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LNG Juniors and the Market Opportunities

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The Liquefied Natural Gas (LNG) industry outlook is characterized as a very tight and dynamic market in the near future. This issue, despite being a concern for the market economy, opens opportunities for many LNG junior players as well as new entrants. This research is to provide some background on the current LNG market and to elaborate on the issues surrounding investment in LNG juniors. Then, it will explain implications for small players as well as investors.

The LNG industry is dominated by a handful of multi-national players that have inter-related set of ownerships across major LNG projects[1]. The 'gang of six', including Woodside, BHP, Shell, Chevron, BP and Japan Australia LNG, equally own the LNG liquefaction plant North West Shelf that contributes $A12.75 billion in export revenue to the GPD[2]. Classically, the market has been underpinned by traditional bulky long-term contracts. Therefore, the gap between supply and demand is minimal. For example, 90% of Australia's production is to support a long-term sale contract with Japan- the primary export customer[3].

However, the future market outlook is predicted to change rapidly with a mismatch between supply and demand. It is anticipated that there will be up to a 20mmtpa shortfall of LNG between 2008 and 2015[4]. These market circumstances have stemmed, primarily, from three issues.

First, there is a substantial surge in demand in LNG, especially in Asia Pacific. The reason is a combination of many factors including sustained economy growth in Asia; diversification of energy for local energy security, changes in energy consumption due to environmental policy[5]. The global demand will triple from 700 billion cubic feet in 2006 to 25 billion cubic feet in 2015[6]. For Australia, Australian Bureau of Agriculture and Resources Economics (ABARE) projected the number of 150 mtpa as the demand for LNG by importing countries for Australia compared to the demand of 75mtpa in 2004[1]. Part of this increase is not yet covered by long-term contracts, leading the market to move toward shorter term trading as to meet this unexpected demand[7].

Second, the tight market is due to a restricted LNG supply. In spite of the abundant gas resources underground and a large number of proposed projects, many significant projects around the world (such as Sakhalin in Russia and Browse, Gorgon in Australia) have been delayed due to escalating costs and lack of skilled and non-skilled labor[4]. This is especially true under the current credit crunch while many small firms find it hard to get capital access.

Third, domestic projects in Australia, such as those in Western Australia, face further obstacles. The

[1] The reality of Australia's 2020 LNG supply target, http://www.gas-matters.com/lng-focus-article1.shtml
[2] WA Business News, Big miners push exports to $68 million, http://www.wabusinessnews.com.au/login.php?url=http%3A%2F%2Fwww.wabusinessnews.com.au%2Fstory.php%3F%2F13%2F66913%2FBig-miners-push-exports-to-68bn
[3] Energy Information Administration, World LNG Imports by Origin, 2006
[4] Juniors follow big players in methanol.com, www.methanol.com.au/!upload_files%5Cattachment%5CPet_May%2007_LNG%20juniors%20follow.pdf
[5] Atlantic Institute for Market Studies, The LNG Window of opportunity, www.aims.ca/library/LNGWindow.pdf
[6] ExxonMobil 'LNG demand set to triple', http://www.upstreamonline.com/live/article151937.ece
[7] PWC, Value and Growth in LNG, http://www.pwc.com/extweb/pwcpublications.nsf/docid/529043ed959b8a6c8525728b0057bb14

Reservation policy imposed by the Government requires new export projects to hold 15% of production for domestic use. Moreover, the government is seeking a single LNG hub serving the Browse Basin, in order to maintain the country's environmental standards - which could be destroyed by the separate facilities being proposed by various companies[8]

The tight market together with its greater opportunities has many implications for small players and new entrants. These juniors can enter the field in many different ways.

First, due to the intensive capital and technical expertise requirements for LNG projects, small players have to enter into partnerships with LNG majors in order to operate projects. Examples include the partnership between junior Karoon Ltd and ConocoPhillips in the Browse exploration, or Nexus Energy Ltd and Shell Corporation in the Echuca Shoals project[3]. Partnerships such as these enable junior LNG firms to access the resources required to complete such capital intensive projects. For example, through partnerships with LNG majors, juniors firms are able to gain access to global resources and expertise to overcome skill shortages and capital costs.

On the other hands, juniors who operate independently will have to identify their niche market that they are capable of successfully penetrating. These markets are usually located in areas that are either physical or economical inaccessible by the typically large LNG vessels. A very good example is Gasnor, a Norwegian company, who operates small vessels to ship LNG to areas of narrow waters and small LNG receiving terminals[9]. In Australia, LNG Ltd operates small scale LNG projects that provide low cost stranded LNG reserves to power generators in developing countries such as India and South Africa[10].

Finally, juniors can enter the field by quickly identifying and gaining exploration acreage that is highly prospective regions, like when Karoon quickly grasped two of the Browse Basin permits when Woodside was focused entirely on Sunrise and North West Shelf[3]. "The only way you really gain control is being there first" as commented by Ian Tchacos, Nexus Managing Director[11]. Likewise, Nexus's growth is recognized by its ability to buy assets in Victoria's Gippsland Basin and in the Timor Sea before the competition among energy giants push up the prices[9]. Then, juniors have the opportunity to accelerate the process by selling down interest via various farm-in agreements to gain access to critically required capital. Juniors in such circumstances run the risk of losing the control interest of their assets, due to bargaining power of the LNG majors[3].

The three above mentioned opportunities of entering the market for juniors have important implications for investors. Since they are small, they are nimble. As such, investors should keep an eye on their every move in order to understand their strategy and future plans. For example, Karoon Ltd had a large share price gain of 31% to $2.32 after the release of the information that Karoon Ltd and its partner,

[8] EIA, International energy Outlook, 2008, http://www.eia.doe.gov/oiaf/ieo/index.html

[9] http://webfiles.ebm.as/gasnor/Web/Small_scale_distribution_nettversjon_Gasnor.pdf

[10] LNG Limited Corporate Presentation http://www.lngtheenergylink.com.au/IRM/Company/ShowPage.aspx?CPID=1058&PageName=Company%20Presentation%20August%202007

[11] The market for Australia gas is booming, http://www.abc.net.au/insidebusiness/content/2007/s2038549.htm

ConocoPhillips expanded their acreage in Browse Basin, one of Australia's premiere LNG provinces[12]. Similarly, MEO Ltd gained 21.7% when they swiftly secured all-necessary environmental approvals for its twin projects on the Tassie Shoal[12]. Clearly, juniors who are able to act quickly and proactively will be of great investment interest. In all circumstances, those juniors able to gain easy access to capital have a key advantage of their peers in that they are not required to rely on, potentially, costly partnership arrangements with the majors.

In summary, three opportunities have been identified for juniors and new entrants to tap into the LNG market. These are the ability to join partnership with LNG majors, develop for niche markets and, finally, they can aim to proactively identify worthy exploration acreage. The critical attributes of juniors include the ability to act quickly and initiatively. Given their risky investment profile, many LNG juniors offer significant opportunity for high investment returns.

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[12] LNG boom puts some heat under three Victorian juniors, http://www.theage.com.au/news/business/lng-boom-puts-some-heat-under-three-victorian-juniors/2007/04/22/1177180482725.html

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