Landscape and recent developments

Liquefied natural gas (LNG) infrastructure scarcity and other constraints are being unlocked and converting the traditional LNG supplier dominated market defined by long term contractual arrangements with inflexible terms to short-term and more flexible arrangements.

Overall, the LNG industry is bracing itself for a new era under buyer power and fuelled by a new set of non-traditional buyers and buyer expectations and as traditional Asian LNG demand growth begins to slow and a proliferation of new LNG supply projects enter the market.

These developments are gathering momentum to rapidly convert the LNG industry, all increasing contracting and portfolio management complexity and adding new risk considerations.

1. LNG market is globalizing with increasing diversity and capacity among sellers and buyers: Recent developments in regasification technology have been a catalyst in connecting more countries with the LNG market; increasing the number of potential buyers. A resulting increase of LNG traded, liquefaction and regasification capacity is occurring at the same time as increased sell side competition with the new US and Australia volumes.

The abundant supply picture has changed the negotiating dynamic in the LNG market; buyers will have the upper-hand in both new contracts and contractual renegotiations due to both excess supply and locational optionality. Sellers will need to review and rationalize their portfolio and development options in light of attractiveness and exposure to buyer sensitivities and expectations.

2. LNG demand is growing, albeit, at a reduced rate; Asia is still a key buyer but its demand shape will change into a more uncertain and price sensitive demand: Buyer’s demand is increasingly price sensitive, shorter term and seeking flexibility

Sellers need to prepare for fewer locked-in long-term contracts and for buyers to be more aggressive, seeking more favourable options such as: price reduction and openers; location optionality; volume flexibility; alternative pricing mechanisms, broader Force Majeure provisions, and even contributions to onshore delivery fees. All elements add new complexity to risk assessment and contracting.

3. Contractual arrangements are evolving through decoupling of oil and a move to gas hub indexation: The traditional oil linked contracts, both Brent and JCC — linked LNG contracts have been strained by oil price volatility over the last 24 months. The divergence in oil and gas price fundamentals has seen significant dislocation in long-term LNG contract prices — particularly in Asia.

In Europe, most LNG contracts contain a ‘price review clause’ which have allowed many European LNG and long-term gas contracts to remove oil pricing altogether. Europe, with a variety of natural gas pricing hubs is leading the charge in non-oil LNG indexation — with NBP, TTF some of the major pricing components within LNG contracts.

In Asia, LNG has been heavily linked to the oil price with the vast majority of contracts referring to a price slope of the JCC oil benchmark. With the US exporting LNG on a Henry Hub basis, and the significant volume glut, oil prices and the traditional price slope may no longer dominate or prevail in setting Asia LNG prices.
The industry will move to a range of pricing mechanisms and remaining traditional oil index contracts will be under pressure to reduce their slope. Gas indices and switching fuel alternatives will become more prominent in medium-long-term contracts. The development of liquid derivative LNG markets will also play a key role in the future pricing component of LNG contracts. The dislocation between long-term prices and spot markets will also see buyers seek to optimise portfolios with an increase in shorter duration contracts.

4. Emerging trends and micro-dynamics

- increased demands from buyers for locational and lifting flexibility
- spot pricing embedded in long-term contracts (e.g. JKM, NBP)
- increase in spot market volumes, as buyers seek to diversify portfolio away from long-term contracts
- push to reduced pricing formulas and inclusion of non-oil/alternate fuel pricing (e.g. HH)
- burgeoning growth of hedgeable instruments and derivative markets (e.g. Asia)
- evolution of new derivative instruments (e.g. location swaps)
- anticipated increase in uncontacted volumes
- mega-merger of Chubu-Tepco — setting the tone for a ‘buyer’s market’ and consolidation of interests with need for sellers to respond in kind to buyer segmentation and exposure
- increased risk-taking from sellers to ensure volumes are placed. New buyers with reduced credit worthiness, requiring credit enhancement or taking on additional risk appetite, capacity and mitigation.
- russian oversupply: threat of Russia swamping the European market with gas (impacting US LNG exports).

The above factors will herald a new era of portfolio optimisation considerations. Sellers will need to look to secure value in the medium to longer-term by extending existing contracts and doing business with new, more risky counterparties (whilst relaxing stringent credit requirements). Buyers will look to widen the scope of term contracts, convert pricing mechanisms and seek both spot and shorter term strip deals.

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Mary Hemmingsen is a regular author on the LNG industry and speaker, moderator and chair at industry conferences around the world and brings over 25 years of experience as an energy business leader in asset management and related business development. This includes leadership in the development and delivery of policy, strategy, initiatives and projects for energy, power, utilities and related infrastructure businesses in a range of capacities in both the public and private sector and for major utilities and global energy and asset managers. She advises a number of largest LNG global players on their interests in development, contracting and portfolio management.