Singapore as an LNG hub: Understanding challenges and identifying opportunities in 2014

KPMG's Global Energy Institute (GEI) organized a reception for energy leaders in February 2014 at the Maison BARSAC restaurant in Tokyo.

This event – one of a series of regular receptions held by the Institute in key Asia Pacific (ASPAC) cities – gathers industry players to share insights about the global energy sector.

Mina Sekiguchi, Head of Energy & Natural Resources, KPMG in Japan hosted the event together with her colleague, Tsuneo Miyamoto, Transactions and Restructuring Lead of Energy & Natural Resources, KPMG in Japan.

The keynote speaker was Pek Hak Bin, Partner and Head of Energy & Natural Resources, KPMG in Singapore. Hak Bin is also the former Country President of BP in Singapore.

Hak Bin started the evening's discussion by providing a brief overview of the key trends and dynamics that had an impact on the sector in 2013. He noted that global energy players faced a tough business environment last year due to various factors.

These factors included oil price volatility driven by geopolitical issues, abundant gas supply from unconventional new sources, low coal prices and the slow nuclear recovery in Japan.

Challenging environment in 2013

Global energy consumption has grown over the past four years, albeit at low rates. However, global supermajors saw declining profitability in 2012 and 2013 as their margins were squeezed by a challenging operating environment.

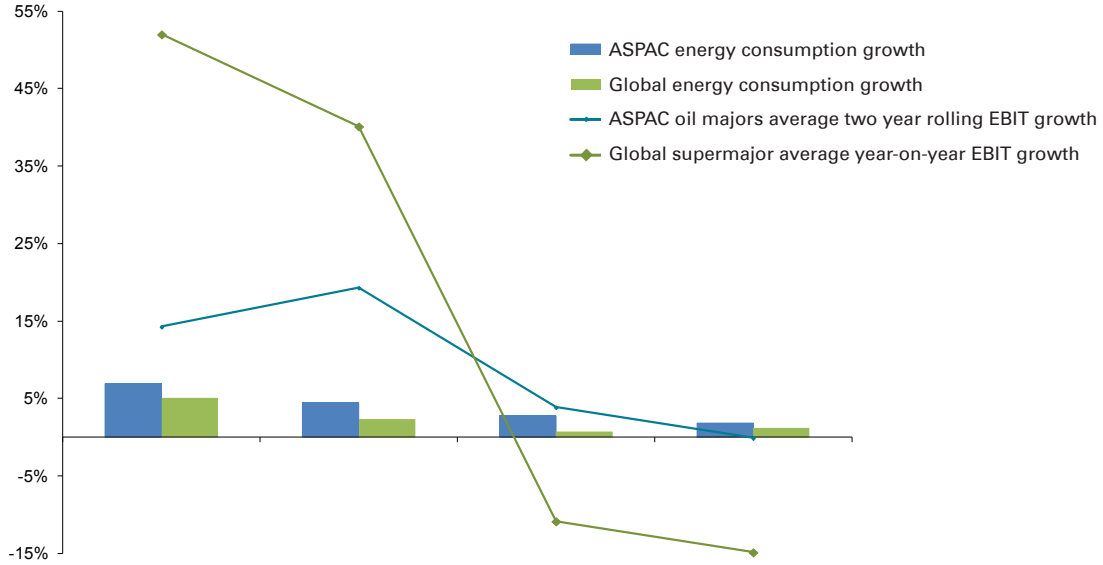
The picture has been slightly brighter in the ASPAC region, where energy consumption has seen higher growth rates compared to global levels.

Nonetheless, regional oil majors were unable to avoid the same profit growth crunch experienced by their global peers.

Hak Bin noted: "An interesting trend from 2013 was that profit falls reported by the international major oil companies were comparable to boosts in earnings by the national oil companies in South-East Asia. However, the rate of increase in earnings has slowed for the national oil companies."

"We are not surprised by these trends. A high oil price benefits upstream operations but puts a tighter squeeze on retail markets. This has a further impact on the performance of internationals."

Average Earnings before Interest and Tax (EBIT) change for ASPAC oil majors and global supermajors verus energy consumption growth



Return on assets	2010	2011	2012	2013
Asia Pacific oil majors	12 %	12%	10%	8%
Global supermajors	13 %	15%	12%	10%

Note: Average of BP, Chevron, ExxonMobil, Royal Dutch Shell, Total SA, Petronas, Petrochina, Sinopec, ONGC, CNOOC and PTT

Sources: International Energy Agency, Bloomberg, Company Annual Reports

Eight key themes for energy companies in 2014

In the year ahead, we expect to see energy companies enhancing their performance to combat the squeeze in margins.

International companies are already seeking improvement in areas such as supply chains, shared services, rationalized procurements and order-to-cash cycles. Nationals are still pursuing both domestic and international growth opportunities. They are experiencing growing pains as they transform business operations, implement new strategies and make new investments and acquisitions.

The work KPMG firms are doing in Southeast Asia largely reflects these trends. Against this backdrop, we have identified eight key themes below that will influence the ASPAC energy sector in 2014.

While some of these themes encompass factors outside the control of individual companies, organizations that can adapt quickly and optimize their position within the changing environment will be well-positioned for growth and sustainable profitability.

Delivering performance

The challenge here is not around setting strategy but in execution and bringing out the underlying value of operations.

Joint Venture structuring (JVS)

This is a very important area in the Asian region. Key considerations are ensuring compliance with Production Sharing Contracts and finding the right partner in the downstream sector to bring mutual benefit and added value through, for example, licensed technology.

Cyber security

Protection of Information Technology (IT) systems and business continuity have emerged as major issues. Many energy companies including national organizations with reputations to protect are finding their IT platforms under attack. These companies have become higher profile targets than as the world becomes more energy conscious.

Capital and projects

These are key concerns for Chief Financial Officers. Ensuring discipline around planning, budgeting and in all phases of 'coming out of the ground' is a central issue for energy and natural resources companies. Projects consume billions of dollars of investment, concentrated over relatively short build phases.

Clean energy

This is an area drawing increasing attention. Every government and company wants to get clean energy right. Environmental damage can have a detrimental impact on a project, or on an organization's reputation. This area is not necessarily profit driven.

Energy markets

In Asia, countries in the region are competing to establish an LNG trading hub and create a pricing point. Regulators are seeking to develop power markets. Companies are looking to protect their value creation from exposure to high energy prices.

Talent development

People and Talent is an unsurprising area of focus as good people in the sector are in demand across all regions. As hubs emerge, there will be more competition for talents, who already are highly mobile.

Role of governments

Companies will not make investment decisions unless the right regulatory frameworks are in place and energy policies are stable. Governments with major or developing energy markets must play a key role in setting up an environment conducive for investment.

The two themes driving Asia in 2014

In Asia, high fuel prices will damage regional competitiveness.

- **Delivering performance** in a low growth environment. Corporate strategy should ensure the organization is able to rationalize asset pools within the energy ecosystem.
- **Energy markets** are growing in Asia. Southeast Asia is playing an increasing role in the global market. Futures markets and pricing points for Asia are gradually being developed.

There is a need for more bargaining power in Asia. Japan is struggling to lower its energy costs in light of the nuclear shut down and a 25 percent increase in LNG imports will have a large financial impact on the country.

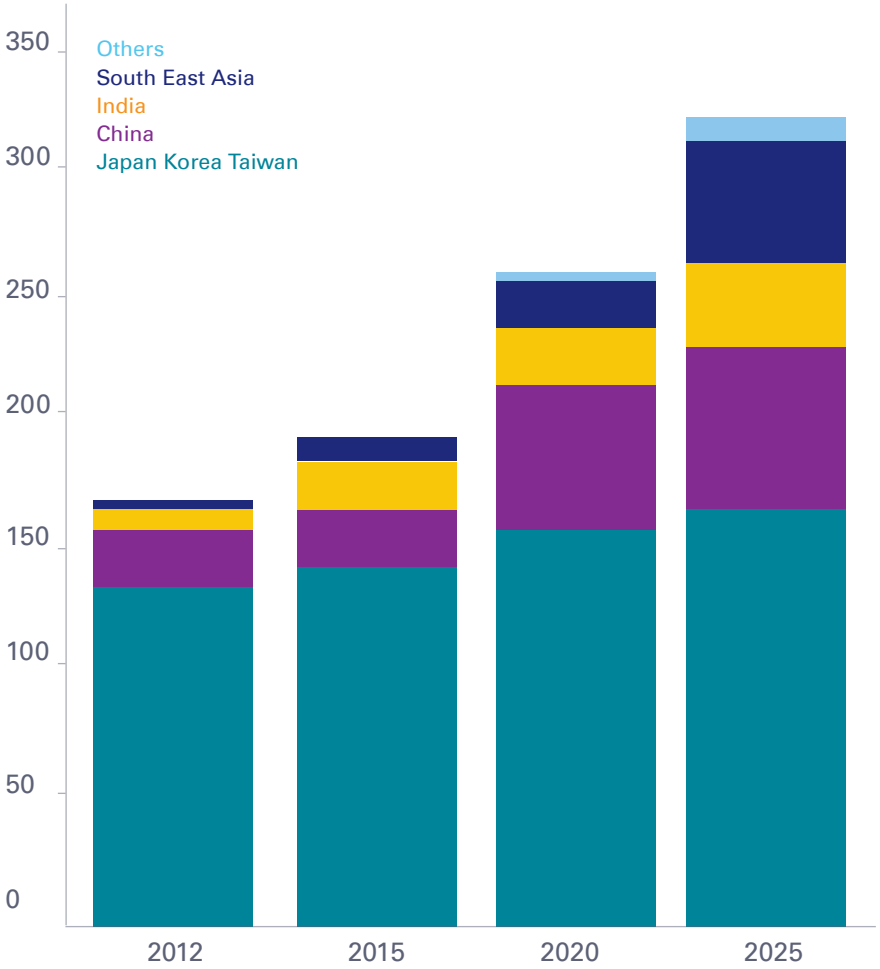
The Japanese Government is seeking partnerships that will help secure supplies or allow a natural hedge against high prices. The cold winter in the United States has kept prices there high (Henry Hub prices spiked at US$8/mmbtu in February 2014).

This has in turn reduced Asian bargaining positions with the region therefore keen to develop its own pricing mechanism.

Middle Eastern companies are conserving supplies for future generations so bargaining positions there are reduced as well. Having only one price point globally in Henry Hub means that oil indexed pricing will remain for Asia with its long-term contracts.

Asia is seeing huge increases in demand for LNG. Japan, Korea and Taiwan are accounting for around 160mmtpa of the demand, far outstripping the combined demands of India, China and South East Asia.

Asia LNG Demand Forecast (2012-2025)



Source: Wood Mackenzie

However, there are over 50 import terminals in the pipeline for Asia, which will provide some 150mmt capacity in the next 10 years. On the trading front, Japan has announced that it will launch LNG futures trading and Singapore is seeking to be the pricing point for spot trades in Asia.

Around 20 oil majors have also set up shop in Singapore, attracted by good tax incentives. Some form of Asian pricing mechanism would be necessary to remove the link between gas prices and oil indexes, and this will be ideal for Asia.

The current high price paid by Japan, whilst necessary due to the nuclear shutdown, is not ideal for Asian competitiveness in the long run. Therefore, some form of collaboration on trading mechanisms and more generally on energy policies might be desirable.

The Singapore energy sector in 2014

Singapore currently has a 3mmt capacity LNG terminal and there are plans to expand capacity to 15mmt in the future. The terminal is currently owned by the Ministry of Finance, which is not a normal funding structure for an LNG plant.

The Government is unlikely to want to carry the US$3 billion loan for the plant on its balance sheet. Moving forward, it will be interesting to observe how the Government will transfer the plant to a new funding or ownership structure.

The role of the aggregator is another key issue. Currently BG Group is the sole aggregator for the first 3mmt of LNG. The Government is in the process of consultation and there will be more parties bidding for the next 3mmt.

The Singapore Government announced in February that a second LNG import terminal will be built in Eastern Singapore.

Energy security has always been a major concern for Singapore, with the need to reduce reliance on the two import gas pipelines from Indonesia and Malaysia. Since Singapore does not need 15mmt for its own use in the short term, the country could consider positioning itself as an emerging LNG hub.

Delivering performance in a challenging environment

With rising costs and many existing challenges set to persist in 2014, the global energy sector will continue to face hurdles as companies strive for growth and profitability

Current forecasts suggest that the ASPAC energy sector will see low growth in the year ahead.

"Although demand growth remains positive, there are several factors, both global and regional, driving a slowdown in profit growth among oil and gas industry players", explained Hak Bin.

Hak Bin noted that companies in this sector tend to have long planning cycles, which make it difficult to react quickly to changing business conditions.

To deliver performance industry players will have to identify areas for improvement in a very challenging, low-margin environment. Yet despite the obstacles, KPMG believes that there is potential for sustainable business improvement.

Four key challenges ahead

Market supply is generally increasing either in line with or ahead of demand growth. This is translating into relatively static pricing with reduced volatility, limiting the opportunity for price increases.

The regulatory impact from subsidies and price controls in some ASPAC markets is also influencing selling prices and the ability of companies to drive profitability growth through pricing.

Rising costs will also affect margins and the return on assets. For example, the rising cost of expatriates working in China due to changing tax policies will have an impact on companies seeking to retain these talents.

In addition, wage inflation is running significantly ahead of productivity growth in many Asian markets. Industry players are struggling to deal with this inflationary cost pressure.

Energy markets to play a key role

Energy markets will also have a strong influence on the ASPAC energy sector in 2014. Given that the industry is currently at a low point in its growth cycle, companies should be focusing on getting the basics right. This includes looking into areas such as achieving operational efficiency and ensuring robust risk management.

One way to do so is via the smart management of energy price risk.

"There are always opportunities for improvement in your business, and it doesn't always involve doing something radically different. Sometimes we can derive significant value by tweaking the part of the business that we take absolutely for granted.

"In an environment where there are a lot of challenges and restrictions on growth, looking inward can help to reveal opportunities for innovation", said Hak Bin.

For companies looking to manage energy price risk, a good place to start is with exposure identification and quantification. This may involve re-examining basic underlying business assumptions, as these may be hiding both significant exposures and opportunities for improving risk management.

Once a company has a solid understanding of the nature and scale of its energy price risk, it can take active steps to manage this exposure through the use of derivatives, changes in procurement practices or other risk management approaches.

Conclusion

The global energy sector faced a tough business environment in 2013 and it appears that industry players globally will continue to face constraints on growth and profitability in 2014.

While the ASPAC region is faring relatively better compared to global players, energy sector companies in the region will face their own set of challenges. Energy markets and LNG trade will help ASPAC countries and companies in their energy security and procurement.

Successful organizations are those that can effectively manage the key themes driving the energy sector to their advantage.

About the KPMG Global Energy Institute (GEI)

The GEI is a worldwide knowledge sharing platform detailing insights into current issues and emerging trends within the Oil & Gas and Power & Utilities sectors. Launched in 2007 in Houston, United States, the Institute opened its first regional centre in Singapore at the KPMG Global Energy Conference – Asia Pacific 2013.

Energy professionals will have access to valuable thought leadership, studies, events and web-casts on key industry topics. A regional focus to the GEI provides decision makers tailored insight within the Americas, Asia Pacific and the Europe, Middle East and Africa regions.

The GEI strives to equip professionals with new tools to better navigate the changes in the dynamic energy arena.

About the Business Club

Launched in 2013, the KPMG Global Energy Institute in Asia Pacific aims to bring together senior decision makers in the Energy & Natural Resources sector every two months. While the main objective of the event is to allow participants to network, the GEI also aims to be a platform for our global energy specialists to share their insights into the sector. Participants will therefore be able to gain a broad perspective on what's happening in the enrgy sector.

Register

Individuals can register for the GEI at the following link: www.kpmg.com/energyaspac and receive regular updates, thought leadership and invites to events and web conferences.

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