1 Massive Risk That Could End Canada's Natural Gas Boom Before it Begins

Description

Bloomberg published an interesting article the other day in which Shamsul Azhar bin Abbas, the CEO of Malaysian energy company **Petronas**, warned Canada not to follow in the footsteps of Australia. That country, like Canada, is rich in natural resources. The only problem is that Australia made a number of policy missteps that are now threatening to put a lid on investments to build future natural gas export facilities.

What went wrong

Global energy giants like **Chevron** (NYSE: CVX) have been hit by massive cost overruns at Australian liquified natural gas projects. While part of those cost overruns were inflationary due to increasing competition, Australia didn't help matters. According to Shamsul, Australia introduced "severe fiscal and regulatory policies" that he said added to the cost of doing business and had a negative impact on project economics.

This is one reason why the current costs of projects under construction have ballooned to A$200 billion. However, it is also making it far less likely that a second wave of LNG projects will ever be built. Right now there is a pipeline of potential projects worth as much as A$180 billion that might never get the green light because of the added costs due to Australia's policy moves.

This is why Shamsul warned Canadians at an LNG industry conference that "there are pivotal lessons to be learned from the Australian experience." These lessons need to be learned so that Canada won't "slaughter the goose before it has the chance to hatch the golden egg."

What this means for investors

Shamsul's warning is one that Canadian investors need to take seriously. Big oil giants are drowning in high-cost projects overseas, which could make them reluctant to invest in big Canadian projects. For example, Chevron's Gorgon project, where **Royal Dutch Shell** (NYSE: RDS-A) is a partner, was supposed to cost US$37 billion. However, late last year Chevron raised its costs estimate to US$54 billion. Meanwhile, partners including Royal Dutch Shell are expecting the project will eventually cost a staggering US$60 billion, which is closing in on twice the original estimate.

Because of what happened in Australia there is a real risk that Chevron and its partner **Apache** (NYSE: APA) might never be in the position to earn strong returns from Kitimat LNG. Chevron and Apache have plenty of experience with Australian LNGs, as the pair are partners on the US$29 billion Wheatstone LNG project. If the partnership sees that it will be too expensive to make Kitimat LNG profitable, then it's possible the project could be scrapped.

The same of course goes for Royal Dutch Shell, which is working with Petronas on the Pacific Northwest LNG project. The $36 billion project is currently one of the front-runners to be the first project fully approved by the government. However, it could be scrapped if British Columbia's LNG tax framework proves to be detrimental to project economics.

This would have reverberations beyond just those companies building LNG export facilities. Large Canadian natural gas producers like **EnCana** (TSX: ECA)(NYSE: ECA) and **Canadian Natural Resources** (TSX: CNQ)(NYSE: CNQ) could be affected. While both are focused on growing liquids production, each holds significant upside to natural gas, which could be unlocked through exports.

Canadian Natural Resources, for example, is the second-largest natural gas producer in Canada. It has a massive acreage position of 16.2 million net acres, including two very compelling unconventional asset positions in the Duvernay and Montney plays, that could drive a lot of value with the higher gas prices found in exports.

Likewise, EnCana has a massive resource position with natural gas assets in the Horn River Basin as well as in the Montney and Duvernay plays. These positions could be lucratively developed if Canada can get that gas out of the country in an economical manner and into the profitable Asian markets.

What does this mean for investors?

Canada stands at the forefront of a massive boom in natural gas. However, that boom might implode if the country doesn't enact the right policies. It needs to learn from Australia's missteps if it wants to profit from the LNG export boom. It's a risk that investors need to watch carefully, as it could really mute the upside of Canadian gas producers.

CATEGORY

1. Investing

TICKERS GLOBAL

1. NYSE:CVX (Chevron Corporation)
2. TSX:CNQ (Canadian Natural Resources Limited)

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