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HORIZON

Second Mexican LNG Project Aims to Beat US Rivals to Asia

Sempra's Energia Costa Azul (ECA) in Mexico recently became the first LNG project to take a final investment decision (FID) this year (WGI Nov.18'20). But nearly a quarter of the planned 3.25 million ton per year output is still uncontracted after it lost Tokyo Gas as a long-term buyer. The Japanese utility joined Mitsui and Total in signing preliminary deals for 800,000 tons/yr each in 2018, but never firmed up the agreement. That left the Japanese trading house and the French major as the only confirmed offtakers, now lifting a combined 2.5 million tons/yr.

Tokyo Gas declined to say why it got cold feet, but a market source suggests it may have been due to differences over the price index for the 20-year contract. The project will source feed gas from the US Permian Basin and Tokyo Gas wanted 100% indexation to prices on West Texas' Waha Hub, which trade at a discount to the US Henry Hub benchmark. Sempra offered a Waha-Henry Hub hybrid, according to the source. Tokyo Gas feels it already has enough exposure to Henry Hub, with term contracts for more than 2 million tons/yr from Cove Point and Cameron indexed to the benchmark, he says.

The brownfield Costa Azul is on Mexico's west coast, which means that — unlike US Gulf Coast LNG — cargoes can be shipped direct to Asia without using the Panama Canal. It will be the country's first liquefaction project, with exports expected in late 2024.

A second project eyeing the Asian market is a 12.9 million ton/yr, three-phase development at Puerto Libertad in Sonora, again in the west. The project, proposed by Houston-based Mexico Pacific (MPL), intends to price-link 100% of its LNG output to Waha since feed gas will be priced off the hub, CEO Douglas Shanda tells Energy Intelligence. MPL hopes to take FID on the 4.3 million ton/yr first phase in late 2021 or early 2022, targeting first gas in the second half of 2025. Shanda says it may sanction two phases at the same time due to strong commercial interest. The company is in talks with eight buyers from Asia and elsewhere, but he declines to say whether Tokyo Gas is among them.

Most Asian buyers are unfamiliar with the Waha index — although Shanda reckons that is less applicable to firms with Texas upstream assets — and a source with a buyer believes an innovative customer like Tokyo Gas or Jera would have to take the Waha plunge before others follow (WGI Jan.8'20).

"Waha has some very favorable attributes but some risks as well," says a source who advises Asian buyers. While it trades at a discount to Henry Hub for lack of Permian takeaway capacity — and has at times entered negative territory — the differential could narrow. Energy Intelligence's Research & Advisory unit expects it to expand from 60¢ per million Btu in the third quarter of 2020 to $1/MMBtu in the fourth before shrinking to 50¢/MMBtu in 2021 and 2022 — essentially the cost of transport — as new takeaway capacity opens.

One concern is that Waha is more volatile than Henry Hub as it is heavily influenced by tight oil production, and exposed to regional supply/demand shocks such as weather and pipeline/storage capacity constraints. Waha prices dived to as low as minus $5/MMBtu at one point in April. Henry Hub is much more tradable, so risk management is easier.

Unlike MPL, Sempra probably won't buy all its gas off the Waha index, another source says. As the discount to Henry Hub is more likely to narrow than widen, the company "would be more likely to lose value based on the spread risk than gain value if it sold more LNG on Waha pricing than the amount of feed gas it purchased at Waha pricing."

Shanda says the MPL project will be "incredibly competitive against US Gulf Coast projects," and can hold its own against Qatar. He dismisses US developers' low cost-per-ton claims, saying that represents only a "fraction of the full cost. For buyers, what's important is the landed price delivered in Asia, which includes other factors such as liquefaction and shipping costs." He says it would take around 11 days to ship to Japan, versus at least 20 days from the US Gulf Coast, and shipping costs would be about 45% lower. TechnipFMC is now conducting front-end engineering

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and design work. MPL's price formula is for long-term supplies on an f.o.b. basis with a fixed cost. It is still in talks on whether to sell on a tolling or sales and purchase agreement basis.

MPL is backed by private equity funds Avaio Capital and Tortoise Capital. It is led by a team of industry executives with LNG experience: Shanda was previously senior vice president of operations at Cheniere and oversaw the US' first LNG export project at Sabine Pass.

He says the Sempra FID augurs well for its own project. It "is a great indicator for investors and buyers how the administration views LNG projects — they value them incredibly." MPL still needs an export permit, which Shanda says is due in the first half of 2021. ECA was only awarded its export permit after agreeing to mop up a regional gas surplus, but he says the administration of President Andres Manuel Lopez Obrador has not set conditions. "The government likes private investment which does not compete with state-owned companies and can support the socioeconomic goals of the country." MPL plans to open talks with state power utility CFE, which has signed contracts for unneeded gas.

Shanda says MPL is open to buying gas from anyone provided it's priced off the Waha Hub, which he thinks will remain at least $1/MMBtu lower than Henry Hub. Even if new Permian pipelines are built, the gas has to find a home and "if there are no end-users ... the differentials will still be there."

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