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BLOG

The pre- and post-COVID-19 landscape of the LNG industry

Shashank Sharma

The liquefied natural gas (LNG) sector, which was already dealing with a demand-supply imbalance (low demand and high supply), has now been confronted with two new challenges: the COVID-19 pandemic and falling global oil prices.

These have impacted LNG producers and gas exploration companies, as they are not able to invest in the development of new production assets due to financial strain. On the other hand, it is a good opportunity for LNG buyers to take advantage of this low-price environment to improve their contract terms. This could also be a good opportunity for utility companies to switch from coal to gas as a fuel, which would help them reduce their environmental impact as well.

The pre-COVID-19 landscape of the LNG industry

Even before the outbreak of COVID-19 globally, the LNG sector was grappling with oversupply. The significant expansion in liquefaction capacities that started in 2016 continued until 2019. In 2018-19, liquefaction capacity increased by 30.6 MMTPA, and the majority of such additions were in Russia and Australia. In 2017 and 2018, liquefaction capacity increased by 7%, on average, and the majority of these additions were from new projects rather than the expansion of existing liquefaction plants. Combined, these factors have increased LNG supply by 10% per annum. China, South Korea and Japan, the largest importers of LNG (c.55% of total LNG imports), had the ability to absorb such supply in 2019, but the economic slowdown in China and low demand in Japan and South Korea have pushed LNG spot prices to USD5/mmbtu from USD10/mmbtu in Asian markets. Europe, on the other hand, has the ability to absorb LNG oversupply, as it sees higher gas consumption in winter and also has storage capacity. That said, the warmer winter in 2019-20 could hurt demand.

The current pandemic will likely further impact the LNG industry. The major importers of LNG are based in Asia and Europe – China, Spain, Turkey, France and India. These countries have imposed strict lockdown measures to contain the spread of the virus, halting economic activity and resulting in declining gas demand. Japan and South Korea, among the top three importers of LNG, have not imposed severe restrictions, but demand for LNG is expected to be impacted there as well. China has now resumed industrial activity, but growth in gas demand is expected to remain half that in 2019.

Impact of lower oil prices on the LNG industry

Two-thirds of global LNG sales is based on oil-indexed term contracts. The recent shocks to oil prices have sharply reduced the gap between spot prices of LNG and oil-indexed term contracts. LNG suppliers or upstream gas producers, which prefer oil-indexed term contracts, are now under pressure. Spot prices of LNG in the Japan Korea Market (JKM) have dropped below USD2.5/mmbtu, and LNG prices linked to oil-indexed term contracts have reached around USD4/mmbtu. The gap between these prices could reduce further, as crude prices have remained at low levels, despite the agreement on production cuts between OPEC and Russia. Spot prices related to Henry Hub are below USD2/mmbtu, and Dutch TTF prices have also fallen below USD2.7/mmbtu. Prevailing prices, based on the indices of different regions, are below the average capital expenditure breakeven point for most upstream gas companies and suppliers. The breakeven price of US LNG delivered to the Asian market is around USD5.56/mmbtu, and prevailing spot prices are way below that. The average liquefaction cost is around USD3/mmbtu, and the shipping cost from the US to Japan and China is around 60 cents and 80 cents, respectively. Current spot prices are also below the breakeven points for exporters from Australia, Malaysia and Indonesia, as they incur a cost of around USD3/mmbtu to liquefy gas, although their losses are less than those of US companies.

How stakeholders can mitigate risks associated with COVID-19

LNG producers: The main objective of LNG producers amid the COVID-19 pandemic should be to maintain operational continuity. They should identify and assess which markets (LNG importers) would be deeply affected and the risks associated with them. Major demand comes from the energy utilities and fertiliser manufacturers, among others. LNG producers should also identify their unique selling propositions/points (USPs) in this competitive and strained environment and compare them with those of other players to gain an advantage. They must optimise LNG production by using digital platforms and capabilities. Some companies can also focus on mergers and acquisitions, as a number of producers are in dire need of investment.

The implications of the COVID-19 pandemic on the LNG industry are not yet fully clear, and changes in the market situation are quite evident. The consequences of the pandemic would be long-term in nature in countries where investments in regasification facilities are higher or in countries that are the largest gas producers, such as Qatar, Australia, Malaysia, and the US. The current impact and prevailing uncertainty could force industry participants to improve their short-term and long-term positioning strategies.

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contact@acuitykp.com | acuitykp.com