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PNG's LNG Growth Outlook Revised Down, Following P'nyang Talk Collapse

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Key View:

- ExxonMobil's proposed plan to develop the P'nyang field has been removed from our forecasts as negotiations with the PNG government have broken down.
- The P'nyang dialogue break down means only one half of PNG's ambitious USD13bn LNG expansion plan will go ahead.
- The lack of gas output from P'nyang has led to a downside revision of our LNG growth expectations for PNG over the forecast period.

ExxonMobil's proposed plan to develop the P'nyang field has been removed from our forecasts as negotiations with the PNG government have broken down. Talks between the two parties for the USD9.2bn valued development first broke down in January, as **ExxonMobil** and the PNG government failed to agree on appropriate financial terms for the project. In spite of reports that small-scale talks had been resumed following a brief hiatus due to the Covid-19 pandemic, a breakthrough for the project failed to materialise. P'nyang's progress has suffered since the ascension of James Marape to the role of Prime Minister in May 2019, and his flagship pledge to 'take back PNG' by securing greater control over national resource wealth. The PNG government is believed to have demanded 'far better' terms from P'nyang than those agreed in prior resource projects negotiations, leading Exxon to step on the brakes.

SELECTED FISCAL TERMS FOR PNG'S LNG PROJECTS

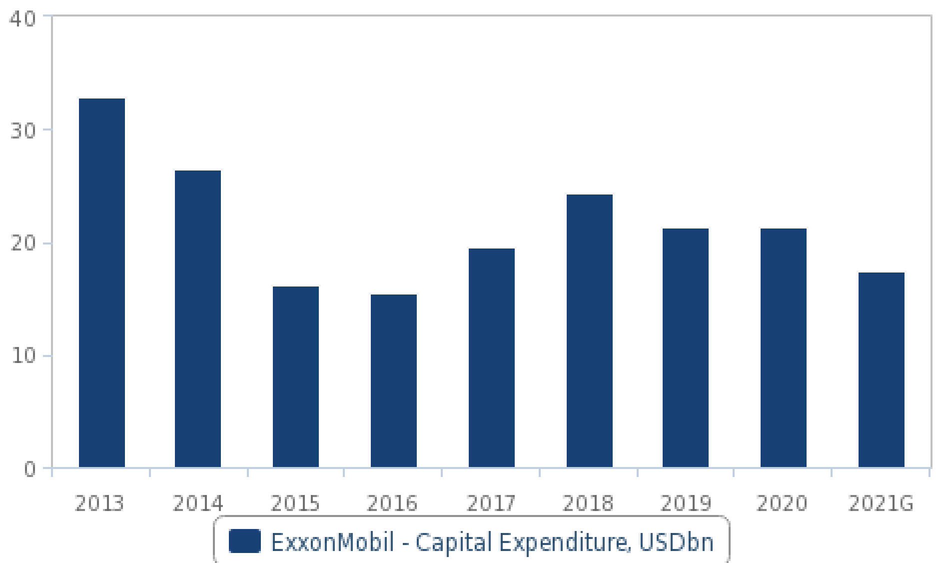
	PNG LNG	Papua LNG	P'nyang
State Profit Take	40	46	60-65
Corporate Tax Rate	30	30	30
Development Levy	1.2	2	2
Domestic Market Obligation	-	5	5
Import Duty	-	-	5
Production Levy	-	2	10
Royalty	1.2	2	2
Social Levy	-	-	2
Witholding Taxes	-	15	15

Note: All figures are percentages. Source: National Sources, Company Data, Fitch Solutions

Marape has expressed confidence that the project will eventually be resumed, and it very well could, given the attraction of PNG's cheap, high quality gas, ideal location and the economic benefits it could generate for the local economy. Though the fiscal and regulatory conditions for the project would first need to make economic sense in order to pique Exxon's interest. Even more so as the firm's strategic priorities appear to be shifting away from costly, high-risk fossil fuel projects, and towards higher-value, lower-risk upstream plays and on decarbonisation efforts. Exxon has already made public the plan to further reduce its capex in 2021 by 11-25%, while retaining the flexibility to make further reductions should global oil prices underperform it expectations. In the natural gas and LNG front, the firm identified projects in the US, Argentina, Canada and Mozambique as being the short-term priorities, indicating that it remains in no rush to resume discussions over P'nyang. In addition, even without the P'nyang field, Exxon is a large stakeholder in the **Total**-led Papua LNG development, and remains in prime position to maintain its large PNG exposure in the coming years.

Exxon Plans To Cut Capex Again

ExxonMobil - Capital Expenditure, USDbn

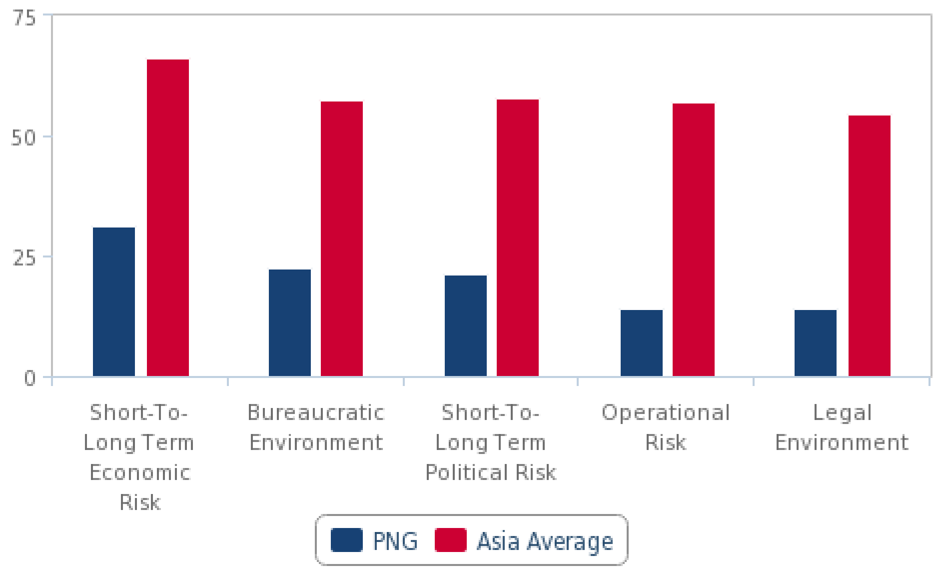


g = guidance. Source: ExxonMobil, Fitch Solutions

PNG for all its positives, is still a risky market. It scores poorly in several major risk metrics in the Fitch Solutions Upstream Risk/Reward Index (RRI) well underperforming the regional average scores. It is also a chronic laggard in the 'Ease Of Doing Business' and 'Corruption Perception Index' compiled by the World Bank and Transparency International, placing 120 (out of 190) and 142 (out of 180), respectively, in 2020.

PNG Remains A High-Risk Market

PNG Select Risk Scores vs Asia Average Score



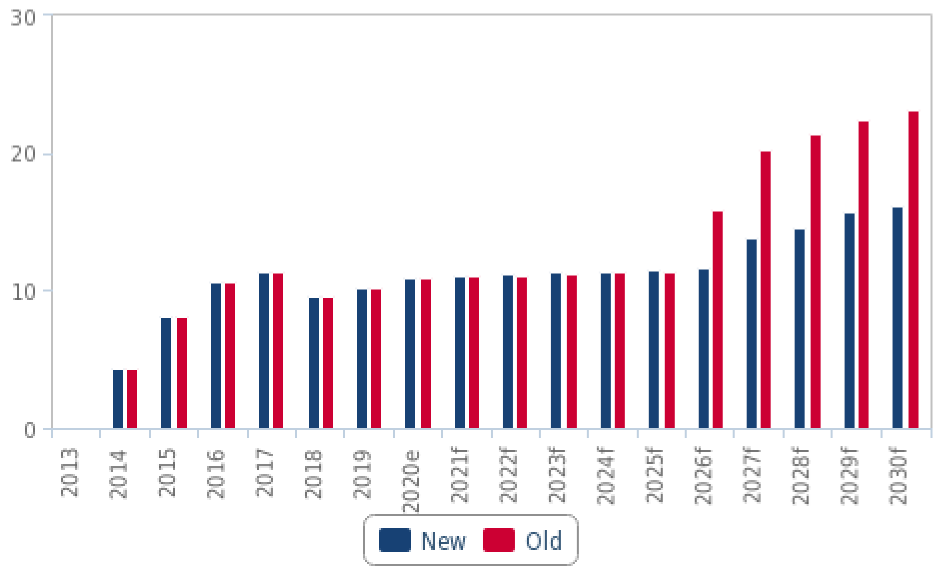
Note: Scores out of 100; higher score = more attractive market. Source: Fitch Solutions

The P'nyang dialogue break down means only one half of PNG's ambitious USD13bn LNG expansion plan will go ahead. The other half of the USD13bn plan to double PNG's LNG production in the next decade is Total's Papua LNG project and the development of gas at the Elk-Antelope field. The process surrounding Papua LNG has been smooth sailing compared to that of P'nyang, with Total agreeing to make a number of concessions even before the start of the current Marape administration. The initial agreement for the project was signed in April 2019 under the previous leadership of Peter O'neill. The terms were then endorsed by the Marape administration in September 2019 and again in February of 2021. The agreement moves the project forward and will now support the addition of two LNG liquefaction trains (as opposed to three). The timeline set forth by project partner Oil Search expects a final investment decision will be made in 2023, and first gas by 2027; both are delayed from most recent targets of 2020 and 2024.

The lack of gas output from P'nyang has led to a downside revision of our LNG growth expectations for PNG over the forecast period. PNG's LNG exports are still anticipated to increase sharply in the course of the next decade, although absent contributions from P'nyang, the forecast growth in volumes post-2025 will be much more measured. The revised expectation is for annual growth in exports to average 7.2% over the 2026-2030 period, down from 16.1% previously. The risks to the forecasts are still to the downside given the early stage of the Papua LNG development and the volatile nature of the domestic project environment.

Growth Projections Lowered

PNG - Net LNG Exports, bcm



e/f = Fitch Solutions estimate/forecast. Source: JODI, Fitch Solutions

Apart from P'nyang, another standalone LNG venture has also appeared to have hit a recent snag. The outlook for the Western LNG project, which was to be developed via pooling gas resources together from several different gas fields in the Western Province, has been made much less certain, following the exits of two major project partners in 2020.

In October 2020, operator **Horizon Oil** offloaded its PNG holdings to Australia's **Arran Energy Investments** for USD3.5mn, following a series of legal disputes with the PNG government. Assets divested include the operatorship of PDL 10, which contains Stanley, and stakes in the Elevala and Ketu fields, assets that were earmarked to support Western LNG. In the same month, **Osaka Gas**, Horizon's partner in broader Stanley and Western LNG project, also divested its PNG subsidiary Osaka Gas Niugini to Arran Energy for an undisclosed fee.

Arran Energy is a relative junior firm in the LNG space and has no other upstream assets under its portfolio. The firm joins **Mitsubishi**, **Talisman Energy** and **Kina Petroleum** in the remaining Western LNG joint venture, although it is not known whether it is even interested in LNG exports. The firm is believed to have submitted plan of development for the three fields to the PNG government but details and the timeline proposed remain unclear.