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$100b LNG projects imperiled by African gas rush

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The discovery along Africa's east coast of the world's biggest gas finds in a decade threatens to undo investment plans on the other side of the Indian Ocean.

Royal Dutch Shell, BG Group of the UK and France's Total may scale back projects to build liquefied natural gas export plants in Australia and switch to Tanzania and Mozambique, where the new prospects lie and will cost about half as much, according to Jefferies International.

The LNG boom in Australia, where $180 billion of planned investment was set to make gas the country's fastest-growing export over the next five years, risks losing strength as labor and material shortages force up building costs. As energy companies consider the next $100 billion of projects, a switch to East Africa would hold back Australia's market share in China and India, where energy consumption is forecast to rise more than 60 percent by 2030.

“Because of the volume that's been discovered in East Africa, the economics look to be able to challenge Australian LNG projects, given the cost inflation they have experienced,” said Peter Hutton, an RBC Capital Markets analyst in London. “All companies will have that on their radar.”

The Asian market for LNG, gas that's chilled to a liquid for shipment by tanker, accounts for about two-thirds of global demand and will grow by 6 percent a year this decade, according to Sanford C. Bernstein & Co. Among six Australian projects scheduled to reach investment decisions in 2013, few will be approved because of climbing costs, Neil Beveridge, a Hong Kong- based analyst at Bernstein, said in a report this month.

'Real Competition'

“There is real competition in the 2020 time frame,” said David Knox, the chief executive officer at Santos, which is developing Australia's $18 billion Gladstone LNG venture together with Total, Petroliam Nasional Bhd. and Korea Gas Corp. “But we can compete, provided we keep our productivity up, our cost base under reasonable control and we can unlock the resources.”

Dale Nijoka, an analyst at Ernst & Young LLP, said this month in a report that LNG from East Africa “could become more competitive than unsanctioned Australian LNG projects, causing them to be delayed, re-worked or possibly canceled” over the long term.

One such Australian project is a third processing plant, or train, at BG's Curtis Island project. Reading, England-based BG said in May that spending on the first two trains would rise 36 percent to about $US20 billion because of higher costs and a more expensive Australian dollar. BG is considering investing in East Africa's first LNG project in Tanzania.

Tanzania LNG

“The ability for Tanzania to compete for capital in BG's portfolio is growing,” said Theepan Jothilingam, an oil analyst at Nomura Holdings. It can “prioritize Tanzania LNG” over expansion of its venture on Queensland's Curtis Island.

Kim Blomley, a spokesman at BG, declined to comment on payments to East African nations for the fuel, saying that the company is "only in the exploratory phase right now" and "it's a little early to say any more."

Explorers in Tanzania and Mozambique may build at least two trains in each country with combined costs of about $US32 billion and ship the first LNG as soon as 2018, according to Jefferies. The cost per unit of capacity will be about 44 percent lower in Tanzania than at Pluto LNG in Australia, the most expensive plant built, the bank said. Mozambique, ranked 213 of 227 countries for per capita income, may be even cheaper.

Woodside Petroleum, operator of the Pluto project in Western Australia, acknowledged that East Africa is an "extraordinary gas province."

Anadarko talks

Still, "as I look at East Africa, I look at the maturity of oil and gas regulations, the lack of infrastructure, and my view is some of those projects probably won't come on as quickly as people think they will," Woodside Chief Executive Officer Peter Coleman said in an Aug. 23 interview in Sydney.

Shell and Total have been in talks with Anadarko Petroleum Corp. and Eni SpA about buying into gas fields discovered off Mozambique with more than 100 trillion cubic feet (2.8 trillion cubic meters) of gas resources, enough to meet Asian demand for almost five years.

There are still 95 trillion cubic feet of gas reserves yet to be discovered in Mozambique and Tanzania, Wood Mackenzie Ltd. said Aug. 22. "There is clearly plenty of gas to supply the likely commercialization route of LNG -- theoretically enough to support up to 16 LNG trains."

There will be risks to developing LNG projects in East Africa, where there's no history of large-scale oil and gas production and roads and airports are often relatively poor.

Regulatory 'gaps'

"East Africa's regulatory and infrastructure gaps could hinder the transition from gas exploration to production in the medium term," said Clare Allenson and Anne Fruhauf, analysts at Eurasia Group in London. "Now that investors are confident of the existence of commercial natural gas reserves in the region, the focus will shift to the evolving operating environment."

For some smaller investors involved in the gas fields, financing their share "will certainly prove challenging and could delay development," said Giles Farrer, an LNG analyst at Woodmac.

BG is developing plans for an LNG project in Tanzania after discovering about 7 trillion cubic feet of gas together with partner Ophir Energy Plc. At the same time, it's trying to find a partner for Curtis Island to cut Australian costs.

Tanzanian LNG

"While it's going very well in Tanzania, when the result of six in a row discoveries are very encouraging, we are not in the place to take discussions further" on the LNG project, said Neil Burrows, a spokesman for BG. He declined to comment on whether BG would opt to develop Tanzania LNG before making an investment decision for the third train in Queensland.

Kentz Corp., an Irish oil and gas engineering company working on the BG project, said awarding activity hasn't declined "significantly" in Australia.

Contractors "just have to wait and see" if it slows down, Edward Power, the chief financial officer at Kentz, said today in a phone interview. "You often see some level of delay, but we are not seeing any slowdown of project coming out today," where Kentz is involved.

Australia's LNG industry faces a shortage of skilled workers and has to pay higher wages in the world's fastest growing developed economy. The strong Australian dollar has also boosted costs for the developments in U.S. dollar terms after the currency rose 23 percent since 2008.

Competition for Australia

"East Africa has got potential to be a bigger LNG supplier than for example Australia or Qatar on a much lower cost base," said Barry Rushworth, the CEO at Australia's Pancontinental Oil & Gas NL, which is drilling now a well off Kenya. "People are just not actually realizing how much potential East Africa has yet."

Planned North American exports are set to add to the competition for Australia after a boom in production from shale reduced U.S. natural gas prices to a 10-year low. Shell has already started talks with Freeport LNG Development LP in Texas, which is aiming to become the second venture to win U.S. approval to export the fuel from the Gulf of Mexico coast after Cheniere Energy Inc.

$US30 billion Shell investment

Shell, which plans to invest $US30 billion in Australia over the next five years, is looking at opportunities in Africa. The Hague-based company has drilled in Tanzania and last month dropped its $US1.8 billion bid for Cove Energy Plc, a U.K. explorer with assets in Mozambique, because Thailand's state oil company made a higher offer. The decisions to walk away was described by the Anglo-Dutch company's CEO Peter Voser as an "example of capital discipline."

"The bid for Cove highlighted the potential need to rotate exposure from Australian LNG projects to the new East Africa frontier," RBC's Hutton said. "We believe Shell was right to withdraw, but the shift in portfolio still needs to be addressed."

Shell spokesman Jonathan French referred Bloomberg News to Voser's comments made July 26 when the CEO described East Africa as "an interesting province" and "a big resource."

$US34 Billion Ichthys project

Total, based in Paris, has increased its stake in the $US34 billion Ichthys LNG project in northern Australia, where costs may beat Pluto's record, according to the Australian Bureau of Resources and Energy Economics.

The French company CEO Christophe De Margerie plans to expand in East Africa after joining a $US10 billion oil project in Uganda. In June, Total secured the latest permit to explore for oil and gas off Kenya.

"East Africa is a strategic oil and gas province for Total, where the group seeks to build a stronger presence and currently pursues exploration activities," said Anastasia Zhivulina, a spokeswoman at the company.

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