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Widodo's re-election could prompt Shell's exit

Energy giant may soon sell its stake in Indonesia's largest gas field, a potential $1 billion vote of no-confidence in the sector under a new nationalist government

John McBeth

Investment Coordinating Board chairman Thomas Lembong points to Indonesia's "scariest macro-economic graphic," showing an energy trade balance where oil and gas production keeps falling, fuel imports keep rising – and the country which was once the world's largest exporter of liquified natural gas (LNG) becomes a net importer by 2020-21.

"I can't begin to tell you how dramatic the implications from that will be on the trade balance, the balance of payments and ultimately our exchange rate," Lembong told foreign journalists last week in Jakarta. "We have three years to fix the problem, or we will be in a world of hurt."

His surprisingly candid appraisal came in response to unconfirmed reports that Royal Dutch Shell is close to selling its 35% stake in eastern Indonesia's giant Masela gas field. If true, it would be a potential serious blow for President Joko Widodo, who was elected to a second term last month partly on an economic nationalism ticket.

While Shell would likely be replaced in the project by a regional investor with deep pockets and access to cheap financing, the giant energy company's withdrawal would send another wrong signal to oil majors that, as prospective as Indonesia may be, it is not worth the politics and regulatory hassle when other opportunities abound.

Quoting industry and banking sources, the Reuters news agency is so far the only media outlet to have run a story on Shell's potential withdrawal. Sources close to Shell told Asia Times they are convinced the report is untrue and that it is still " full steam ahead" on the project.

Oil and gas regulator SKKMigas claims to have received a statement from Shell denying the report, but in explaining the Anglo-Dutch company's silence to the Reuters report, one executive told Asia Times it never comments on commercial matters "until they are full and final."

Shell and Japanese majority partner Inpex Corp were both taken aback by the government's decision in 2017 to change the Masela project from a floating LNG platform to an onshore processing plant in the remote Tanimbar islands, aimed solely at the domestic market and to boost economic development in the Maluku region.

As a global player, Shell always appeared less flexible than Inpex, which has already spent millions of dollars on the project. Shell's original interest in the project rested largely on the fact that it is the first petroleum giant to develop a floating LNG facility, in this case a 600,000-ton platform off the coast of Western Australia.

So-called "FLNG technology" allows LNG to be off-loaded at sea onto purpose-built carriers for direct shipment to world markets. But Indonesia's new nationalist policy under Widodo appears to exclude fuel exports altogether.

The Reuters report suggested Shell wants to raise $1 billion from the sale of its share in Masela to help pay for its $53 billion purchase of British energy giant BG Group, an acquisition that made Shell the world's second largest energy company.

The company pulled its Masela-specific staff out of Jakarta early last year in a sign of declining interest, but majority partner Inpex would be expected to do much of the planning work anyway, based on an agreed 20-year extension to its current production sharing contract which expires in 2028.

Construction of the 9.4 million ton processing facility is expected to begin on the main Tanimbar island of Yamdena in 2021-22. But the so-called Plan of Development (POD) faces one big obstacle in particular — a $4 billion gap in the project's pricing.

The government is insisting on $15 billion, while Inpex and Shell have been holding out for $19 billion, the same estimate given by a New York-based consulting firm Poten & Partners three years ago when the Widodo administration was considering the onshore option.

It has long been understood that a 180-kilometer pipeline between Masela's Abadi gas field and Yamdena would be a major added cost because it has to traverse a 2,000-3,000 meter-deep trench, part of the Indian Ocean fault line that skirts Sumatra, Java and the Nusa Tenggara island chain.

Abadi has a proven 12.7 trillion cubic feet of gas, with possible and probable reserves elevating it to more than 40 trillion cubic feet, three times larger than BP's Tangguh operation in West Papua where a third $8 billion production train is under construction

The Tangguh facility will supply about 75% of its output to domestic customers, but it is understood that while the construction of the offshore platforms are on schedule, there are delays to the onshore plant that may push the completion date out beyond next year.

Tangguh is now Indonesia's biggest producing gas field ahead of East Kalimantan's Mahakam block, where output has dropped alarmingly to an annual 700 million cubic feet a day, 300 million below target, since Pertamina took over the field from French giant Total in 2017.

SSKMigas chairman Dwi Soetjipto has blamed the decline in production on a lack of investment in drilling wells, with only 30 dug out of a 2019 target of 118, 10 of which have still not started to produce. Three other Pertamina subsidiaries have failed to meet their drilling targets as well, according to industry sources.

In his presentation, Lembong referred to that same production fall-off, then expressed concern that the same thing could happen to Sumatra's Rokan block, the country's biggest producing oilfield, when state-run Pertamina takes over from US energy giant Chevron in 2021 – as well as to other expiring blocks that will fall under state control over the next few years.

Mahakam and Rokan are both mature fields, tracing their histories back to the 1970s. Each presents their own unique and costly challenges, with Rokan depending on the tricky technique of steam-driven enhanced recovery to maintain production at about 200,000 barrels a day.

Little wonder that SKKMigas officials are already predicting the country will fall short of this year's 750,000 barrels of oil a day target, with some blocks declining faster than expected. Ironically, they are looking to ExxonMobil's Cepu block in East Java to ensure production doesn't slide any further.

One recent industry analysis estimated Indonesia will need to invest more than $150 billion in exploration, gas distribution infrastructure and refinery capacity to slow production decline and meet growing demand from the country's 270 million-strong population.

Without new investment, Indonesia could see its oil and gas production fall by another 20% before 2024, yet only two potential foreign investors showed any interest in this year's first auction of five oil and gas blocks and even then they failed to meet all the tendering requirements.

Now that last month's election is "in the bag," Lembong says he has full trust in Widodo to do the right thing, which he hopes will mean slowing down nationalist policies and "swinging the pendulum back to a more pragmatic, realistic and honest" appraisal of its national capabilities in the energy sector.

"The reality is we need technologically advanced and competent partners in the energy sector," he said. "The report of Shell's potential exit is another disconcerting milestone and should be seen as a wakeup call as to whether our energy policy, as such, is working."

Lembong, a former trade minister and investment banker known to have Widodo's ear on economic issues, says the growing energy trade imbalance in the next 5-10 years will weigh on the trade and current account deficits and impact on Indonesia's overall industrial and commercial competitiveness.

It's not clear whether he will be in Widodo's new Cabinet when it is announced in October, but the current line-up is expected to undergo a limited reshuffle in June, apparently to discard three or four ministers currently under a corruption cloud and others who have won seats in the legislative election on April 17.

The investment chief's comments appeared to be an early warning to Widodo that continuing on the same nationalist course, which he inherited from predecessor Susilo Bambang Yudhoyono and was directed at boosting his populist credentials ahead of the elections, could be potentially disastrous for a country already staring at declining production and a loss of investor confidence.