Russia to boost presence on global LNG market, helped by lower costs

FILE PHOTO: Russian Deputy Energy Minister Pavel Sorokin speaks during an interview with Reuters in St. Petersburg, Russia May 26, 2018. REUTERS/Sergei Karpukhin/File Photo

* Russia plans to produce up to 120 mln T LNG per year by 2035

* To compete with Australia, U.S. on global LNG market

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ST PETERSBURG, June 1 (Reuters) – Russia plans to raise its annual production of seaborne liquefied natural gas (LNG) to as much as 120 million tonnes by 2035 and take market share from Australia and the United States by capitalising on low costs, a deputy energy minister said.

In December, Russia's No.2 gas producer Novatek and its partners including France's Total launched the Yamal LNG plant in the Arctic, with capacity of 17.4 million tonnes per year seen reachable by the end of 2019.

The project highlights Russia's ability to produce LNG in harsh climates and further strengthens its foothold in the global energy market.

"Russia may set a goal of producing 100-120 million tonnes (of LNG) per year by 2035," Deputy Energy Minister Pavel Sorokin said in an interview.

"We understand this from our discussions with the companies about their potential, which they can add to their previously announced projects."

Yamal LNG aims to help Russia double the country's share of the global LNG market by 2020 from about 4 percent now. Qatar, aided by production costs that are among the world's lowest, is the biggest LNG exporter with a 30 percent market share.

Novatek also plans to launch LNG production at the neighbouring Gydan peninsula.

Russia's Gazprom, jointly with partners including Shell, launched the country's first LNG plant in 2009 on the Pacific island of Sakhalin with a capacity of more than 10 million tonnes per year.

Yamal LNG has produced around 2 million tonnes since its launch in December.

So far, Russia has been the dominant player in pipeline gas supplies to Europe, with Gazprom supplying around a third of the continent's needs.

Demand for seaborne LNG has taken off in recent years as it is cleaner than oil or coal, and can reach markets worldwide because it does not depend on pipeline networks. LNG is typically more expensive than pipeline gas, however.

Sorokin said he expects global LNG demand almost to double in the next 20 years to exceed 500 million tonnes per year.

U.S. export capacity has shot up from less than 2 million tonnes per year in 2015 to 18 million tonnes in 2017, and is projected to top 77 million by 2022. That would see the United States leapfrog Australia to become the world's No. 2 exporter.

"What will trigger the rivalry are the additional volumes that the U.S. or Australia could supply," Sorokin said, adding that Russian companies are highly competitive due to their low costs for production and transportation.

According to the Moscow-based Skolkovo think tank, average

production and transportation costs at Yamal LNG for exports to Shanghai are seen at just above $8 per million British thermal units (mBtu) by 2025.

That is roughly the same as the cost for LNG projects in Western Australia and less than the approximately $9 for LNG exports from the southeastern United States.

Sanctions aren’t stopping Russia’s LNG ambitions

Despite the imposition of US and EU sanctions in the energy sector, new projects continue to flourish in Russia. Already the world’s largest exporter of traditional natural gas, the country is gaining a foothold in the liquefied natural gas market. For the last 3 years, Russia’s LNG capacity has been growing substantially.

Competition from Qatar, Australia, and the US, the world leaders in LNG exports, coupled with the impact of political tensions after the Ukraine crisis, have made Russia reconsider its traditional pipeline exports. After Lithuania and Poland built their own LNG terminals with gas from Norway, Qatar and most recently the US, Gazprom’s conventional gas intake was significantly diminished in both countries. Despite Gazprom’s cheaper price, Lithuania and Poland preferred to pay a premium for their LNG to reduce the dependency on Russia’s energy resources.

Gaining a foothold

Novatek, Rosneft and Gazprom each set out to develop their own unconventional gas resources. Novatek's Yamal LNG is Russia's most ambitious project. Based on the Kara Sea in the Arctic Circle, gas extraction is conducted under the permafrost, which makes it incredibly challenging. Funded by Russia's Novatek, France's Total, China National Petroleum Corporation, and China's Silk Road Fund, Yamal LNG is a $27 billion facility that will start full operation in 2018. It will produce 16.5 million tonnes of LNG per year. Yamal LNG's gas plant will be finished in November. As a symbolic gesture, Russia will send the first shipments to China, which supported the project. Another four shipments will follow in December.

Rosneft is developing its Far East LNG project in Sakhalin, which aims to produce 5 million tonnes of LNG gas. Its goal is to deliver supplies to the Asia-Pacific region, in particular to Japan and South Korea.

Gazprom is pushing LNG as in-house transport fuels. Russia's gas giant signed agreements with Avtodor, the Russian highways state company, and Gazprom Gazomotornoye Toplivo, a Gazprom subsidiary, to grow a network of LNG and compressed natural gas filling stations for locomotives and trucks. Expanding its reach, Gazprom also launched small-scale LNG projects abroad in places like Vietnam, Belarus, Ghana and Bolivia.

Bypassing Western sanctions

The impact of Western sanctions on Russia's LNG development proved to be rather limited. Despite the restrictions on financial borrowing and export of Western technologies (e.g. drilling and hydraulic fracturing), Russia managed to keep its LNG projects afloat. Loopholes in the sanctions regime and new partners allowed Russia to bypass legal implications and to find new funding.

While both oil and gas exploration projects were prohibited under US sanctions, the EU sanctions exempted gas projects. This allowed European investors to further participate in the development of Russia’s LNG gas plants. Both French Total and Dutch Shell preserved their 20% and 27% shares in the Yamal and Sakhalin projects, respectively.

Despite Western restrictions on capital, Russian energy companies still manage to attract European investments. Italy’s Saipem is set to be a subcontractor for Arctic LNG 2, Novatek’s second gas plant on the Kara Sea. In 2015, Shell agreed to invest in the expansion of Gazprom’s Sakhalin II, while in 2017, a Dutch company set up a joint venture with Gazprom to design and construct the Baltic LNG project in the Leningrad Region. However, Rosneft’s Far East and Gazprom’s Vladivostok LNG projects were delayed until 2020 due to a lack of funds and low fuel prices. Partnered with ExxonMobil in 2014, the Far East project was stalled due to looming Western sanctions over the Ukraine crisis. Recently, Rosneft announced that it may build the LNG plant using its own resources exclusively.

Russia’s pivot to Asia and the Middle East lessened the country’s dependence on Western lending. In March 2017, having difficulties raising funds from Western banks, Novatek sold a 9.9% stake to China’s Silk Road Fund. Similarly, Rosneft turned to Chinese investors after Glencore and the Qatar Investment Authority cut their stakes. A 14% stake of Rosneft was bought by CEFC, China’s Energy conglomerate, for $9 billion. Recently, investors from Japan and the Middle East showed interest in Gazprom’s Baltic and Novatek’s Arctic 2 LNG projects.

Making strides in the LNG market

With the latest reports predicting 13% growth in the LNG market by 2025 and an overall 53% share in long-distance gas trade by 2040, Russia is under further pressure to develop its LNG projects on time. Currently, Russia exports 10.8 million

tonnes and has a 4.2% market share.

Following the completion of the Arctic 2 LNG project, the country might challenge the dominance of Qatar, which currently occupies 30% of the market. By building the second gas plant on the Gydan peninsula, Russia could produce up to 70 million tonnes of LNG annually, just below Qatar's 77 million. The construction of Arctic 2 is slated to commence in 2019, with the first shipments due on the market in 2023.

Challenging Qatar's dominance in the LNG market would make Russia not only the world's largest exporter of conventional natural gas, but also of liquefied gas. The conditions for that are favourable. With funding from China and Saudi Arabia, Russia can bypass Western restrictions on capital. Russia's LNG exploration sites are strategically close to the Asian market. Located in the Far East, LNG would be easy to transport via sea to Japan and South Korea, the world's largest LNG importers.

Total to buy 10% stake in Russian LNG project

France's Total has agreed to take a 10 per cent stake in Arctic LNG 2, a liquefied natural gas project being developed by Russia's Novatek in the Siberian arctic.

Total did not specify the financial details, but the acquisition values the project at $25.5bn, Novatek's chief executive Leonid Mikhelson said. He added that he was in talks with other companies to acquire other stakes and that Novatek intended to hold 60 per cent of the project.

Total, which already owns 19 per cent of Novatek and has a 20 per cent stake in Yamal LNG, a similar project launched this year, has an option to increase its Arctic LNG 2 stake to 15 per cent. The deal was signed during French president Emmanuel Macron’s visit to Russia for talks with Vladimir Putin.

“Total is delighted to be part of this new world class LNG project alongside its partner Novatek, leveraging the positive experience acquired in the successful Yamal LNG project. This project fits into our strategic partnership with Novatek and also with our sustained commitment to contribute to developing the vast gas resources in Russia’s far north which will primarily be destined for the strongly growing Asian market,” said Patrick Pouyanné, chairman and chief executive of Total.

“Arctic LNG 2 will contribute to our strategy of growth in LNG by developing competitive projects based on giant low costs resources.”

When up and running, LNG 2 will have a production capacity of approximately 19.8m tons per year. Total said the final investment decision is expected in 2019, with plans to start up the first train by the end of 2023.

Mr Mikhelson said: “We are talking to a number of companies [about selling other stakes in the project]. Not empty chit-chat but serious discussions.”