American LNG - a Failed Publicity Stunt

"... America is now on the verge of becoming a net exporter of natural gas, which may occur in the next year or two. This may save Japan, which is in dire need of energy, from its debilitating ultra-high prices, and liberate Europe from the iron grip of Gazprom. The networks of LNG export terminals on the Gulf Coast and the West Coast of the USA have already received the necessary permits and are under construction or ready for operation. Untold riches await daring investors..."

At least, so it may seem in the cloud of dust thrown in the eyes, which has become as thick as summer fog in San Francisco, and has enveloped this segment of the gas industry. The shares of some companies hoping to ride the wave of the export boom in LNG are soaring. Billions, mostly borrowed from unsuspecting creditors of a particular type have already been spent and will be spent on the construction of even more highly capital-intensive export terminals for LNG exports.

For example, Cheniere Energy is known today for its mounting losses in the context of sharply declining revenues: in 2013 it had a loss of 507 million dollars, with 267 million in revenues, which is quite a feat! Its losses increased by 156% compared to 2011, while revenues fell by 8%. Now the company’s debt is 9.5 billion dollars, whereas in 2011 it was 3.3 billion dollars. The price of the company's shares soared from a level below the dollar in 2003 to more than $40/share in 2006 and 2007 before going through purgatory in 2008 and again falling to a diminutive value. Then, in 2012, all this fuss about LNG exports began to envelop the profits of the company's operations in a veil, and its stock price soared again, recently reaching its peak - $72/share at the auction on August 5, 2014. Truly, this was a devilish ride.

Why does this keep happening from time to time? It now has already become forgotten that in 2008, Cheniere spent 2 billion dollars on the construction of an LNG import terminal which quickly became useless when the rapid growth in the supply of domestic production put an end to the demand for imported gas, reducing the price of this type of energy in the US from $13/million BTU to less than $3/million BTU. Over the next two years, the company’s share price remained at the level of about $1/share, and the Houston firm itself teetered on the brink of bankruptcy.

But in 2010, chairman and director of the company Charif Souki placed his bet on the shale boom and proposed to build an export terminal. Analysts, advertisers, loud statements of companies, free money from the FRS, and investors and traders ready to cash in on this market - they are all part of the publicity stunt. For them, this entire enterprise is based on the declared opportunities to profit from the difference between the prices for natural gas in the US, Japan, and Europe.

Cheniere aspires to become the largest buyer of US natural gas by 2020. Its gas liquefaction plant in Louisiana, worth $12 billion dollars, and another similar enterprise that is planned to be built in Texas, will allow it to export about 6% of the total gas produced in the United States. The company concluded with its customers 20-year contracts based on the cost of natural gas in the US market, which amounted in the first nine months of 2014 to an average of $4.47/million BTU. According to calculations, for new customers in Asia LNG will cost approximately $11.64 after payment of all fees, and $9.64/million BTU for consumers in Europe.
Meanwhile, natural gas prices in the US are held in electronic trading below $4/million BTU. However, in Europe, they are more than twice as high, and in Japan more than four times as high. But do not forget that the processing of natural gas into LNG in the US and its transportation from the US to Europe and Japan will require expenditures that will eat up part of the difference in prices.

Thus, the stock prices of Cheniere are based on the risky assumption that gas prices in the US will remain just as low, while the prices for it in Japan and Europe remain high, and that the signed contracts will reflect this difference in prices in the coming years.

**And besides this whole concept is based on the hypothesis that the US will produce enough gas for export.** However, there is a certain flaw in this logic: in fact, the United States is still a net importer of natural gas, despite years of "excess drilling" and the allegedly formed "glut in the market" of natural gas, which led to the fall in prices below the cost of production of gas and their retention at such a low level.

The US currently exports natural gas via pipelines to Mexico and Canada, however, at the same time it imports it in even greater quantities from Canada via pipelines (and also buys a small amount of LNG from abroad). Despite the boom in drilling activity, the United States remains a net importer of natural gas.

So what natural gas are these LNG exporters going to sell abroad? US domestic production is unable to fully meet domestic demand. The gap between supply and demand is met by imports from Canada. The large-scale export of LNG still remains a beautiful dream. Unless a miracle happens - and miracles rarely happen in the oil and gas industry - American production will fully meet domestic demand without relying on imports by 2018. And if production continues to grow even after this, the US may eventually begin to produce enough to become a net exporter of LNG in significant volumes.

But herein lies another trap: drilling for dry natural gas has almost come to a stop. According to the latest (early August 2014) data, only 313 rigs were drilling for gas in the US, while in September 2008 there were 1,606.

Production is growing, but this production is increasing mainly due to the development of the Marcellus shale deposit, where the incredible boom in drilling activity of recent years has led to the emergence of thousands of gas wells that have no connection to pipelines. Now pipeline infrastructure is overcoming this gap, and deferred production capacity is being put into operation. The gas coming to the market as a result is accounted for as a new production. However, many of the wells that maintain this growth were drilled years ago.

At that, drilling activity - which is essentially a guarantee of future production - on the Marcellus shale is only a shadow of what was observed here in the past: In January 2012, 143 gas wells were drilled here, whereas at the beginning of August 2014 drilling was underway in 77 of the wells. Wells in which hydraulic fracturing technology was used demonstrate a rapid production decline. And after 18 months their yield is only a small fraction of the initial level. As soon as this drop in production occurs at the recently commissioned wells, the total production figures for the Marcellus shale will fall sharply. Only a new boom in drilling activity can restart production growth.

But herein lies the third trap. Current gas prices are simply too low to justify the use of hydraulic fracturing technology for production of dry gas, although if a production well yields oil and liquid forms of natural gas, which are sold at higher prices, and dry natural gas is merely a by-product, then the equation is less bleak. So in order to encourage a new drill boom, gas prices must be much higher.

And hence the fourth trap: these significantly higher gas prices in the United States, which are necessary to restart the boom in drilling, will also lead to the destruction of the difference in prices, on which investors in LNG exports primarily rely. However, the universal hallucination cannot be subject to any doubts or apparent paradoxes in the current situation. Reality no longer plays any role. Instead, importance is placed on the immensity of the reserves of the FRS, the practically free money and abundant opportunities of the cloud of dust in the corporate and financial sectors.

I am afraid that US Senator John McCain, who confidently stated that “in order to ‘balance’ the import of gas from Russia to Europe" the US will begin deliveries of natural gas to Europe by 2020, is obviously premature. Easy to say...

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