

## Hard times, hard decisions for LNG projects

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*(Larry Persily, assistant to the Kenai Peninsula Borough mayor, was invited to participate in a global LNG conference and prepared this report as part of the borough's ongoing efforts to share information about LNG market developments. The conference paid the travel expenses.)*

The frustrations of an oversupplied LNG market and low prices were evident as about 100 liquefied natural gas buyers, sellers, lenders, advisers and goods and services suppliers gathered in London last month.

“How the hell do you plan your business in an environment like that,” said David Ledesma, managing director of South-Court Ltd., a U.K.-based oil and gas consultancy. “How the hell are you going to go out and make final investment decisions?”

Spot-market prices for LNG cargoes delivered to Asia this fall are down two-thirds from the record \$20 per million Btu in February 2014. Demand in China is not growing as much as was expected — just as new supplies are coming online from Australia and the United States — creating fears of an oversupplied market and low prices for several years.

Meanwhile, buyers are demanding shorter terms and more flexibility in their LNG supply contracts. Speakers at the fifth annual LNG Global Congress Sept. 23-24 in London said the oversupply could play itself out by the 2020s, creating opportunities for new projects to meet demand, but those investment decisions are getting tougher on LNG project developers.

“Gone are the days when you can expect to get 15 percent return on your LNG plant,” said Mike Fulwood, a principal in Nexant's global gas consulting practice.

### **LOW PRICES WILL HELP BUILD DEMAND**

Conference speakers talked a lot about the price for LNG: It was way too high a couple of years ago. Now it is far too low. But the price needs to stay low enough to continue attracting new customers — which, the theory goes, would lead to increased demand and somewhat higher prices.

That means producers will need to hold down costs for new projects if they are to make money in the low-price world.

“The industry needs to find new ways to get lower costs,” said Thierry Bros, senior European gas and LNG analyst for Paris-based banking and financial services company Societe Generale. “If you want to increase demand, you decrease prices.”

Kazumi Takahata, deputy general manager at Tokyo Gas, had the same message: Keep the price down, and we'll buy more. In addition to lower prices, Japanese utilities are looking for a more diversified supply portfolio, Takahata said, listing North America (including Alaska), Russia and East African nations as potential suppliers.

A conference poll showed a strong majority believe LNG prices will stay below \$10 per million Btu (roughly 1,000 cubic feet of gas) through the end of the decade. Even though \$10 would be a big increase from the \$7 range sellers received for spot cargoes in September 2015, it's still a long way from the highly profitable prices of 2012-2014 that averaged over \$15.

### **LNG TRADE HAS CHANGED**

"We had this impression that the good times would never end," said Vivek Chandra, CEO of Texas LNG, a smaller liquefaction project proposed for the Texas coast. "Instead of feeling sorry for ourselves, we need to embrace change."

LNG markets used to operate in their own tradition-bound world of long-term contracts between a limited number of buyers and sellers. Now the market is behaving like any other commodity, Chandra said. Supply and demand dictate price, and price determines customer decisions.

"When I buy chocolate, I look at Swiss or Belgium. ... When I buy gas, I look at the price," Bros said. Gas is a commodity, and there is nothing special about one country's LNG over another. Bros said he stressed that point when he told a group of Canadians recently that their LNG is no better than anyone else's and they should not expect a premium price. Developers are promoting two dozen LNG export plants on Canada's western and eastern shores, though none have committed to construction.

The risk, many of the conference speakers said, is that developers of LNG export projects will shy away from final investment decisions (FIDs) this decade, setting the stage for supply shortages in the 2020s.

### **NEW MARKETS DEVELOPING**

"Looking ahead, the current situation might delay FIDs and set the basis for the next cycle (beyond 2020) where demand grows faster than supply," said Carmen Lopez-Contreras, senior analyst for the gas and power planning team at Repsol, a Madrid-based global oil and gas company. Lower prices will accelerate demand in new markets, she said, pointing to Pakistan, Jordan and Egypt as examples. "We have this amazing (demand) growth in Middle East countries that we have to watch." Mideast countries are increasingly turning to natural gas for power generation rather than burning oil products.

In addition to the Middle East and Pakistan, growth markets are building in Southeast Asia (particularly Thailand), the Baltic region and Latin America, said Matthew Monteverde, vice president for generating fuels at Argus, a global energy news service.

The lower-cost and relatively quick development time (months, not years) for floating import terminals — ships that offload the cargo from an LNG carrier, store it, regasify it and pipe it to shore-based customers as needed — is making it easier for more countries to sign up for LNG deliveries.

Several speakers, including Stephanie Wilson, managing editor of the Asian LNG team at Platts news service, repeated the possibility of a tight market by 2025 if not enough new supply is developed. But it won't be easy for developers to make investment commitments for new supplies. More buyers are demanding shorter-term contracts of three to five years, Wilson said, with diversified pricing to replace the traditional LNG price link to oil on an energy-equivalent basis.

“We know there will be shortages in the future because FIDs are not being taken,” said a senior adviser to a multinational oil and gas company who stipulated that no one could attribute any statements to him by name. The deterioration of traditional long-term, take-or-pay contracts and the growth of shorter-term deals — with buyer flexibility to redirect or resell the cargo — is “uncharted territory,” he said.

Therein lies the conundrum.

“The banks still will need a long-term offtake from a creditworthy customer,” said Ian Catterall, senior vice president and head of natural resources at the Bank of Tokyo Mitsubishi. “Good projects will always be financed,” Catterall said. “I’m not sure which projects are the good projects.”

Conference speakers raised several other topics:

- LNG imports have gotten so cheap for China that the average prices are less than pipeline gas deliveries from Central Asia, Platts’ Wilson said. Meanwhile, smaller, private buyers are gaining access to China’s LNG terminals controlled by the nation’s biggest importers, providing a new market for more import cargoes.
- India will take an increasing volume of LNG, as long as prices are low, Bros said. The government holds down the retail price of natural gas, putting pressure on importers to avoid high-cost contracts. India’s main LNG importer is pushing Qatar to negotiate lower prices on a long-term contract that dates back to 2004.
- China wants to develop its substantial shale gas resources, to help reduce its reliance on imports, but “that’s moving much more slower than the official plan,” said Victor Perez,

a partner at consultancy A.T. Kearney 's energy practice. Geology and a lack of technical expertise are the hurdles, he said.