Some players won't get a seat in LNG musical chairs

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A NEW JP Morgan report says it is not possible to bring all of Australasia's proposed liquefied natural gas projects onstream in their planned timeframes.

As many as half of the proposed projects could be delayed beyond 2015 given constraints on customer demand for liquefied natural gas and the supply of skilled labour, according to JP Morgan.

The report says LNG demand will not grow fast enough to absorb the rise in production capacity, which would surge by 300% by 2015 if all the proposed developments went ahead as planned.

Just as significantly, the report suggested there were not enough skills and labour to develop all the proposed projects, particularly in Western Australia, home to the largest LNG development proposals.

JP Morgan oil and gas analyst, Mark Greenwood, who co-authored the report, said it was accepted there was capacity for only one greenfields LNG project in WA every two years.

But four projects were vying for the next available slot in 2012 – Pluto 2, Gorgon, Ichthys and Browse.

"Only one of those projects will get it, and that will push the rest into the next slot in 2014 and beyond.

"It used to be a race between projects to get to a final investment decision and capture the next sales contract. Now there is less of a constraint in terms of contracts, but there is certainly a constraint of labour and resources in WA."

The projected oversupply is based on independent supply forecasts by market consultants Purvin & Gertz and Sempra LNG.

These forecast contributions by Australia to global LNG supplies of 50 million tonnes per annum and 54MMtpa respectively by 2015, which is slightly more bullish than the Australia Petroleum Production and Exploration Association's forecast of 50MMtpa by 2017.

According to the JP Morgan review, Australia's existing and approved LNG production is 21.3MMtpa, which includes Train 5 of the North West Shelf and Pluto. This leaves room for an additional 30-33MMtpa by 2015, but LNG projects already proposed have capacity of more than 60MMtpa, or double the capacity the market is expected to support.

The report says the most viable LNG projects would proceed first. The remaining projects may well proceed, but they are likely to be deferred beyond 2015, and this means the key share price drivers such as gas sales agreements and reaching final investment decisions would be pushed beyond the timeframe of most investors.

Greenwood said this had important implications, particularly for investors in Woodside, Santos and Oil Search, which had growth strategies geared almost exclusively to LNG projects.

"We undertook a detailed review of all the factors in a decision to develop an LNG project, then ranked and compared the major proposals," he said.

"This allows investors to differentiate between competing projects, and make their own decisions accordingly."

The JP Morgan report identified four categories of LNG project. Only one project not yet under construction, the ExxonMobil-operated PNG LNG, was in the first category in which it had high confidence and few hurdles to development.

The second category contained "wild cards" – projects that could be next across the finish line in the race to develop LNG if one remaining hurdle to development could be cleared.

This category contained a second phase of Woodside's Pluto project and the Woodside-operated Sunrise joint venture.

The third category of LNG projects included (in order) Gorgon, Ichthys and Browse. JP Morgan said it was confident these projects would proceed, but the timing was uncertain.

The final category was created for projects in which JP Morgan had lower confidence of development or it considered to be projects of longer term. This group included (in order) Gladstone LNG, Scarborough and Caldita-Barossa.

JP Morgan did not discuss the Liquid Niugini Gas project being planned by InterOil and Merrill Lynch for development near Port Moresby.

The front-runner

The report said ExxonMobil's Papua New Guinea LNG was the most robust LNG project in the region. It had the advantage of a large resource size (9.3 trillion cubic feet), an onshore location, supportive government and joint venturers with aligned interests (Exxon 33%, Oil Search 30%, PNG Govt 20%, Santos 12%, AGL 3%, Japan Pet 2%).

In addition, the economics of the project were boosted by high liquids content and low levels of carbon dioxide that would not require geosequestration.

Prefeasability studies are all but complete, and the PNG Government is exerting pressure to have the project progress to front-end engineering and design studies in the first quarter of 2008.

Wildcards

Back in Australia, Pluto 2 could sneak in front of its more advanced rivals on the North West Shelf if Woodside could prove up a gas resource from exploration in 2008 and 2009 in the deepwater Cazadores blocks (WA-347, 348 and 353-P).

The report points out that Woodside is pre-investing "several hundreds of millions of dollars" in infrastructure at Pluto that could be used in a second LNG production train.

It notes that if Woodside's exploration was not successful, Chevron's gas from the adjacent Wheatstone field could be considered for Pluto 2. This is calculated to offer Chevron a better return than other development options being considered for Wheatstone. But Pluto 2 could push Gorgon further back in the queue of LNG developments competing for limited skilled labour.

The Woodside-operated Sunrise LNG project is the other wildcard in the pack.
The report says Sunrise, discovered in 1975, is an excellent resource that would have been developed many years ago but for the political issues. It has a large reserve (8.8 trillion cubic feet), high liquids content (second only to Ichythys) and a low carbon dioxide level that will not require geosequestration.

JP Morgan says Woodside is evaluating three development options:
• Sending the gas via a 450km pipeline to Darwin for processing in a brownfield LNG development at Wickham Point;
• A floating LNG option – a technology that joint venture partner Shell has always been keen to promote; and
• Sending the gas via pipeline to Timor for processing.

JP Morgan considers Darwin the most feasible option. Wickham Point already had permits for an additional capacity of 6.4MMtpa, which was a good match with the resource size of the Sunrise field.

"Given the quality of the resource and the robust economics of producing Sunrise gas, we believe that the joint venture partners would quickly align behind a single development concept if the Timor Leste Government were to support a development concept outside of Timor."

Gorgon, Ichythys and Browse are the next leading contenders for development. JP Morgan says these projects are a lot more complex than PNG LNG, Pluto 2 and Sunrise, largely because of their high carbon dioxide levels and site-specific factors.

"We see Gorgon as the next most likely to proceed out of these projects," the report notes.

"While the project has faced significant hurdles, it has been overcoming these hurdles, and is far more advanced than Ichthys and Browse. Our understanding is that the major remaining issue for Gorgon is JV partner alignment on the estimated cost of the project."

JP Morgan says Ichthys has "stellar" economics because of its high liquids content, and its Japanese operator (Inpex) should ensure that obtaining gas sales contracts is not a constraint. The main obstacles for the project are reaching agreement on unitisation and environmental and landowner agreement to base an LNG facility on the Maret Islands.

But Browse LNG is a "highly complex" project, according to JP Morgan, and the analyst said it would not be surprised to see this project's start-up slip beyond 2015.

A similar assessment is made of Santos' Gladstone LNG proposal, which has the technical risks of being a world-first in using coal seam methane as feedstock.

The implications of JP Morgan's share price valuations depend on assumptions about long-term oil prices. It recommends being overweight in Oil Search in all scenarios, but is neutral on Woodside and underweight on Santos, even with a bullish assumption of long-term oil prices at $US75 a barrel.

If this report is correct, LNG development in Australasia has become a highly competitive game of musical chairs that could get a bit rough and leave some players and investors in tears.