

Shell deal signals endgame in LNG

MATTHEW STEVENS



THE fitful but inevitable consolidation of Queensland's LNG future has entered the endgame in the wake of the resolution of the super-profits tax, with Santos and Shell confirming discussions are afoot on what would effectively be a massive asset-sharing deal on the Australian independent's Curtis Island project.

The important starting point to appreciating what is going on here is that the \$1 billion or so equity-for-volume contracts being pursued by Santos with Sinopec and Kogas are being negotiated concurrently with, but quite separately from, the Shell talks.

In essence, Santos is still talking about luring potential customers to its Curtis Island project with the offer of up to 20 per cent in its GLNG project, which is arguably the most advanced and best positioned of the Gladstone Island ventures.

But it is also in discussions with Shell about a deal that would introduce its potential competitor in the coal-seam methane to LNG space to the GLNG project as partner in the downstream project.

Now the word is that the deal, still very tentative, would probably not involve a whole lot of cash changing hands upfront but instead would see Santos and Shell effectively share the cost of infrastructure which links Curtis Island to the inland gas fields and storage facilities and which links the proposed LNG trains to port.

Given talks translate into action — and it is understood we are at a very early stage of negotiations if only because Shell wants to close out its \$3.5bn acquisition of coal-seam boom baby Arrow Energy — Santos and Shell would end up effectively sharing the Curtis Island site and, most likely, committing before the end of 2010 to the construction of one train each at the Australian's Curtis Island site.

The essential logic underpinning that sort of outcome is that there are substantial synergies to be extracted, and presumably shared, by committing immediately to a two-train build rather than just one.

The back of the envelope numbers are that it might cost Santos \$8bn for its first train and only \$4bn for the second.

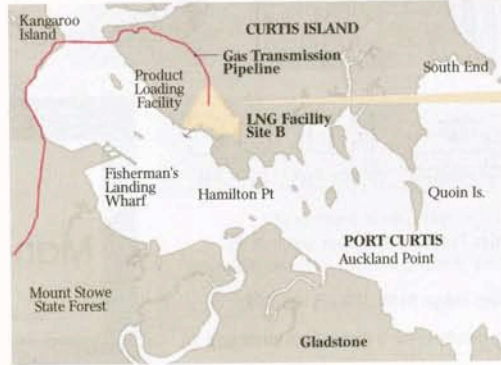
By bringing Shell in early, Santos brings forward the potential of synergies without adding to

Continued on Page 28

Merger talks on \$16bn Gladstone plant



Santos's Gladstone Liquefied Natural Gas project on Curtis Island could see a deal that would merge two of the region's four LNG projects



TRAIN 1*	SANTOS, PETRONAS, KOGAS, SINOPEC
TRAIN 2	SHELL, PETROCHINA, FUTURE TRAINS
TRAIN 3	SANTOS, PETRONAS
TRAIN 4	SHELL, PETROCHINA
TRAIN 5	TO BE DETERMINED

* production unit



Santos deal

There'll be no change in ownership of the gas fields. Two of the four major LNG projects would merge and split the development costs of \$12bn.

An LNG plant at the Santos site on Curtis Island already has Queensland government approval.

Shell and PetroChina could take ownership of a full production train. Santos would continue to supply Sinopec and Korea Gas and could sell them up to a 20 per cent stake in its project.

Talks herald the consolidation of four rival LNG projects

MATT CHAMBERS
LNG

ROYAL Dutch/Shell and PetroChina are in early talks to take ownership of a full production train at Santos's Gladstone Liquefied Natural Gas project, in a deal in which two of the town's four LNG projects would merge and jointly fund an expected \$16 billion development.

Little cash or equity is expected to change hands in the deal and it is understood the two previously competing Gladstone projects are now in talks to split the costs of a two-train LNG plant on Santos's Curtis Island LNG site.

The proposal would allow Santos, which owns 60 per cent of GLNG, to continue existing supply and equity talks with Sinopec and Korea Gas. Malaysia's Petronas, which has a long history of working with Shell, owns the remaining 40 per cent of GLNG.

The negotiations herald the start of the long-awaited consolidation of the four competing LNG projects at Gladstone that want to export Queensland's huge coal-seam gas reserves.

According to CSG industry sources, there is probably only the potential for two separate projects on Curtis Island, meaning a Santos/Shell partnership would put increased pressure on Origin Energy, whose partnership with Conoco Phillips is the biggest but least advanced of the projects, to get involved in consolidation.

Reports in *The Australian* and other media yesterday that Shell and Santos were in talks sent the Adelaide oil and gas producer's shares 9.7 per cent higher to \$14 yesterday, their biggest one-day surge since late 2008.

Shell is understood to not be considering an equity stake in Santos's GLNG project.

Instead, if its \$3.5bn joint takeover of Arrow Energy with PetroChina is successful, Shell and PetroChina will be able to have full ownership of one of the first two trains built on the site.

The deal would give Shell

access to Santos's site, which has state government approval, and speed the expected time frame for Queensland LNG production.

For Santos, the deal would lower its cost outlay, provide upfront substantial cost savings that come with building a second LNG train and bring on board one of the world's most experienced LNG producers.

Deutsche Bank estimates a two-train project (including on-shore gas field development that Shell and Santos propose to develop and operate separately) would cost \$16bn.

Santos and Shell were tight-lipped on the talks yesterday, but Santos admitted it was in talks about consolidation.

"GLNG remains in detailed and ongoing discussions with a number of parties in relation to potential LNG sales, equity in the project and collaboration between projects," Santos said.

"These discussions are incomplete and there is no certainty that definitive agreements will be executed by the parties."

Santos chief David Knox said in February that the period for

consolidation had passed, and in recent statements he said only that talks revolved around sales and project equity.

The window for consolidation has now clearly reopened.

Although a two-train project that would produce up to 8 million tonnes of LNG a year would be the starting base, Santos's site has room to produce up to 22 million tonnes a year from five trains, meaning both parties' ambitions to each produce from two or more trains could be realised.

To put the project's ambitions in perspective, the \$43bn Gorgon LNG project in Western Australia, the nation's largest resources project, will produce 15 million tonnes a year.

It is believed that the talks have touched on Shell developing and operating the LNG project, although this is yet to be finalised.

UBS analyst Gordon Ramsay boosted his rating on Santos to "buy" from "neutral", based on reports of the Shell/Santos deal.

Morgan Stanley analyst Stuart Baker said a deal with an operator of Shell's experience would be a good one for Santos.

"Building these things is a hard job," Mr Baker said. "Having Shell in there reduces the execution risk a lot. You could really get a better partner."

The structure of the deal would allow Santos to continue to talk with Kogas and Sinopec for LNG sales and up to a 20 per cent stake in a one-train project.

Gas giant BG Group is the most advanced of the projects and ready to supply contracts.

It is expected to give a formal go-ahead on its project when federal government environmental approval is granted.

Analysts said the status of the BG project and talk that state and federal governments saw room for only two big projects at Gladstone meant Origin/Conoco might feel pressure to join its project with BG, or in a less likely scenario Shell and Santos.

"BG don't have to do a deal with anyone, but while Origin has a lot of gas, it is starting to look a little left out in the cold if it doesn't get a partner," Mr Baker said.

But he said Origin/Conoco might not be pressured to do a deal.