

Export demand drives \$7bn project

Resigned to mixed reviews from analysts, Santos simply focuses on growth, writes **Stephen Wisenthal**.

It's turning out to be a year of big announcements for Santos. And so far, in contrast to last year's series of disappointments, the news has been good for the gas company's share price.

But managing director John Ellice-Flint, who this week made Santos's biggest announcement yet — a planned \$7 billion liquefied natural gas development at Gladstone in Queensland — seems resigned to analysts' complaints that Santos doesn't have enough growth projects.

"We just have to keep doing what we're doing and day in, day out keep growing the company," he says.

He barely mentions the Cooper Basin gas reserves that built Santos, preferring to focus on coal seam gas in Queensland, offshore oil and gas developments, a program of boosting Cooper Basin oil output and an expanding selection of potential LNG projects.

The Gladstone announcement on Wednesday came as investors expect Santos's rival, Woodside Petroleum, within the next two months to give the final go-ahead to the \$10 billion Pluto LNG project on the Burrup Peninsula in Western Australia.

Ellice-Flint resists comparisons between the two LNG plans. "We're not in competition with Pluto," he says. "There's so much demand in South-East Asia it's not an issue."

And he dismisses suggestions there is a short period for LNG producers to tap rising gas demand.

"It was never a window," Ellice-Flint says. "You have huge energy demand from Japan, China, Korea, the US. All those countries are looking to diversify from [buying from] the Middle East."

Gladstone LNG, which is due for final investment go-ahead towards the end of 2009 and first production early in 2014, will be the first LNG project supplied by coal seam gas,

which will come from Santos's huge resource in central Queensland.

Ellice-Flint concedes it may take time for analysts and investors to get used to the idea of exporting coal seam gas, but insists there are major advantages, including development costs. "Anything onshore is going to be cheaper than anything offshore."

Gladstone LNG is forecast to produce between 3 and 4 million tonnes of LNG a year, requiring between 170 and 220 petajoules of gas a year.

Analysts say Santos will have to manage the ramp-up of production from the 500 wells it plans to drill during the five-year development of Gladstone LNG, but it will be able to shut in some of its conventional gas output to match domestic supply and demand in the meantime.

The company gets mixed reviews from brokers. Merrill Lynch upgraded its price objective by \$1 to \$15 on the Gladstone LNG news, while Credit Suisse maintained a \$10 price target.

"A Queensland development includes the added benefit of changing the dynamics of the east coast Australian gas markets, which in our view could lead to higher domestic gas prices as evident in Western Australia," Merrill Lynch analyst Cosimo Damiano says in a report.

But Credit Suisse analyst Andrew Williams says the export plan supports a theory that domestic prices will not increase soon. "We will need to see the proving up of reserves and some de-risking of the project through customer letters of intent before we could start to de-risk the project significantly," he writes.

Santos shares rose 42¢ yesterday to \$14.44, close to the record \$14.74 they reached in June. The stock has gained more than 50 per cent since March on expectations of a takeover if the South Australian government removes a 15 per cent shareholding limit, and rising oil prices.

One of Ellice-Flint's challenges is to make sure that in September, when the state government is due to announce the results of a six-month review of the takeover protection, the Santos share price is high

enough that predators are scared away, or at least need to pay up.

He also wants to have a strong enough valuation to allow Santos to consider bidding for other oil and gas companies or assets. This may be necessary to bolster the near-term production outlook, although Ellice-Flint insists developments in Indonesia, Vietnam and WA, as well as Cooper oil, should be enough. It's at least five years until Santos is likely to see any expansion of output from the future LNG projects it has on its books. Santos became an LNG producer only last year, courtesy of its 10.6 per cent stake in the Darwin LNG project, which is preparing for a major expansion.

The experience in Darwin is just one of the reasons Santos rejects criticism it lacks the necessary experience to develop an LNG plant.

"We haven't been an operator [of an LNG plant] before but Santos has historically been involved in building huge infrastructure projects," Ellice-Flint says.

And the first offshore development operated by Santos, the Mutineer-Exeter field in WA, came in early and under budget, he says.

Ellice-Flint says Gladstone is a cheaper place to build an LNG project than either Darwin or the North-West Shelf because it has existing infrastructure and a large number of experienced workers.

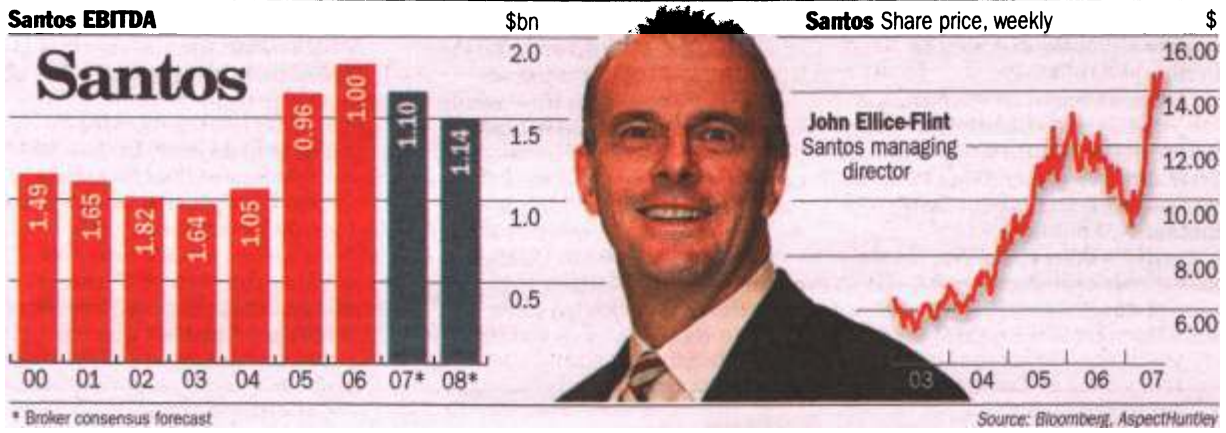
Between 200 and 300 of the workers who built Darwin LNG, for example, live in Gladstone.

"If you compare the access to skills and facilities in Gladstone, you cannot compare them with northern Australia or Western Australia," he says. "You've got rail, you've got power, you've got people that are used to building large construction projects. Deepwater ports [like Gladstone's] are critical in LNG."

The Queensland government has given Gladstone LNG major project status, which will help ease regulatory hurdles, and Central Queensland Ports Corp has agreed to provide Santos a site on Curtis Island.

“We just have to keep doing what we’re doing and day in day out keep growing the company.”

ENERGY RELEASE



Location, location . . . Santos says it is cheaper to build an LNG project in Gladstone than Darwin or the North-West Shelf.

Photo: GLENN CAMPBELL