

Time for Return of Higher Slopes in the LNG Market?

Low oil prices and low slopes are a deadly combination for sellers. In the world ahead of us, with low oil prices and buyers stuck at slopes in the 11% range, the vast majority of sellers cannot recover their costs for new projects.

The oil price war initiated by the Saudis and the massive demand destruction by COVID-19 mean we have a step change to a world of oil in the US\$40-50/bbl range for some time, even after the price war has settled and COVID-19 has passed. In this world, slopes of 10-11% do not work.

Buyers need to be realistic. LNG prices of US\$4-6/mmBtu over the long term are not sustainable. We may well need to return to slopes of 12-13% to make the equation work economically and psychologically.

But the buyers are intent on getting lower slopes. Slopes have been falling from the high of 15% to the 11% range. We had expected further erosion to the 10% range by late-2020. However, COVID-19 and the oil price war have dramatically changed the equation. Low slopes are simply not viable anymore, at least not for new projects at today's oil price.

Some buyers may prefer to buy on a JKM basis instead of accepting higher slopes. But any mid - to long-term contract based on JKM is likely to require a minimum price, probably on a Brent basis, to offer downside protection and enable sellers to cover costs. Naturally, there should also be a maximum price to offer upside protection for buyers. This is especially applicable to all the new projects.

Qatar Petroleum, Novatek, and PETRONAS may well be able to offer lower slopes by relying on existing production and recent FIDs. However, it is next to impossible to expect new projects to survive on low slopes. Eventually, buyers will suffer if new projects do not take FID.

It is time for a fundamental change of approach to LNG procurement. S-curves helped buyers and sellers come to an agreement in the past, with protection for both sides. A JKM-linked formula with downside/upside protection seems the most relevant in today's market. Oil indexation will remain an important element of the market, but at slopes which deliver a price that justifies new LNG projects.

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