Cripps Sears & Partners in Partnership with Tellurian Inc.
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President Trump trade wars

Do President Trump's actions stop Chinese investment into the US? Does China have a choice? President Trump has shown a track record of making a big and public noise about issues before settling, having achieved his own goals. In reality, the trade war is seen as having less of an effect on energy than other sectors and the various approvals committees in the US to sanction LNG projects are probably more of a threat than a trade war with China.

China does have a structural shortfall of gas. Ultimately it can source gas outside of US supply, but it will be paying a premium. Longer term, China needs to address this gas imbalance and will prefer to invest in the value chain and own the molecules rather than simply purchase LNG. The US is a hostile market for the Chinese to invest in regardless of trade wars and will be an unlikely recipient of Chinese investment.

Investment

Where will the money come from to finance the next wave of LNG investments, does private equity have a part to play?

Consensus is that the large-scale projects will be financed by the bigger balance sheets of the super majors, the ticket sizes are simply too big for private equity investments. The private equity investments so far seen in US LNG projects have been secondary market investments. Outside of the US there has seen to be no private equity appetite for investments in LNG projects.

Investment banks are driven by the threat of regulators and long-term lending greater than 7 years has penal implications. In addition, the sweet spot of the bond market is also 5-7 years and as a result there is little appetite of for longer investment.

There has been an interest from infrastructure funds to invest in existing operations. The apparent funding gap lies between projects phase and operational phase. With perceived risk in long term investment, most banks and private equity investors would prefer to deploy capital in other markets. In addition, the rates of returns seen historically do not seem to be available now and therefore fundamentally do not make an investment case for private equity funds.

Although not in LNG yet, there is a developing trend of pension funds taking greater risk, emerging market risk to get the rate of returns that they are not achieving in other sectors.

Shipping

The debt financing market in shipping is changing, legislation is driving banks to have a much tighter view. As a result, the ship finance model is evolving towards a bond and capital markets driven model.

Leasing legislation is also changing which is pushing the sector towards longer term charter agreements, but there has not been a huge market appetite for these term deals, the magical number 7 comes up again as the longest seen in the market to date.

Investment in infrastructure

There is good appetite, but the number of projects is reduced, the lower hanging fruit of using existing terminal infrastructure in existing demand markets has seen huge growth but green field projects have been limited.

Small scale

With pending IMO regulations and serious non-compliance regulations, LNG as a marine fuel is the largest growth sector, initiated by ferries and cruise liners, new build LNG powered container carriers are also on the rise – see recent CMA CGM order of 9 new LNG fuelled box ships. Future pressure from end user customers to have a greener supply chain will force shipping companies to switch to cleaner fuel and LNG is the obvious option. Already 7 of the 10 largest container shipping companies have publicly announced that they will not be using scrubbers, to clean exhaust emissions from existing fuels. Large ship companies cannot afford to make a mistake and what is emerging is a "me too" attitude and domino effect that is predicted to see all the major container shipping companies converting to LNG fuelled vessels. The advantage that LNG also presents is that, in an uncertain fuels market, LNG can provide price certainty and the opportunity for shipping companies to lock in their fuel costs and manage risk appropriately.

Based on ratios on new build order it is estimated that in 10 years' time, 10-15% of merchant fleets will be fuelled by LNG. This equates to an estimated 30m tonnes of LNG that will need to be supplied from the large-scale terminals to end user customers. There will be a huge demand for last mile infrastructure including LNG bunkering vessels which will require significant financing.

There is a case that bunkering infrastructure has other potential uses and is therefore diversified risk and is bringing a lot of non-traditional investors into the market.

Consolidation

There are constraints to large scale consolidation coming from the public market in the next 5-8 years based upon price uncertainty. Strong appetite for longer term LNG investment is being restricted by shareholder concern and preference to focus on shorter term cycles.

The market is fragmenting and some question whether there are many deals left to be done, though there is a dual aspect to this discussion on US v non-US. In general, it is very difficult to develop a project in isolation outside of the US.

Though it was agreed that consolidation has been a consistent feature of the energy industry and could be both at LNG level or indeed could be within a larger scale transaction.

The role of commodity traders

Commodity traders can and are playing a larger role in the sector as they begin to gain access to supply positions, though their short-term outlook may restrict them to current projects (with some exceptions). However, it is also noted that others have been more forthcoming, and it is in fact the short-term view that will inject liquidity to the market to enable the evolution towards a traded commodity market.

Exceptions to this trend has been Trafigura in its 15-year offtake agreement with Cheniere and Gunvor's 10-year arrangement with Fortuna LNG. As commodity traders get bigger they will evolve form a convenient partner in more challenging projects to a genuine competitor in the industry.

The result is that the LNG market is evolving towards a traded market that most agreed was like that of crude oil. The development of a benchmark price by Platts is also aiding market development.

New shipping orders from trading houses are growing incrementally as the value of information alone is not the trading edge it once was and are increasingly investing in assets as they have already in the oil sector.

Indexation

Platts JKM liquidity has increased significantly and is becoming viewed as a serious benchmark product. The volatility being seen in the oil and gas markets demands an appropriate index to create stability in the market that currently does not exist.

One of the challenges has been that the industry has created too much choice in pricing structures ultimately creating decision inertia. An indexed product, particularly in Asia would be welcomed.

FSRUs

Two years ago, in this forum we were discussing the significant opportunity that existed in the FSRU market. The FSRU companies saw the opportunity and made several speculative orders, this has driven prices down and created an imbalance and supply overhang, therefore whilst the opportunity may still exist, it is not as attractive.

It was also noted that all the companies are chasing the same projects and in the same locations which by their nature are difficult markets. The result has been that, where there has been fundamental shortage of gas and significant government pressure to act, the first project (or 2) has been fast tracked through the approval processes. As the pressure on governments has eased, have subsequent projects have become tied up in corporate and governmental bureaucracy?

Europe/Russia

Russia sold record volume of Gas in 2017, it is unlikely that sanctions will have a significant impact and that in Europe, pipeline gas will be the primary driver. Limiting LNG to an optimisation role.

In addition, strong development of renewable power projects has reduced the required for gas in new developments. In this scenario, does Carbon Capture and Storage become a serious issue for the gas market. Discussion for next time – if gas wants to have a long-term role in the energy mix, it needs to address CO2.