

Korea Gas (036460)

BUY

TP W110,000
Stock (Dec 13) W68,400

KOGAS' position reconfirmed as modified version of City Gas Business Law revision passes

National Assembly passes modified version of revised City Gas Business Law revision

On Thursday, the National Assembly passed a revision of the City Gas Business Law restricting LNG sales among direct importers. The revised bill proposed by Han-Pyo Kim (Saenuri Party) was considered a step towards privatization of the gas industry, as it focused on: 1) establishing a natural gas import/export law to be enforced abroad, 2) allowing sales of LNG by direct importers (for internal use) to other direct imports or overseas, and 3) allowing sales of evaporated gas (small amount of gas generated at LNG terminals due to changes in temperature or pressure) to city gas companies or other direct importers (for internal use).

Core modification was restricting domestic sales among direct importers

Major content of the revisions passed by the review committee on Thursday, including: 1) establishing the legal groundwork for the natural gas import/export law for the resale of LNG overseas, and 2) allowing sales of evaporated gas to direct importers for internal consumption. However, the article to allow domestic sales among direct imports, which they have lobbied aggressively for, was not included.

Press considers gas privatization efforts abandoned

Energy News considers this the defeat of the Ministry of Trade, Industry & Energy and Han-Pyo Kim's efforts to introduce competition to the gas market at the hands of KOGAS' labor union and other civic groups. Even if the original revisions passed, it would have had no immediate impact on KOGAS. However, the union argued to scrap the bill as sales between direct importers may erode national gas supply security, while expanding the scope of direct importers would have privatized the gas market.

Big burden on KOGAS shares lifted

OP at KOGAS is guaranteed by the government, by multiplying the rate base (mainly tangible assets) by WACC. Even if LNG sales market share falls due to City Gas Business Law reforms, earnings would not change over the near term as lower sales volume does not affect tangible assets. But as this was considered part of an effort to privatize the gas market, the passage of the modified revisions should bolster sentiment for KOGAS. Furthermore, direct importers should not be able to expand business scope over the near term, which should further reinforce KOGAS' market position.

Global gas market focusing on Northeast Asia; opportunity for KOGAS

Recently, the US has commercialized shale gas projects sooner than expected, leading to higher exports. As such, countries that have developed gas fields to export to the US have lost a major potential buyer. Experts have recommended that gas sellers will have to focus on Northeast Asia for potential natural gas buyers. Furthermore, these exports forecast Korea will have an opportunity to buy natural gas at low prices, and that the government should capitalize on these opportunities. Meanwhile, the Korean government forecasts national gas demand will fall from 2015. We believe this outlook should change within the next one to two years. Once the gas demand forecast changes, the role of KOGAS should grow, suggesting a faster change in the rate base and subsequently earnings growth. We believe these changes will be visible from next year.

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Valuation

Our TP was derived on September 3 by adding W48,071 (per share value of E&P businesses, not reflected in PB valuation) to the value derived by applying 0.6x 12MF PB.

Table 1. Korea's direct importers of LNG

	Posci-SK E&S	GS Caltex	Korea Midland Power Co,
Amount	1.15million tonne/year Posco: 0.55million tonne/year SK E&S: 0.6 million tonne/year	0.5 million tonne/year	0.4 million tonne/year
Contract period	2006-2025(20 years)	2015~2035(20 years)	2015~2024(10 years)
Contract mad	2004 August	2009 September	2012 April
Supply source	Indonesia, Tangguh (BP)	Australia Gorgon (Chevron)	Switzerland (trading company)
Usage type	Posco: Gwangyang, Pohang still mill SK E&S: Gwangyang power plant	GS Caltex Yeosu factory	Power plants(Incheon, Boryung, Seoul)

Note: 1. We estimate KOGAS should sell 39.5 million tonne of LNG this year. Considering direct import (by private firm) volume of 1.15 million tonne, Korea should carry in 40.65 million of LNG per year, and 2.8% of them are carried in by private firm.

2. Current law only allows LNG import for self-consumption

Source: Industry

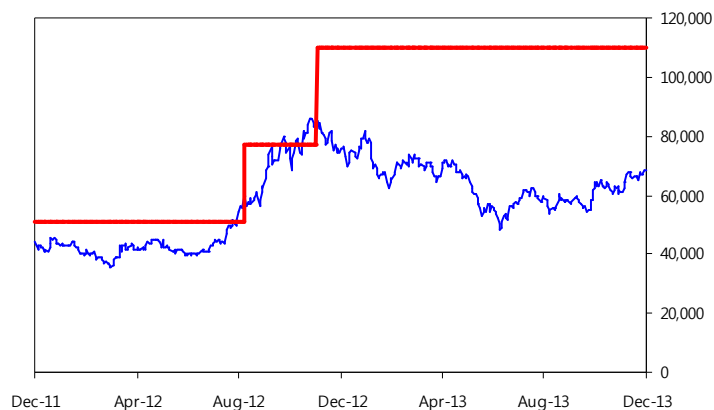
Table 2. Policies regarding direct import of LNG by private firms

Date	Content
1998. 7	Government publishes a plan for privatization of KOGAS
1999.11	Foundation plan for restructuring gas industry was formed
2002. 2	Labor strike against the restructuring plan, government and union agreement was signed
2002. 4	City Gas Business Law, Korea GAS Corporation Law, Energy Committee Law are brought in to National Assembly, but reviews were delayed
2003. 3	Restructuring plan modified due to stability of natural gas import
	Direct LNG import for self-consumption was allowed to open gas market incrementally
2008. 1	Review of restructuring and privatization of gas industry resumes (Ministry of Knowledge and Economy reported to Presidential Transition Committee)
	Restricting plan to be formed by 2008, and plans to introduce competition on LNG import and sales
2008. 6	Government and ruling party announce no privatization of gas, electricity water supply, and health care insurance
2008.10	Attempts to introduce competition in natural gas imports and sales (Third advancement plan for public companies)
2009. 9	Revised bill for City Gas Business Law to introduce competition was submitted to National Assembly (Ministry of Knowledge and Economy)
	Scrapped with close of 18 th National Assembly
2012.12	Revised bill for City Gas Business Law to restrict regulations on direct import of private companies is submitted to National Assembly (Wan-Ju Park, Democratic Party)
2013. 4	Revised bill for City Gas Business Law to ease regulations on direct import of private companies is submitted to National Assembly (Han-Pyo Kim, Seanuri Party)
2013. 4	Mr Park's revised bill of City Gas Business Law was passed in the Review Committee of Trade Industry and Energy at the National Assembly
2013. 6	Mr Kim's revised bill of City Gas Business Law was reviewed at the Review Committee of Trade Industry and Energy at the National Assembly
2013.12	The Review Committee of Trade Industry and Energy at National Assembly passed Mr Kim's bill after deleting the article allowing domestic sales between direct LNG importers

Source: Industry

Changes to recommendation and price target

Company (Code)	Date	Recommendation	Price target
Korea Gas (036460)	06-28-12	BUY	W51,000
	08-23-12	BUY	W77,000
	11-19-12	BUY	W110,000



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