Senex Energy Limited

# Stable policy matters

## Address to Australian Domestic Gas Outlook conference

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Good morning everyone.

Let me acknowledge the Gadigal people of the Eora Nation, the traditional custodians of this land, and by paying my respects to Elders past, present and emerging.

I'd also like to acknowledge the really tough times endured by everyone affected by the flooding of the past week and wish those communities a speedy recovery.

Before I begin, I'd like to say that I was fortunate to attend yesterday's presentations and was encouraged by the general tone.

The Federal Resources Minister, Keith Pitt, set the scene when he said the current regulatory balance was right between affordable gas for manufacturers and a price that encourages gas resource development.

And I thank him for his constructive comments.

I noted that the minister said the states should bring more gas online – I think COVID has taught us we are in a Federation – and that the recent Heads of Agreement between the Federal Government and Queensland's LNG exporters would help ensure the east coast has sufficient gas at affordable prices. The HoA is the right instrument for this.

This final point is one that I'll keep returning to today.

I've been Managing Director and CEO of the Queensland-based natural gas producer Senex Energy for more than 10 years now.

I love what I do and I'm extremely proud to work in an industry that has done so much to support Australia's great standard of living.

And I'm proud of the role Senex and the domestic gas industry is playing, and will continue to play, in shaping a prosperous and healthy future for our country.

Our young, Australian-born and bred company employs people in secure, well-paid, highly skilled jobs – and we continue to support the jobs of thousands of employees in the manufacturing sector.

Senex alone has invested around half-a-billion dollars over the past two years alone – and hundreds of millions more in the past decade – in developing gas supply for the east coast market.

We are supported by a broad shareholder base of self-funded Australian retirees, mums and dads and institutional investors.

With that solid backing, we are able to invest in the production of natural gas that, in turn, helps east coast manufacturers make everyday products that we all take for granted.

Like bricks and plasterboard in your home and the beverage bottles on your table.

Because we are successful in what we do, we pay royalties and taxes and support our host communities in regional Queensland; communities which are thriving.

We are just one of many good companies in our industry who are doing great things.

That's why I cannot stand by as attempts are made to hollow-out the ground on which my company, and our industry, stands.

Let me explain what I mean by repeating a simple but critical comment from Esso Australia, the Victorian domestic gas producer, yesterday:

*"Investments in domestic gas supply that sit in front of industry today, require a stable and secure policy environment that provides industry with confidence.*

*"Confidence to invest, so the gas all of us rely on continues to be available when and where we need it at competitive and sustainable prices."*

Unfortunately, this is the one thing missing from the gas market today – a stable and secure policy environment, along with the confidence to invest that comes only with that.

It's hard to comprehend that some elements of the Federal Government and some large gas users who want more and more intervention in gas markets cannot see that this will result in less investment in gas supply and higher gas prices.

This is, of course, the very opposite of the liquidity and lower gas prices they seek and it threatens them as much as it threatens gas producers.

Make no mistake: this, is a high-risk game for Australia.

I will explore these themes today, focusing on:

1. changes and misinformation in the gas market;

2. related threats to investment in gas supply; and

3. the possibilities if we all get on with the job of developing more supply and committing to gas contracts.

Ladies and gentlemen, there are many reasons why Queensland has become Australia's leading natural gas state and why it is now doing all the heavy lifting.

Queensland is blessed with an abundance of resources, bipartisan political support, and a strong pioneering spirit.

It was the case when Australia's first hydrocarbons were discovered in 1901, accidentally, at Roma in the Surat Basin, during the drilling of a water bore.

And it has been the case ever since.

Despite decade after decade of exploration efforts across Australia, hydrocarbon discovery and production was evasive.

It was a further 60 years before commercial natural gas production occurred, again near Roma, in 1961, for a power station.

But the company which discovered the gas, Australian Associated Oilfields, faced difficulties securing more gas buyers because there was no infrastructure link to Brisbane.

In the mid-Sixties the newly formed Associated Pipeline Limited, now known as APA, did a feasibility study to fill the void.

The Queensland Government was keen to attract this investment and, in 1967, Austral-Pacific Fertilizers Ltd, which later became part of Incitec Pivot, signed a 15-year contract to take gas to Brisbane.

Backed by US investors including Dow Chemicals, they built a $40 million fertiliser factory on Gibson Island, on the Brisbane River.

This gas supply agreement allowed funds to be secured for development of the pipeline and in 1969, the 438-kilometre Roma Brisbane Pipeline, or RBP, was opened.

Other industry in Brisbane quickly connected, including the Brickworks company.

The pipeline was also the start of the Wallumbilla Gas Supply Hub, near Roma, which the Federal Government now seeks to become Australia's future primary east coast gas hub.

This was an incredible feat of collaboration between producers, pipeliners, manufacturers, government and investors.

It's the story of how Queensland shored up its fledgling gas industry, built Australia's first natural gas pipeline and gained what was then its biggest manufacturing facility.

Queensland's historic success, quickly replicated in other states, encapsulates the challenges and achievements that define a successful gas chain:

- firstly, significant investment and risk taken by gas producers;
- secondly, significant investment and risk taken by the pipeline company;
- thirdly, significant investment and risk by the manufacturer;
- fourthly, the Australian and international financial backers of each of these players; and
- finally, the Queensland Government, which guaranteed supply of gas through the pipeline and to the fertiliser manufacturer.

Given the threats of Federal Government regulatory intervention leading to market uncertainty today, it's questionable whether we could achieve something similar in 2021.

But we have done it in the past and in the next few minutes I'll provide my view on what it will take to achieve similar feats in future.

Let me first explain who we are at Senex, and why we're relevant to the topic of Federal Government regulatory intervention.

Although for most of our 30-year history we have primarily been an oil and gas explorer and producer in the Cooper Basin, our recent history begins – again – in Roma as a Surat Basin natural gas producer.

Following the sale of our traditional Cooper Basin business, which closed last month, we are now unique in that we are a Queensland-only producer of scale focused on the east coast market.

We have a valuable natural gas business currently supplying the equivalent of 10 per cent of Queensland's gas demand, to excellent commercial and industrial customers in Queensland and in southern markets.

The foundation of our Queensland business began in 2014, in Roma, when we sought to develop a newly acquired block which could only be described at the time as marginal acreage.

In seeking to develop this block we spoke to a lot of domestic customers to secure an offtake contract to secure our required financing.

The only customer – I repeat, the only customer – who stood up to agree a contract to take our gas was the Santos-operated GLNG venture, with whom we reached a 15-year gas supply agreement.

And I'd like to formally acknowledge them here.

Without that agreement, Senex's gas supply may never have occurred.

We are now well on the way to producing around 50 terajoules a day from this acreage, or 18 petajoules a year, which is a material portion of supply to the east coast market.

In 2017, on the back of more than $200 million of investment – and a lot of hard work – in Roma, we successfully won a bid for acreage near Wandoan that has become our second, and biggest, foundation project in the Surat Basin.

It's called Atlas and it is Australia's first dedicated domestic-only acreage.

We've had strong support from some great commercial and industrial customers as we've developed Atlas, and I'd like to acknowledge them now: CSR, Orora, Visy Glass (formerly O-I), Alinta Energy, CleanCo Queensland and Southern Oil Refining.

These are strong relationships that are highly valued by Senex – relationships we hope to extend and expand over time.

And I'd like at this point to acknowledge Jemena, our infrastructure partner, who also stood up to support us.

These are relationships we will continue to invest in, and customers we will continue to support.

We are proud that Senex is today one of the key producers finding and developing gas for the domestic market on the east coast.

At this point I'd like to explain in a bit more detail what's at stake for Queensland communities, in particular, from ongoing federal regulatory intervention and market disruption.

Over the past 10 years we've paid more than $70 million of royalties to state governments to help provide roads, schools and hospitals.

In the past two years we've created more than 250 jobs during development – with 150 more on the horizon as we expand.

Last year we spent $37 million directly with 56 small businesses.

We also worked with more than 30 community organisations on long-term partnerships supporting areas from STEM education to regional tourism.

These tremendous benefits are only a few examples, and they are not unusual across our industry.

We’re an industry which is proud to support the regional communities where we operate and which are thriving because of the jobs, business opportunities and community investments we provide.

As I said earlier, I’m excited about the role the gas industry can play to shape a prosperous and healthy future for our country.

However, I am also concerned that this future is being put at risk from elements of the Federal Government who have raised the threat of regulatory intervention.

The gas-led recovery announced by the Prime Minister last year is a great concept, certainly one that the gas industry and Senex fully support.

Its many initiatives will make a difference in delivering sustainable and affordable gas by opening up new gas resources, prioritising pipeline infrastructure and improving competition in gas transportation.

But confidence for the private sector to invest in new gas supply and pipelines will only come with a stable policy and regulatory environment and open, competitive markets.

These initiatives cannot result in one sector of the economy subsidising another.

With that in mind, to have an honest and constructive debate, we need to be very clear about the key elements and relevant facts of the gas market that we’re talking about.

Firstly, gas supply for the household and commercial sector is small and secure.

This point is important because the public should not be scared into thinking that gas supply is at risk for homes, shops and restaurants.

Secondly, commercial and industrial gas users can broadly be divided into two groups:

1. companies that use gas in special applications or to generate their own electricity – this group largely represents our customer base with whom we have open and positive commercial relationships; and

2. those who use gas as a feedstock to make other products, for example, fertilisers and petrochemicals.

This second group is often the most vocal about gas availability and price and, of course, are most exposed to the price of natural gas.

Their goal is, seemingly, to seek subsidies – expressed as significant price discounts – from gas producers so that they can continue to pay the same gas prices they enjoyed historically.

These companies have enjoyed favourable gas supply terms for a long time, including in some instances contract-pricing that did not keep pace with inflation.

But they are now being challenged by structural changes in the market.
These changes include:

1. maturing of the two major and conventional east coast gas sources – the Cooper Basin and Bass Strait.

2. a shift from lower hanging fruit in the declining conventional basins to higher-cost, dry unconventional gas in Queensland.

The cost factors involved in this shift include a lack of the hydrocarbon liquids that are such an important source of returns for natural gas in other energy regions.

3. far greater physical distance between supply – which is now increasingly from Queensland – and demand, which remains concentrated in southern states.

   This means a material rise in transportation costs.

4. And finally, there is greater volatility in the market following the link to international prices established by gas exports.

   It's important to recognise here that, while this has had an impact on prices, the LNG projects and their customers underwrote the replacement of gas from Australia's declining traditional basins like Bass Strait.

All of this, understandably, has put pressure on large users of natural gas.

Rather than all the focus being on gas producers, perhaps more attention should be focused on the challenges facing the big industrial gas users.

Most businesses restructure their costs when faced with fundamental changes in input costs.

This is what the gas industry did when oil prices plummeted in 2014 – and again last year.

Instead, for a decade the executives of some of these big gas users have fed any government official and journalist who will listen a steady diet of doom about the availability and price of gas.

I'll take several of their claims in turn, and along the way do some myth-busting:

Claim No 1: gas has not been available, sometimes at any price.

More than 90 agreements have been struck in the last decade.

More than 300 petajoules of domestic gas contracts have been agreed in the past two years alone.

The ACCC's interim report into gas supply, released in January, noted there is sufficient supply until at least 2024, even before any of the proposed LNG import terminals come online.

Over many years, other reports have consistently indicated a looming shortfall but supply has always increased to meet demand.

This is the nature of our industry, as very large amounts of capital are invested at just the right time to ensure adequate supply.

This investment, however, does require customer commitments.

As we saw in most of yesterday's presentations, more capital for development is required to provide secure and affordable gas – not less.

Claim No 2: Gas can be delivered to users for as low as $4 a gigajoule at Wallumbilla.

This is unrealistic and false.

The wholesale price of gas in Australia has not been below $4 a gigajoule for 15 years - since 2006.

The ACCC says about 90 per cent of all proven and probable reserves in the east coast have a lifecycle cost of at least $6 a gigajoule.

As I've consistently said publicly, my view is that a price of $7 to $9 for term contracts through the cycle at Wallumbilla represents a reasonable price for both producers and consumers.

And I note, this has recently been as low as $6 to $8 per gigajoule for recent term contracts per the ACCC.

Then you need to factor in transportation costs which, from Wallumbilla to Sydney or Melbourne, can be more than $2 a gigajoule.

Which brings me to Claim No 3: east coast domestic gas prices should be at the level of the Henry Hub.

There is absolutely no logical basis for this.

For starters, the US domestic market is 50 times the size of the east coast market and serves a population that is 15 times bigger and far more concentrated geographically.

Henry Hub is supported by a significantly bigger, more liquid upstream gas sector, a pipeline network 12 times as large as Australia's and it is heavily subsidised by the lucrative shale oil alongside which natural gas is produced.

What may not be well understood is that Henry Hub can also be extremely volatile.

The cold snap in the US last month sent prices for physical, next day delivery skyrocketing to US$1,250 US per million British thermal units, or mmbtu – that's a 20,000 per cent increase on only a few days earlier.

Of course, with an LNG import terminal about to be constructed at Port Kembla, buyers can go and source Henry Hub for themselves if they wish.

Claim No 4: domestic prices should be hard-linked to LNG-netback prices based on Asian spot LNG prices to ensure internationally competitive pricing.

LNG prices have no relevance to non-LNG domestic producers in respect of marketing our gas volumes.

You only have to look at the ASX reports of Australian LNG producers to see that their average realised domestic gas prices are consistently lower than their average realised LNG prices.

The respected International Gas Union says Australia's average gas prices are among the lowest in the Asia-Pacific region.

When COVID hit this time last year, Asian spot LNG prices plunged by about a third to $2.80 per mmbtu.

Calls grew loud to link this formally to domestic prices.

The silence was deafening when, as a function of supply and demand, Asian LNG spot prices soared almost 1,000 per cent to record prices of more than US$28 per mmbtu, brought on by the cold snap in the northern hemisphere, earlier this year.

I will now spend a few moments addressing investment fundamentals.

A lot of comments can be made on supply and the relevance of particular price markers, but the irrefutable truth is that the domestic price must deliver the necessary risk-adjusted returns to investors.

This is especially true for domestic players like Senex, who have no direct exposure to higher LNG prices that are available for the big multinationals and which can compensate for domestic gas prices at or below the cost of supply.

Senex has become one of the key producers finding and developing gas for the domestic market on the east coast.

As much as anyone else, Senex and Australia-focused producers like us are wholeheartedly supporting the nation's gas-led recovery.

Senex has a very clear plan to expand and, over time, to increase our market share.

We have proved and probable – or 2P – reserves of 780 petajoules and our target is to produce 60 petajoules a year within five years – from 20 petajoules a year today.

That will likely require additional investment of more than $500 million.

With the right regulatory settings and with customers committing to offtake gas to support development, we will be successful.

But we need the whole value chain to work together.

Our shareholders quite rightly expect us – and banks require us – to reach agreement to sell a material portion of offtake before committing to invest these hundreds of millions of dollars in new natural gas developments.

Our consistent message has been that we are absolutely open to long-term contracts – as evidenced by our 15-year contract with GLNG.

The claim that long-term contracts are not available is simply false.

When investing large sums of capital over a long period of time in a market economy, you're taking a risk.

Prices need to recognise the cost of supply, the risk taken, supply and demand dynamics and the terms and conditions required by each party.

Or investment will dry up.

We've been surprised that some buyers are currently limiting terms to three years or less – others have actually told us that they are waiting until there is greater clarity on market dynamics given the current threatened Federal Government intervention.

Just amazing.

I believe Saul Kavonic referred yesterday to moral hazard – it is alive and well.

Research, including by the Productivity Commission and the ACCC, consistently shows that the threat of intervention in domestic gas markets discourages investment in future supply and threatens gas shortages.

Given all the evidence, it really does beggar belief that some parties continue to advocate for Federal Government regulatory intervention.

Intervention to drive down prices may be able to be absorbed by the multinational LNG export players but it threatens the Australian junior and mid-cap companies who are the very companies that the ACCC says should be encouraged in the market to increase supply diversity.

Ladies and gentlemen, let me conclude by saying: we should manage for the gain of the many rather than a few.

This is what the gas chain did in the 1960s when partners collaborated, took risks and invested together with great success for the community as a whole.

In 2021 we need to learn the lessons of the past so that we can all prosper.

Capturing the economy-wide benefits from a new wave of investment in the natural gas sector would be a great prize.

This would support job creation and profits in industries across the economy, including construction, trade, business services and finance, and manufacturing.

These are the benefits that are at stake: real wealth and real jobs for Australians.

Thank you.

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