

Expiring LNG contracts prompts indexation dilemma

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London, 24 April (Argus) — Long-term LNG contracts covering 29mn t/yr of supply are due to expire before 2020, meaning that buyers that have yet to secure replacement agreements will have to decide whether to re-sign with oil-linked prices or push for natural gas hub indexation.

Contracts with Japanese buyers account for half this supply, or 15.47mn t/yr. South Korean state-controlled oil and gas company Kogas accounts for 5.64mn t/yr and Taiwan for 1.84mn t/yr.

Asian buyers have in recent years moved away from oil indexation because of high crude prices compared with the US Henry Hub and UK NBP gas markets. But the fall in oil prices since mid-2014 may make buyers reconsider plans to push for gas hub indexation.

Over 30mn t/yr of US Henry Hub-indexed LNG has been contracted to Asian buyers. The flexibility of the contracts with US suppliers means that fob cargoes can be traded on to other consumers. But the trend towards Henry Hub-linked contracts could be waning, with other buyers turning back to oil or requesting hybrid contracts.

The Japan oil-linked des price for winter 2016-17 was \$10.51/mn Btu today, while the indicative US Gulf coast fob price was \$6.84/mn Btu. This compares with a Japan oil-linked price of \$9.80/mn Btu and an indicative US Gulf coast fob price of \$6.48/mn Btu in winter 2015-16.

Taking into account shipping costs of around \$1.39/mn Btu based on projected Panama Canal fees, the difference between oil-linked and Henry Hub-linked US exports is around \$2.10/mn Btu for winter 2016-17. This means that Henry Hub US supply is still relatively competitive with oil-linked term supply to northeast Asia. In addition, signing up to buy Henry Hub-linked US LNG would give buyers in Asia the flexibility to send supply to Europe if demand was not urgent.

Up to about 16mn t/yr of LNG has been contracted to long-term customers from the Sabine Pass plant in Louisiana, with around 7mn t/yr contracted to Asian buyers, 3.5mn t/yr to Europe-based trading firms and 5.5mn t/yr to portfolio companies. All the supply is contracted on a fob basis, which means that the offtaker can take the cargoes to any market. Traditional oil-linked LNG contracts are on a des basis, meaning that the buyer has to receive the cargo at a designated location.

Some buyers also have new Australian offtake agreements starting in the next few years, and may hold off renewing contracts with traditional exporters such as Indonesia and Malaysia.

Three contracts with Indonesian suppliers are expected to expire before 2020, along with four agreements with Malaysian suppliers. About 5.84mn t/yr of Indonesian contracts with buyers in South Korea, Japan and Taiwan are due to expire, along with about 4.4mn t/yr of Malaysia's agreements with buyers in Japan and South Korea.

Gas consumption in Indonesia and Malaysia is rising, which may reduce LNG exports. Both countries have already started to import LNG to meet domestic demand.

The fall in LNG spot prices could encourage buyers to purchase LNG on the spot market, rather than renew term deals. The closing price for the month-ahead Japan oil-linked des price in January was \$14.03/mn Btu. The ANEA price, the *Argus* assessment for northeast Asia, averaged \$10.03/mn Btu

for cargoes delivered in February, indicating that it has been consistently cheaper to buy spot LNG over term deliveries in the past six months.

This may be an option for India and China, but buying on the spot market could be riskier if supply tightens and prices increase. Asian buyers that are largely dependent on LNG for their gas requirements, such as Japan, South Korea, and Taiwan, will likely renew long-term contracts.

The emergence of new LNG supply and contracts, especially with projects in Australia, may prompt some buyers to not renew existing deals. Demand growth in Japan, South Korea, and Taiwan is expected to be limited, or even decrease over the next few years. Japanese imports are expected to fall as nuclear power reactors restart, while consumption growth in China could weaken as economic growth slows. And even LNG production project delays may do little to dent a well-supplied market in the short to medium term.

Around 98mn t/yr of new production capacity is expected on line by 2020. The market appears to be well supplied until then, but buyers with contracts that come up for renewal after 2020 may face tighter supply and different questions over indexation.