Gas Strategies

Out of step. FLNG is challenging traditional project development mentalities

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Executive Summary

- Where liquefaction projects deploy floating LNG (FLNG), development schedules are increasingly departing from the sequential approach seen historically as established practice in onshore projects. In FLNG, the procurement of vessels and long-lead items as well as the award of engineering, procurement and construction (EPC) contracts often occurs without recognising traditional project milestones.

- FLNG technology has derisked construction and is enabling compressed development timelines through standardised modular designs, redeployment optionality and new business models, placing further strain on traditional project development sequencing.

- However, unconventional project sequencing also creates new risk dynamics. For example, there may be a disproportionate distribution of liabilities and value between stakeholders. Or, workstreams may become disaggregated such that actions and commitments in just one part of the value chain hinder a successful integrated project.

FLNG is redefining LNG project development sequencing

The LNG industry has evolved such that project developers generally follow a well-established process from concept selection to final investment decision (FID).

A high-level typical project development schedule is shown in Figure 1. Projects often start with an early stage pre-front-end engineering and design (pre-FEED) to determine technical viability while marketing and financing activities are limited to initial discussions with counterparties. The appointment of advisors and active market engagement then follows once technical, commercial and regulatory elements are sufficiently progressed. The next major milestone and capital commitment is FEED award which may coincide with Heads of Agreements (HOAs) with offtakers and assurances around financing. Post FEED, the next major milestone is FID which is likely to coincide with the signing of Sales and Purchase Agreements (SPAs), EPC awards, and the finalisation of financing. Financial commitments at FID are likely to be an order of magnitude greater than those made at FEED award. No EPC without finance; no finance without SPAs.

This approach is driven by the desire to de-risk projects incrementally, i.e., as technical, commercial, financial, and legal/regulatory workstreams are matured, more capital is committed. Each step provides the foundation for the next, with FID serving as the critical juncture where parties enter into significant financial and contractual obligations. By FID, key uncertainties are reduced to an acceptable level for all stakeholders.

Figure 1: **Traditional liquefaction project development schedule**

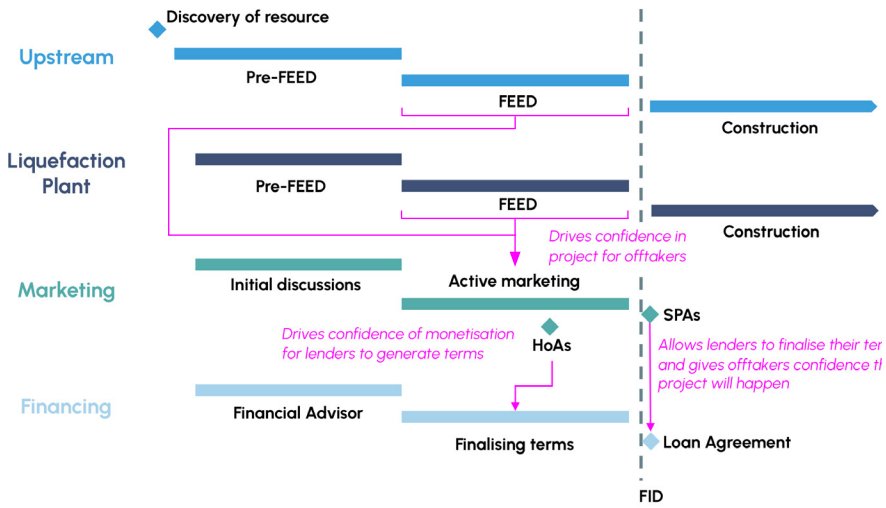
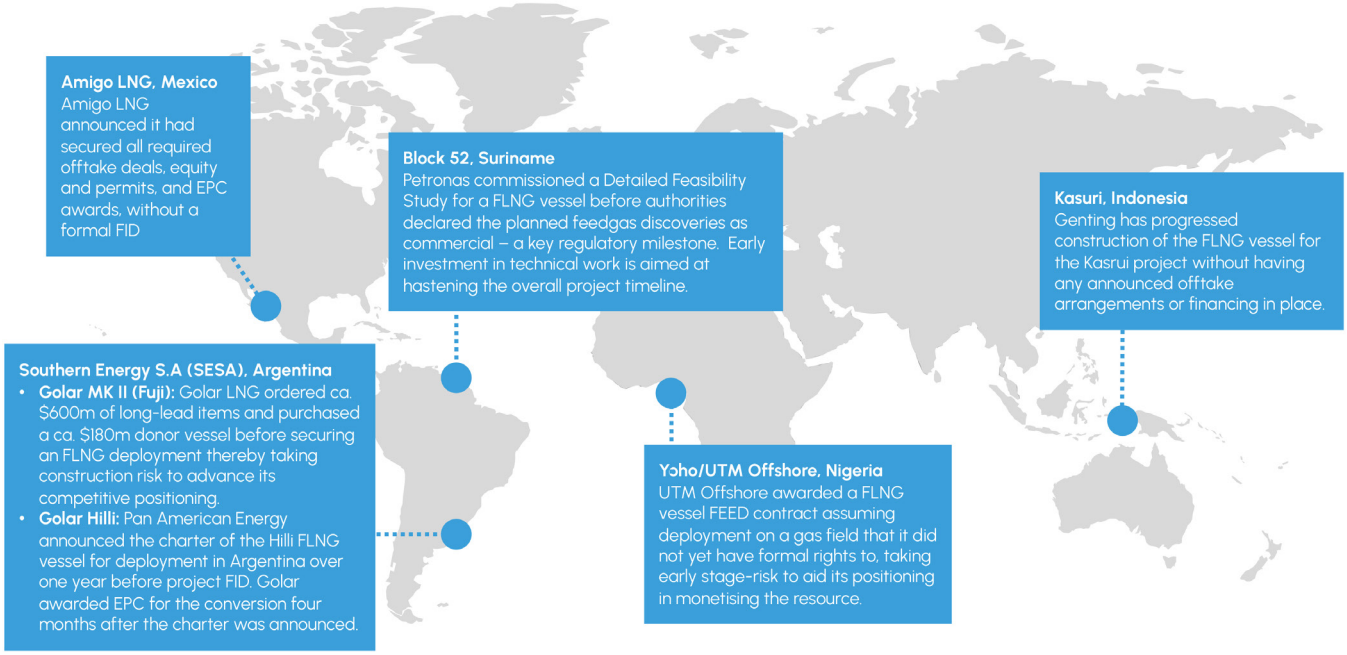


Figure 2: **Examples of non-conventional project development schedules**



In a break from the traditional approach described above, FLNG project developers are increasingly pursuing non-standard project development schedules reflecting the flexibility inherent in the technology. The same core workstreams are followed but key activities and milestones are occurring in unconventional sequences. Activities traditionally conducted in series may be conducted more in parallel, or vice versa.

Figure 2 illustrates just some FLNG projects which have taken non-standard approaches to project development sequencing. These examples are not isolated cases and Gas Strategies frequently sees developers breaking from convention.

Drivers of unconventional schedules

Multiple interrelated factors are driving non-standard project development schedules in FLNG.

1. Modular and standardised designs
As the application of FLNG technology matures and engineering contractors gain experience, modular and standardised designs are becoming the norm, thereby reducing the need for time-intensive bespoke FEED and cutting construction schedules. For project developers, the option to fast-track FEED and construction provides flexibility as the sequencing of these activities has less impact on the overall project development timeline. That said, the procurement of certain long-lead items will always constrain construction timelines.

The use of standardised designs also lowers the cost of FEED studies meaning project developers may commit to this step at an earlier stage. Meanwhile, potential offtakers and financiers are likely to place less emphasis on FEED as a milestone in the knowledge that it is not necessarily a major commitment.

Alongside standardisation in FLNG design, innovation has also served to fast-track construction as demonstrated by New Fortress Energy's first Fast LNG (FLNG 1) project. The Fast LNG 1 project uses three converted jack-up drilling rigs to host liquefaction equipment alongside floating storage which receives LNG via an innovative floating cryogenic hose. The project had an approximate construction timeline of two years, including commissioning. However, some investors have reacted negatively to what is interpreted as under-delivery against stated aims showing that it is important to carefully guide stakeholders when taking a non-standard approach.

2. Optionality in feedgas supply
Where suitably engineered, the floating nature of FLNG units means vessels can be used to exploit multiple gas resources over the course of their life. The feedgas supply component of an FLNG export project is therefore somewhat derisked, giving bullish project developers greater confidence to commit capital to a vessel at an earlier stage, for example, ahead of firm feedgas commitments. If a planned feedgas source does not materialise as expected, developers have the possibility of redeploying elsewhere and while some value may be lost, a completely stranded asset is avoided.

Where an FLNG project is being developed to liquefy a readily available feedgas source, for example from an existing pipeline, developers have more certainty regarding gas specification and the longevity of supply. This too may in turn accelerate projects by expediating engineering, due dilligence, and assurance processes.

3. New business models and a competitive market
The growth in liquefaction as a service, where vessel owners fund, construct, and operate FLNG vessels on behalf of resource holders, is one of the ways in which FLNG is not only lowering barriers to entry to the LNG industry but also disrupting project development schedules.

Vessel owners are now beginning to progress the construction of FLNG vessels without firm deployment options – so called speculative builds – and this is in turn building an expectation among some project developers that a 'plug and play' vessel, or liquefaction service, will be available when needed. The vessel owner, in most cases, will need to hold the asset on their balance sheet for such speculative builds, as financing requirements may be difficult without a firm project to link the vessel to.

Decoupling of the FLNG vessel from other project elements can be a valuable simplification. However, it can also promote a non-integrated view of project development and result in the misalignment in what remains a complex LNG value chain.

Intertwined with these new business models are prevailing LNG market dynamics, notably upcoming oversupply in the short to medium-term and the prospect of peak LNG in coming decades. In this context, smaller, more flexible FLNG projects may be advantaged relative to onshore schemes, but risks are generally heightened for all. Amid this uncertainty, development schedules are likely to be paused or disrupted but the flexibility offered by FLNG means floating projects may be more resilient.

Implications of unconventional timelines on the LNG industry

FLNG has undoubtedly encouraged broad innovation and has lowered barriers to entry to the LNG industry, inviting bold players with a fresh attitude to project development sequencing. It is also true that where unconventional approaches are employed, they inevitably create new dynamics linked to uneven distribution of risk along the value chain and the disaggregation of workstreams.

Determining the proportionate distribution of liabilities and value between stakeholders as a project evolves is a delicate balance and parties often need to be bold in order to make progress. However, where judgment is flawed, projects can easily stall and even collapse.

The disaggregation of workstreams (e.g., gas supply, plant, shipping and marketing) to the extent they are progressed independently is also a significant risk. The loss of synergies, overlooked value, and the need to react to issues emerging once workstreams are brought together, can all outweigh supposed efficiencies brought by pursuing workstreams separately.

That said, where developers do step out and challenge traditional approaches, and do so on a well-informed basis, there is an opportunity to capture significant value. Managing the associated risks requires a thorough understanding of market dynamics and the full value chain, and a considered approach to managing the commercial risks and the liabilities at stake.

Gas Strategies value

Our clients value our partnership in the structuring, development and marketing of LNG projects because we bring an intimate understanding of the market and the considerations made by LNG buyers as well as project financiers. Our people have stood in your shoes and continue to do so as advisors to a diverse range of LNG projects around the world, bringing understanding of the role and requirements of all stakeholders necessary to make a successful project development. We have to date supported clients on seven FLNG projects, several of which have already reached FID, and have further engagements 'in flight'.

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