The Competitiveness of Russian Gas in Asia

April 2014
Russia has clear motivation to turn to Asia

- Growth in Asian gas demand, especially in China
- Significant gas resources in East Siberia and Far East of Russia
- Uncertainty over future of export sales to Europe and FSU
- Gazprom’s declining share of Russian domestic market
- Need for increased tax revenues from export sales
- Geo-political demonstration to western powers that Russia has alternative markets

Key questions:
- Can Russian gas compete in Asia?
- Which company will be the driving force behind Russia’s eastern expansion
Gazprom faces a threat to its western sales volumes

Gazprom has adjusted prices to Europe

Gazprom sales to Europe recovered in 2013, rising 16% to 162bcm as Russia’s export price adjusted to market levels

Post Ukraine crisis EU countries have announced a determination to diversify away from Russian gas

Sales to Russia’s largest FSU market, Ukraine, will presumably fall sharply

There is a longer-term threat to Russian exports to western markets, although Gazprom can offer some very competitive gas
Gazprom’s role in the Russian domestic market has also been in decline

- Gazprom has found its dominant role in the Russian market also being challenged.
- Rising domestic prices have encouraged Gazprom’s development plans but have also incentivised “independent” supply.
- The Russian gas price has now reached a level where independents can undercut Gazprom, take market share and still make significant profits.
- In 2013 Gazprom’s gas had become the “least desirable option” for many of its customers.
Russia has a fundamental oversupply of gas in the West and as a result has turned towards Asia for export growth

There is effectively an oversupply of gas in Russia, which has led to Gazprom significantly downgrading its production estimates for 2020 and 2030.

Gazprom and the Russian government are keen to open new markets for exports, with Asia being the obvious target.

Sakhalin 2 LNG has been in production since 2009, but further expansion is likely to involve piped exports as well as further LNG projects.

However, Asia has now become the new frontier in Gazprom’s competition both with global producers and with its domestic rivals.
Russia’s Eastern strategy is closely related to negotiations with China over piped exports

- Pipeline infrastructure is the key to opening up Russia’s vast eastern resource base
- Fields in Irkutsk and Yakutia are effectively stranded unless “Power of Siberia” is constructed
- Sakhalin has the option of increased LNG exports or the S-K-V pipeline to Vladivostok and possibly into NE China

Source: Gazprom
Reserve and production potential is significant

Eastern regions contain 6tcm+ of reserves

Production potential exceeds 160bcma

- Gazprom dominates the asset base in Russia’s eastern regions with more that 4.5tcm of reserves, mostly in two major fields

- Rosneft also has significant gas reserves spread across its eastern licences, and the company also has broad exploration potential

- Full development of Russia’s existing eastern gas assets could see potential production as high as 160bcma, which would be directed at the domestic as well as the export market
Export sales based around LNG and piped gas

Four LNG projects could export 40mtpa

Pipeline exports could take total to c.100bcma

Russia has multiple options for gas exports via LNG and pipeline

By 2025 total Eastern exports could reach 100bcma, or two thirds current exports to Europe

The China pipeline export route could match current gas sales to Germany

However, decisions about the prioritisation of projects and the sources of gas for liquefaction remain uncertain until China deal is signed (or not)
Negotiations with China have been going on for more than a decade

- Initial discussions took place in the 1990s

- MoU on gas exports via two potential routes (Altai and East Siberia) signed in 2004

- Gazprom purchase of Kovykta in 2011 allowed negotiations to focus on eastern route

- Major parameters agreed by 2013, apart from the vital element of price

- January 2014 – negotiations again rolled over to Presidential visit to Beijing in May

- April 2014 – intensive negotiations and suggestions that Russia may be prepared to make concessions on equity in upstream

- May 20th – Putin to visit Beijing – will politics catalyse final decision and override pricing impasse?
Russia is facing significant competition for a place in the expanding Asian gas market.

Established and emerging gas export regions of the world

Growing global LNG potential

Legend
- Established gas export province / flows
- Emerging gas export province / flows
- Gas export / import province name
- Gas import province

Source: IEA
Outcome of China negotiations is key to competitiveness of Russian gas in Asia

- Despite the high costs of Russia’s gas export projects to Asia they can be competitive on cost with other global exporters
- The proximity of the Russian East to Asian markets keeps transport costs down
- Key questions remain over:
  - Whether Russia’s marketing strategy will exploit this competitive advantage
  - Will the projects be developed in the most commercially logical order?
The growing competition between Gazprom and the Independents is now playing out in the Asian export markets

- A significant battle is taking place to become the leader of Russia’s LNG strategy

- The ending of Gazprom’s monopoly on LNG exports signifies government support for 3rd party exporters – Rosneft and Novatek are actively competing with Gazprom for customers

- Managed competition is the Russian government target, but Rosneft is becoming more assertive – asking for TPA in export pipelines and has formed JV with CNPC in East Siberia
Yamal LNG project likely to be the first new project, with gas going west as well as east

Yamal LNG project schedule sees first output in 2016/17

- The Yamal LNG project is projected ultimately to produce 16.5mmtpa with first gas coming in 2016/17
- The introduction of CNPC as a 20% partner and LNG purchaser is a significant advance for the project
- Technical complexity and the harsh environment could cause some delay
- Gas will be transported west for up to 7 months of the year, creating the potential for competition with Gazprom in Europe
What will happen on Sakhalin? Sakhalin 2 expansion makes sense but could it be trumped by Sakhalin 1?

- Sakhalin 2 infrastructure is ready for a third train
- Sakhalin 3 gas reserves now approaching 800bcm
- Will the gas go to VLNG or stay on Sakhalin?
- Rosneft has concrete plans for a one train scheme at Sakhalin 1
- Sales MoUs have been signed with SODECO, Marubeni and Vitol
- Could request for TPA in pipelines see return to previous China agreement for Sakhalin 1 gas?
Conclusions

- Russia has a number of clear incentives to promote gas exports to Asia, which have been heightened by the current events surrounding Ukraine.

- Russian gas can be very competitive in Europe, but volumes may still be limited in future by political decisions.

- Expansion into Asia has been a long-term Russian goal, and the country’s eastern regions have significant reserve and production potential.

- The exact strategy for export (and domestic) sales will depend upon the outcome of negotiations with China over piped exports.

- Gazprom is under some pressure to deliver, as competition is increasing from international and domestic peers.

- Rosneft appears to have an aggressive marketing strategy that could even involve piped gas as well as LNG.

- Russia’s gas can be very competitive into the Asian market if a suitable marketing strategy is chosen.