natural gas (LNG) in 2016 (*LNG, what's taking so long?*), the outlook for the LNG Canada project in Kitimat, BC going through were dim. LNG prices in markets such as Japan and South Korea, which together comprise over 40% of demand, were at a historical low. At the time it was not surprising that Shell Canada, of Royal Dutch Shell (RDS-US), pushed back on its final investment decision (FID) to build the \$40 bln project. Since 2016, LNG prices in Asia recovered from their lows, almost doubling since then, making a LNG project more economically viable.

About the Project

Shell, which has a 40% interest in LNG Canada along partners PETRONAS, PetroChina, Mitsubishi and KOGAS, announced its positive FID for the LNG Canada project on October 1. The first phase of the project is

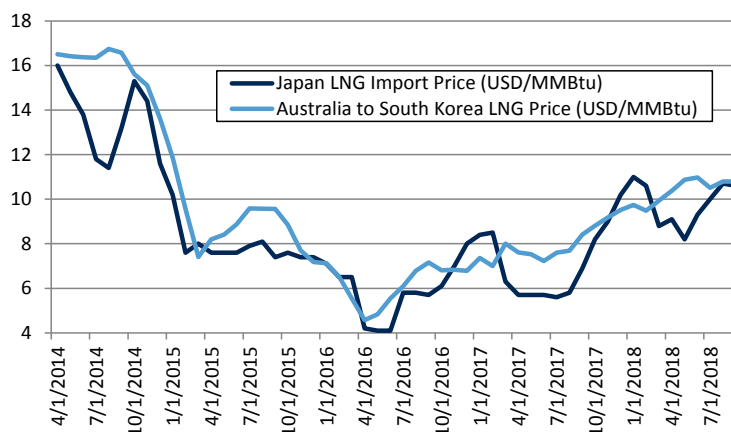
expected to export around 1.8 billion cubic feet per day (Bcf/d) by 2022/23, with the possibility of adding three more phases. The project's main advantages include its location in Kitimat, making distances to North Asia 50% shorter when compared to the US Gulf of Mexico; access to an abundance of natural gas from BC; and cooler weather – since natural gas needs to be cooled in order to turn into a liquid, it is more efficient to do this operation in cold areas compared to warmer areas (such as Gulf of Mexico) as this increases operating efficiency and reduces energy consumption per unit of LNG.

Who Will Benefit

Over the next five to six years, a string of companies are poised to benefit from LNG Canada, including engineering & construction (E&C), accommodation providers and gas producers. Within E&C, our preferred name is **Aecon (ARE-T)**. SA Energy Group, a 50/50 joint venture between Aecon and Robert B. Somerville Co. Ltd, was awarded a \$526 mln contract by TransCanada for parts of the Coastal GasLink Pipeline project. Work will start mid-2019 with final completion expected by end of 2022. The company could also participate in the pre-construction parts of the LNG Canada project given their civil construction experience. It is worth noting that ARE is also partnering with Fluor (FLR-US) on the Gordie Howe Bridge; since Fluor is the main engineering, procurement and construction contractor on the LNG Canada project, management believes this could help ARE land more contracts at the Kitimat facility. Another name worth mentioning is **Russel Metals (RUS-T)**, which owns land and has a facility in Kitimat and could participate during the construction of the project through its energy and service center divisions.

Accommodation providers will also see their services being required with names like **Black Diamond Group (BDI-T)** and **Horizon North Logistics (HNL-T)** participating in both the pre-construction and during the construction of the project. It is estimated that the entire project will require around 10,000 workers, 25% of which will be working on the Coastal Gas Link pipeline. While Raymond James analyst Andrew Bradford sees accommodation providers as benefitting, he recognizes that the direct initiatives are already priced in today. He sees upside coming from indirect initiatives such as higher demand for camps from increased drilling in the Montney area or the initiation of another infrastructure project such as the Trans Mountain Expansion. At the moment, Andrew rates BDI a Market Perform and HNL an Underperform.

LNG Prices Recover



Source: Bloomberg, Raymond James Ltd.

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Gas producers are another way to invest in the long end of the LNG Canada project. While Shell and PETRONAS have their own natural gas production close to the project, we believe other partners may need to access the market to buy any extra gas needed for the initial and future phases of the project. We note that the benefits to the gas producers will only bear fruit once the project becomes operational, meaning post-2023. That said, we like names that have proximity to the project and strong gas production such as **Canadian Natural Resources (CNQ-T)** and **Peyto Exploration & Development (PEY-T)**. Raymond James' analysts Kurt Molnar and Chris Cox also mention other names including **Advantage Oil & Gas (AAV-T)**, **ARC Resources (ARX-T)**, **Birchcliff Energy (BIR-T)**, **Crew Energy (CR-T)**, **Encana (ECA-T)**, **Painted Pony Energy (PONY-T)** and **Tourmaline Oil (TOU-T)**. Our Canadian Research team has done a great job at outlining the companies to benefit at each level of the construction from early to later stages as outlined in their September 28 *Assessment of the LNG Investing Pressure Points In Brief* note.

Conclusion

LNG Canada will be constructed over the next five years, and as the project advances, different firms along the value chain will benefit. As previously noted, while we do not think gas producers will see any immediate financial impact, we believe E&C companies along with accommodation providers will benefit early on and could see financial benefits over the next few quarters. In order of the firms seeing the initial to late stage benefits: 1) for E&C Aecon (ARE-T) and Russel Metals (RUS-T), 2) for accommodation providers Black Diamond Group (BDI-T) and Horizon North Logistics (HNL-T) and finally 3) Canadian Natural Resources (CNQ-T) and Peyto Exploration & Development (PEY-T) for natural gas producers.

Comp Table

Name	Price	Market Cap (blns)	Forward P/E	P/B	2019 Est. EPS Growth
Aecon Group Inc	\$ 19.67	\$1.18	22.0x	1.5x	27%
Russel Metals Inc	\$ 25.88	\$1.61	8.9x	1.7x	-10%
Black Diamond Group Ltd	\$ 2.65	\$0.15	NA	0.7x	94%
Horizon North Logistics Inc	\$ 2.63	\$0.43	NA	1.3x	308%
Canadian Natural Resources	\$ 38.18	\$46.31	10.7x	1.4x	3%
Peyto Exploration & Dev Corp	\$ 10.94	\$1.80	15.6x	1.1x	-28%

Source: Bloomberg, Raymond James Ltd.

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A member of the PCS team responsible for preparation of this newsletter or a member of his/her household has a long position in the securities of Aecon (ARE-T), Black Diamond Group (BDI-T) and Tourmaline Oil (TOU-T).

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