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Australian LNG industry faces headwinds

By Neil Hume in Sydney

Australia's resources minister rarely misses a chance to talk up the country's liquefied natural gas industry – with good reason. Australia is poised to overtake Qatar as the world's biggest LNG exporter as seven colossal projects reach full capacity over the next five years.

But the industry is also facing serious headwinds as a consequence of its rapid growth. A second wave of developments and project extensions, worth an estimated A$150bn, is at risk from rising labour costs, infrastructure bottlenecks and the strong Australian dollar.

If these issues are not addressed then new investment in Australia's LNG industry could dry up in 2017, warn industry executives and analysts, and new suppliers based in Canada, east Africa and the US will move to capture a lucrative prize: 90m tonnes of annual uncontracted Asian LNG demand.

"The first Australian LNG projects have all seen cost blowouts. Not one of them has been delivered on time or to budget," says Duncan Maclean, the Perth-based co-head of law firm Squire Sanders' global energy group.

"If we can't produce gas at a competitive rate then investment will slow down and eventually stop in Australia."

The scale of the challenges facing the industry could be underlined in the next couple of weeks when Chevron, the US oil company, reveals what is expected to be a huge cost over-run at Gorgon, Australia's largest single-resource natural gas project.

The budget for the 15m-tonne-a-year project being built off the northwest coast could rise by as much as A$20bn to total A$60bn, say analysts. Industry executives say Australia is now the most expensive place in the world to develop an offshore oil or gas project.

In a recent speech to the Australian Institute of Energy, David Knox, chief executive of Santos, a large Australian oil and gas group, claimed it cost three times as much to develop a project in Australia than on the US Gulf Coast, and was only getting more costly.

"The Australian LNG projects currently under construction are now 80 per cent more capital intensive than those already in operation," he warns.

The biggest contributor to cost inflation, according to Mr Knox, is Australia's lack of skilled labour, experienced subcontractors, and a dearth of specialist suppliers. "The cost of Australian labour [is] double that of many of our competitors, and productivity in most cases lower."

Martin Ferguson, Australia's minister for Resources, Energy and Tourism, says the government is working with the resources industry to ensure Australia "remains competitive".

But industry bodies such as the Australian Petroleum Production and Exploration Association say the government is not doing enough. David Byers, APPEA chief executive, says major policy reform is needed in areas including labour, taxation and licensing.

"Australia's high-cost environment and the emergence of new LNG competitors in North America, east Africa and elsewhere will make it much harder to win market share and attract investment than has been the case over recent years," says Mr Byers.

However, the industry is also looking to technology and collaboration to help bring costs under control and bypass red tape.

Royal Dutch Shell is championing floating LNG at its A$12bn Prelude project off the coast of Western Australia, expected to be operational in 2016.

It will be the first LNG project in the world to process and store gas at sea. This will be done on huge barges – six times the size of the world's largest aircraft carrier – moored directly over the gasfields.

Floating LNG has several advantages. The plant can be manufactured and assembled in more cost-effective locations overseas. There are no land access issues, and fewer secondary costs such as the need to build housing for workers in remote areas. Decommissioning is also less complex.

JPMorgan estimates the A$40bn Woodside Petroleum-led Browse LNG project, also in Western Australia, could save up to A$9bn by using floating LNG.

"[Floating LNG] is an important breakthrough for the LNG industry worldwide: unlocking stranded gas, and avoiding local infrastructure bottlenecks and inflation," says Andrew Brown, upstream international director for Shell, which recently tripled its interest in the Browse project.

But floating LNG is unpopular with state governments in Australia, which fear they will miss out on economic benefits if gas is processed offshore. It is perhaps no coincidence that the Western Australia premier, Colin Barnett, has in recent weeks warned floating LNG could pose greater safety and environmental risks than conventional gas projects.

Australia needs to move quickly so that it is not priced out of an increasingly competitive market, says Squire Sanders' Mr Maclean.

"The only advantage we have at the moment is transportation costs. It's on the boat for less time and it costs less to move it. That's really the buffer we've got at the moment and it is eroding."