# LNG Market Transformation

# UT Energy Week

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January 31, 2018

# Introduction

- The LNG industry developed as a point-to-point market
  - Large liquefaction projects built with massive project-finance loans supported by long-term contracts with credit-worthy offtakers
  - Capacity developed in tandem with long-term offtake commitments
  - Low-risk, high-return business that benefited everyone
- US projects, expiration of long-term contracts and changing nature of global markets have blown this up
- LNG is becoming more commoditized
  - Shorter contracts
  - Smaller volumes
  - Less credit worthy buyers
  - More spot and short-term trade
  - Demands for more flexibility
  - More risk management requirements
- Long-term contracts will continue to be part of the LNG business
  - But structural change is a problem for project finance

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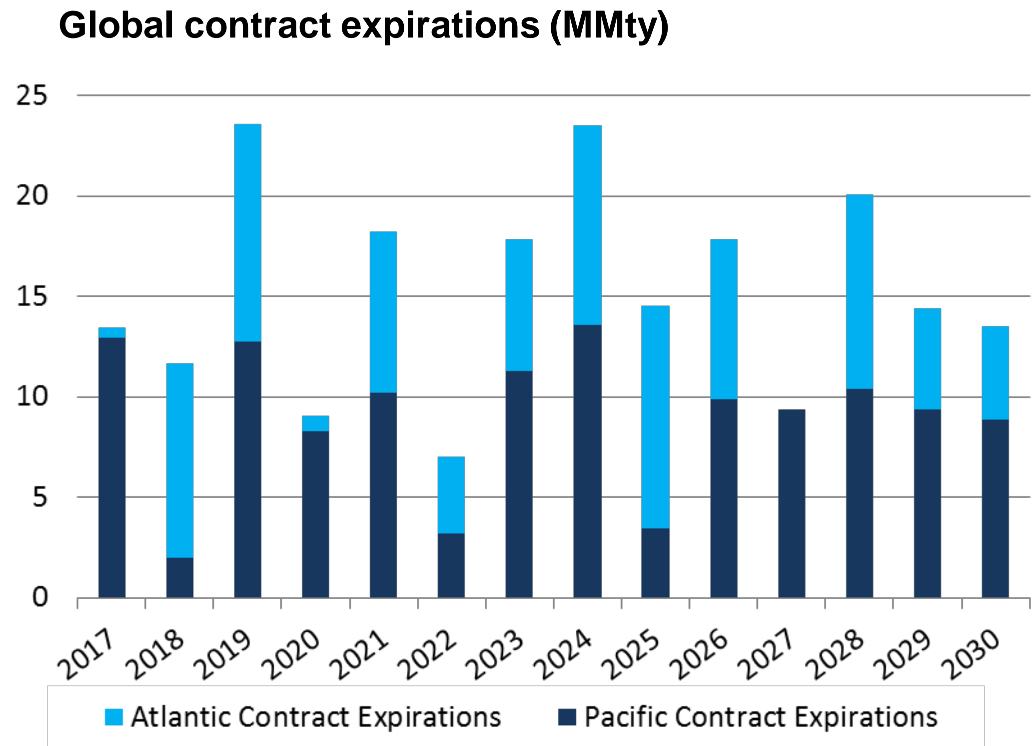
# Contract expirations raise uncertainty

- 213 MMt/y of contract expirations through 2030
  - Mostly long-term supply
  - About 55% of expirations in Asia-Pacific and Middle East, rest in the Atlantic
- Why does this matter?
  - Most of this volume is from projects that have paid off their loans
    - They can sell short term if buyers prefer
  - In some cases, output is declining so a straight renewal is not possible
  - Most buyers now want a portfolio of contracts with different terms, lengths and degrees of flexibility
    - Many 20-year contracts will not be renewed for 20 years or for the full volume of the original contract
- This is a fundamental restructuring of the LNG market




*Source: Poten & Partners' Global LNG Outlook*

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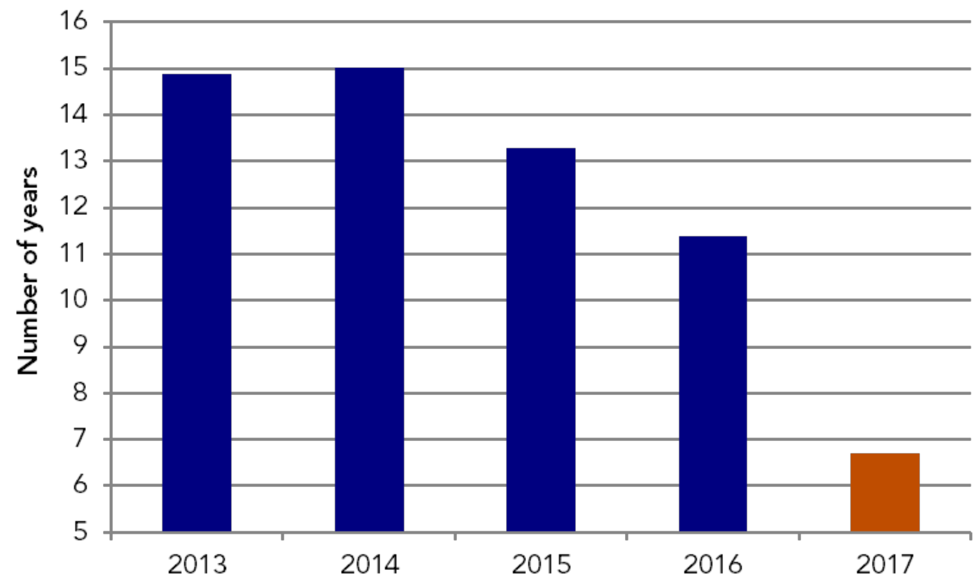
# Overall contract lengths are shrinking

- A rise in the number of short- and medium-term contracts, combined with a decline in long-term contracts has shortened the average length of all signed SPAs
- Overall number of contracts has been roughly stable at 26-31 over the past five years
- 2017 data shows number of contracts within normal range (30) and a significant decline in average contract length (6.7 years)

**Average term of signed SPAs (More than two years)**




*Source: Poten & Partners' LNG in World Markets*

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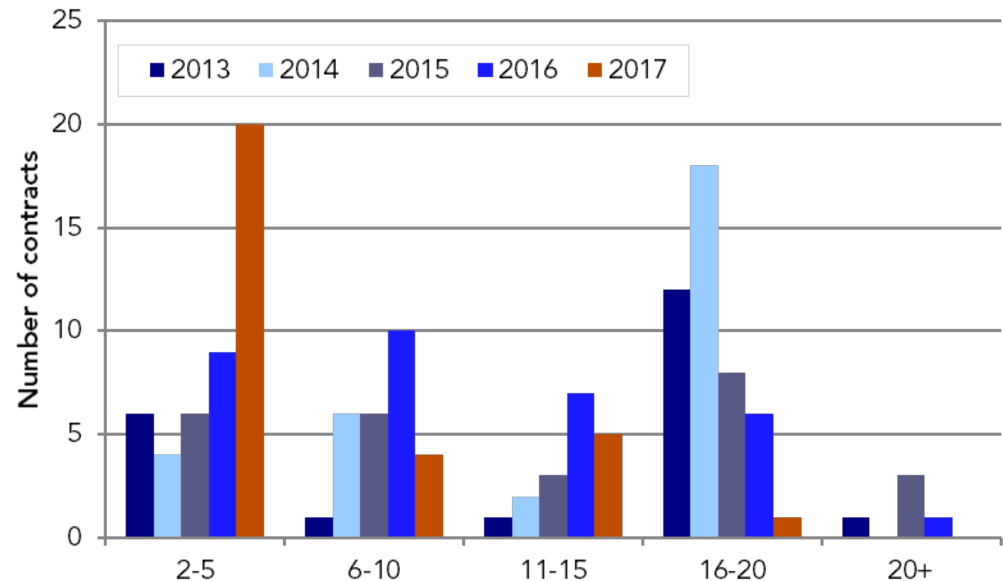
# More shorter duration contracts are being signed

- Shortest contract durations mostly with traders and resellers
- Most 11-15-year deals are with end users or aggregators
  - Deals seen in Asia, Latin America
  - Sellers mostly producers or overcommitted end users
- Two thirds of 2017 deals (20 out of 30) were for 5 years or less. Continued decrease in 20-year deals

**Duration of signed SPAs over time**




*Source: Poten & Partners' LNG in World Markets*

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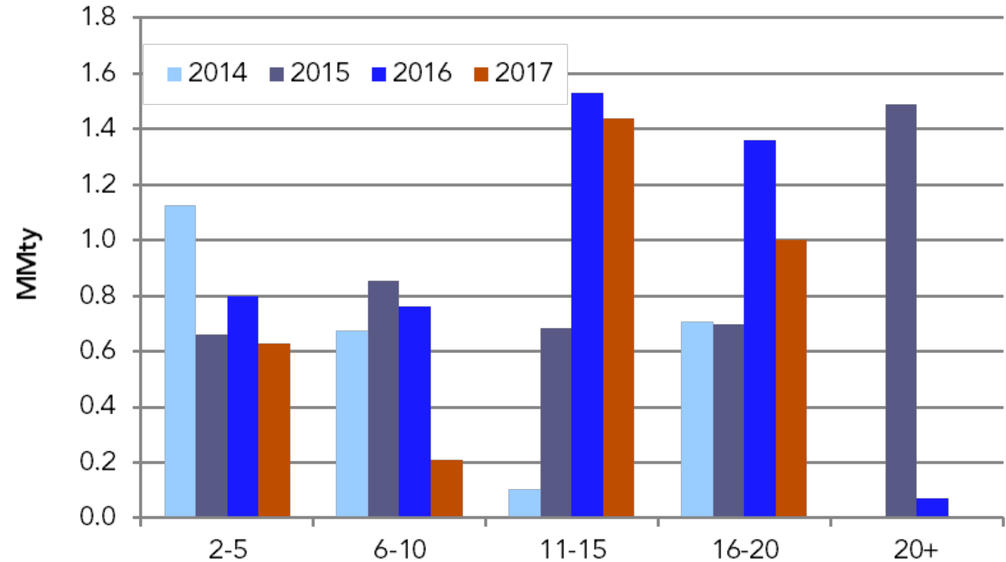
# More volume moving into medium-term contracts

- Volumes falling as buyers opt for smaller contracts
- Average volumes for 11-15-year contracts holding up
  - Supports notion that 11-15-year contracts are the new long-term contract
- 2017 data shows overall average volumes per contract falling to less than 1 MMt/y (720kt/y)

**Average contract volume by contract term**




*Source: Poten & Partners' LNG in World Markets*

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# Uncertainty about new projects is rising

- Buyers are reluctant to sign large volume, long-term contracts
  - Most recent contracts have been for shorter periods and smaller volumes
  - Many buyers feel there is better pricing for shorter terms, and longer, if they hold out
  - Some large buyers are over contracted so they feel no urgency to agree to new long-term deals
- There are many competing projects, particularly in the US
  - Most projects under construction have additional trains that have not gone to FID
    - Their lead times are shorter and capex/opex lower
  - There are too many US projects
    - Driftwood, Golden Pass, Magnolia, Rio Grande, Monkey Island, Lake Charles, Texas LNG
- Lack of FIDs is introducing structural volatility into the market
  - A period of overinvestment in LNG capacity is now being followed by a period of underinvestment
  - This will have an impact on long-term natural gas demand from the LNG sector
  - With low prices, demand from LNG plants may be volatile
- The market changes favor majors and producers who are already in the business
  - Majors can make strategic decisions to build capacity and can pay for it
  - Projects under construction and brownfield projects already have spent money on infrastructure and may be able to offer more attractive terms
  - Greenfield projects requiring long-term contracts and lots of debt financing appear to be disadvantaged

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# Our outlook for 2018 and beyond

- The structure of the market will continue to evolve
  - Shift toward smaller, shorter contracts
  - Buyer demands for more flexibility
  - More short-term and spot trade
  - Much greater diversity of pricing mechanisms, more flexible terms, smaller volumes
  - Credit quality will become more of an issue as developers look to new markets
  - Choppy LNG market may mean additional volatility for US natural gas markets

- One consequence of these changes is that there is a dearth of long-term contracts
  - There have been only two final investment decisions in 2016-17 – Indonesia's Tangguh Train 3 and Coral South FLNG in Mozambique
  - Unless new projects go to FID in the next two years, there is a risk of underinvestment
  - Many buyers are reluctant to sign long-term contracts, but some anchor customers and aggregators might
  - There is a lot of work to be done in developing contract structures that will allow new projects to be developed

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