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HD **The impact of savaging sinks in**

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The impact of savaging sinks in

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The fall-out from the savaging of **oil** prices saw Australian LNG majors, Santos and Origin, reassuring investors that financing and expenditure would be reconfigured and that the economics of their massive projects still worked. Their response was credible enough to convince the market there was no impending doom. But life for these companies has become tougher and the gloss is fading. Thus Thursday's announcements were not sufficient to assuage investor concerns about the prospects for the **energy** sector. And the market took a tumble in the absence of enough good news from elsewhere. The big **mining** stocks drifted lower and a lift in Telstra's share price, when combined with sluggish performances from the banks, wasn't enough to drag up the index. Origin has finessed its funding options, extending the size of its facility and lengthening the repayment terms. It hosed down concerns that the effects on returns, from the fall in the **oil** price, would be especially damaging, telling the market that at the $24.7 **billion**Australia Pacific LNG project would throw off cash even when the **oil** price fell as low as US$40 ($48) to US$45 per barrel. But it also said that its share of

The savage impact of cheaper **oil** is sinking in as life gets tough

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distributable cash flow from APLNG is expected to average more than $900 **million** a year from the 2016-17 financial year - down from the estimate of about $US1billion a year that Origin gave in May this year. Santos said on Thursday it had cut its 2015 capital expenditure from $2.7 **billion** to $2 **billion** as it battens down the hatches to deal with the financial buffeting resulting from the **oil** dive by 40 per cent this year. Despite their attempts to calm investor fears, the share prices of these and other Australian LNG

companies continue to take heavy fire. Santos in particular, which is considered the most exposed to the falling price due to its higher debt levels, has been hit hard with its share price falling a further 6 per cent on Thursday. The latest wave of **oil** price declines comes off the back of news that OPEC has cut its demand forecast for next year and follows last week's news from OPEC had it would not reduce supply. This has unbalanced the demand and supply equation further and sent international **equity** markets, including Australia, into a tail spin.

Many Australian analysts are now suggesting the shares in the LNG producers have probably been oversold.CIMB notes that **equity** markets are "clearly discounting the uncertainty unfolding around supply- demand dynamics." But it reckons this and that price moves are typically amplified; and fundamental drivers do resume. While true, it would be a brave call to wade into this uncertain territory. It is fair to say that almost all experts did not predict the severity of the fall in **oil** prices and few would have expected the producers would act irrationally and maintain supply in the

face of falling demand from the likes of **China**. However, the behaviour of those that produce **iron ore** (they boosted production at a time of falling demand) provides a clear template demonstrating producers that dominate the market have longer-term objectives to rid their respective industries of new entrants. OPEC appears set on crushing some of the new higher-cost oil shale output coming out of the US. The iron ore majors such as Vale, BHP and Rio want to edge out the higher cost producers in developing countries such as China, even if they are to take a short to medium-

term hit to their own returns. So, while producers play to their own agendas the fallout is becoming very costly for countries that are net exporters of these commodities. Australia fits into that basket. Of course there will be particular stocks and sectors in Australia that stand to gain from a falling oil price. The most obvious contenders are transport and logistics stocks and the Qantas and Virgin share price graphs illustrate this story. But for the Australian economy, a net exporter of energy, the wider negatives prevail and this explains why the Australian dollar gets pushed down when the oil price falls.

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