SE What's New
HD Australia's Santos Fends off LNG Attacks
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LP The CEO of Australian independent Santos has come out swinging, saying the reason domestic gas prices are high is down to geology, not his company's Gladstone LNG (GLNG) project. GLNG is one of three liquefaction plants built simultaneously on Curtis Island in Queensland that are blamed for creating gas shortages and price spikes in eastern Australia, prompting government moves to limit LNG exports. But Santos Chief Kevin Gallagher said last week that prices have risen because "all the cheap gas has been developed, so it is costing more to get gas out of the ground."

TD Prime Minister Malcolm Turnbull announced in April that restrictions would be introduced from July to ensure the domestic market was adequately supplied before gas exports were allowed (WGI May3'17). Under the Australian Domestic Gas Security Mechanism (ADGSM), exporters that are not net contributors to the domestic market -- they take out more gas than they put in -- must explain how they intend to plug the gap (WGI Mar.22'17). Unlike conventional LNG plants in northern and western Australia, the three coalbed methane-fed projects in Queensland require new wells to be drilled to maintain production or third-party gas to be bought in. GLNG sources more than half its feedstock from third-party contracts, and Gallagher said the ADGSM "unfairly targets" his project as it is the only one that is not a net contributor. The other two, Royal Dutch Shell's QCLNG and Origin Energy-ConocoPhillips' APLNG, have their own gas.

Gallagher has also taken exception to assertions that Australian prices are higher than in markets like Japan where the gas is sold. "It has been widely publicized that Australian gas is sold in Japan cheaper than it can be purchased in Australia. The GLNG project does not sell gas to Japan [it has long-term contracts with Malaysia and South Korea] ... Given that all of GLNG's gas is contracted overseas, GLNG has no cheap, surplus gas -- indeed it’s all contracted at premium prices."

There is one piece of good news. Turnbull's decision was made partly on the basis of forecasts from the Australia Energy Market Operator (AEMO) of shortages as LNG projects ramped up and domestic production declined. But in an update last week, AEMO said it has raised supply projections, although gas markets "remain finely balanced," and much will hinge on the Queensland plants.

UBS analyst Nik Burns said AEMO's updated supply/demand balance means there is less likelihood that GLNG will be asked to address physical gas shortfalls in eastern Australia by, for example, reducing exports or making more gas available to the domestic market. But as the ADGSM runs until the end of 2023, "the issue of supply adequacy will be revisited every year, leading to a degree of lingering uncertainty around GLNG." Minh Hoang, a credit analyst with ratings agency Standard & Poor's, reckons that even if the mechanism were invoked, GLNG partners would be given the chance to make up supply through means such as LNG swaps.

Santos has a 30% operating interest in the $18.5 billion plant; its partners are Total (27.5%), Malaysia's Petronas (27.5%) and South Korea's Kogas (15%). To say the project has been a challenge is an understatement. Gas supply problems have forced the partners to write down billions, with Santos alone writing down $1.5 billion (WGI Sep.21'16). GLNG has also been operating well below its 7.8 million ton per year nameplate capacity. It produced just 1.4 million tons in the first quarter of 2017 and Santos has said it will only ramp up to 6 million tons/yr by 2019. The Institute for Energy Economics and Financial Analysis, a US-based think tank, said recently that a combination of lower-than-expected production and low oil prices, off which the LNG is priced, may lead to further write-downs. Chinese equity firm Hony Capital and gas distributor ENN Group recently increased their stake in Santos to 15.1% through share purchases on the open market, saying they would "act in concert" at shareholder meetings. There is speculation the Chinese may be looking to take over the company, whose share price has tumbled 25% since the start of the year.

With debt of US$3.1 billion, Santos has been moving to restructure and refocus its portfolio to improve its balance sheet and growth potential (EIF Dec.14'16). The focus is gas and LNG projects. It has 13.5% of Exxon Mobil's PNG LNG scheme in Papua New Guinea, where it hopes to expand. It also has an 11.5% stake in Darwin LNG in Northern Australia, and domestic gas positions in western and eastern Australia.

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