LNG

Gas buyers take control

A revised supply deal between Qatar and India reveals exporters' weakness

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IF YOU needed convincing that the global liquefied natural gas market is shifting, look at Qatar's new deal with India's Petronet LNG. Supplier RasGas has slashed term-LNG prices for its Indian customer, which won't have to pay a penalty for lower-than-agreed purchases in 2015, either. It's another sign that customers are very much in command of the glutted market.

The new deal cuts the price of RasGas's LNG sales to Petronet by half, to $6-7 per million British thermal units (Btu), very near spot LNG prices. The new price will be based on a three-month average price of oil, replacing a five-year average, and will also be indexed against Brent crude, not the basket of oils imported by Japan (nicknamed the Japanese Crude Cocktail, or JCC) that has historically been used in Asian LNG supply contracts.

Petronet will also be spared a $1.5bn take-or-pay penalty. Its 2.4m tonne cut in 2015 will instead be made up for over the remaining life of the contract, which began in 2004. Another 1m tonnes per year (t/y) of supply from January 2016, on top of the existing 7.5m t/y, appears to be the bargaining chip.

RasGas agreed to this largesse because it has India's only long-term LNG contract. For years the Indians have bemoaned high LNG prices, refusing to lock in more deals unless the price was right.

Qatar, aware of the anticipated flood of LNG supply coming in the next two years, knew it needed to be flexible. India is a prime customer, especially as Chinese gas demand growth slows. It also has massive latent, but price-sensitive gas demand.

Fluid markets Still, at first glance, it's easy to miss the significance of the news, which is greater than simply the better price. The revision of the terms could signal the beginning of the end for long-term contract pricing formulas and the rigid market structure.

The Asia-Pacific market, which makes up roughly two-thirds of global demand, is awash with LNG. In parallel, Asian demand growth has slowed and the outlook remains dim in China, South Korea and Japan.

The supply glut will accelerate this year as Australian projects ramp up and first exports from the US lower 48 begin, adding around 35m t/y of new capacity. This will continue to depress spot LNG prices, which have fallen by more than 60% from a year ago.

With supplies surging and demand growth weaker than expected Asian spot prices are likely to track well below term contract prices for several years. Low-priced spot cargoes are already backing out long-term cargoes at the margin in China and India, the fastest growing major markets.

As prices bottom out this year or next – some forecasts think they may fall as low as $4/m Btu – it's not inconceivable that legacy buyers, such as Japan, South Korea and Taiwan, might more openly pursue a strategy of buying low-priced cargoes, while backing out of as many long-term contracted volumes as possible.

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Competition spike Buyers are no longer at the mercy of LNG producers, as they were in 2011-14, a period that saw spot prices eventually reach more than $20/m Btu. Supplies were limited and the March 2011 Fukushima nuclear disaster, which shutdown all of Japan's nuclear reactors, led to a sharp rise in the country's demand for LNG, pushing Asian prices sharply higher.

Now the boot is on the other foot. Worryingly for rival LNG exporters, Qatar – with its large position in Asia – is in a position to respond.

The country is one of the most profitable LNG sellers with the lowest break-even costs in the business. RasGas produces 1m Btu of LNG at $1.60 compared with $7.60 in the US and as much as $13.50 in Australia.

Nevertheless competition will intensify. LNG is sold inflexibly, except for a small and growing spot market of cargoes. It's in this lack of procurement flexibility that LNG has not caught up with coal – the major competing fuel in Asia – just yet.

This is purely a commercial choice – there is nothing fundamentally stopping a move towards more flexible arrangements. So if LNG wants to increase its share of Asia's market, it will happen.

Expect exports to relax unpopular destination clauses, which restrict buyers from reselling cargoes – especially as China chokes on LNG imports. The sanctity of price formulas in term deals should also begin to unravel.

All of the major buyers are haggling for better prices, and the RasGas-Petronet deal will encourage them.

Many long-term contracts into Japan and South Korea, the top two buyers, are set to expire before the end of the decade. They have no plans to be locked into rigid deals on expiration. And there is little chance of new projects taking final investment decisions until then. **PE**

16.89%

Anticipated CAGR of India's LNG demand during 2015-21

Source: *TechSci Research*