Brisbane Mining Club – June Lunch 2014
David Knox – *Managing Director & CEO, Santos Limited*

Thursday, 5 June – Brisbane

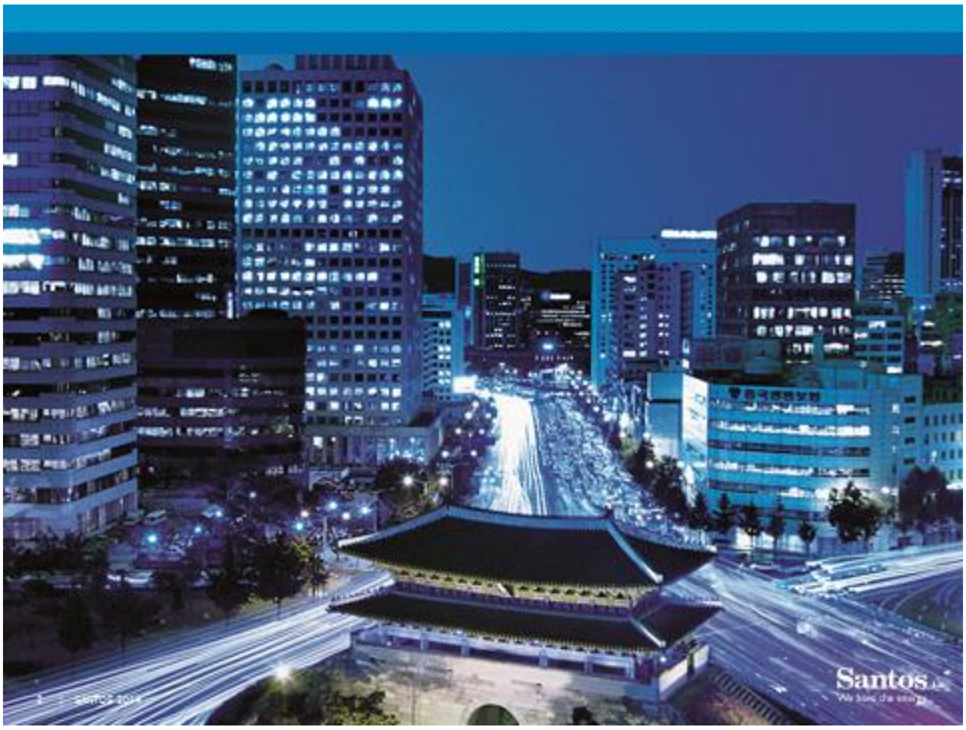
Ladies and Gentlemen

Thank you for inviting me here today.

Today I want to talk to you about a product, a market and an industry that I have great confidence in. Of course, I'm referring to natural gas – and in particular liquefied natural gas or LNG.

I’ll start with an overview of why my confidence in LNG markets is strong. Then I will focus on Santos’ strategy to capitalise on this market, a strategy I presented to your colleagues at the Melbourne Mining Club some four years ago.

I’ll discuss how this strategy is playing out, and finally I’ll tell you a little bit about why I am confident in our ability to continue to deliver on that strategy – for shareholders, for Australians and – in particular for Queenslanders.



So let me start with a discussion about the market that my industry operates in.

In having this discussion it is useful to point out that the energy industry is one where change is most often characterised as evolution rather than revolution. But when change happens, be it political, technological or economical, change creates opportunities.

When I think about change in the energy industry, three things come to mind that are particularly relevant for our discussion.

First – the US shale revolution, the reduction of that country's dependence on energy imports and the momentum it is building to export LNG.

The second thing I think about is Japan – a country which is predominantly reliant on imports for its energy needs. I consider how LNG cargoes have turned towards their shores, helping to offset a nearly 90% decline in nuclear power in the aftermath of the Fukushima tragedy.

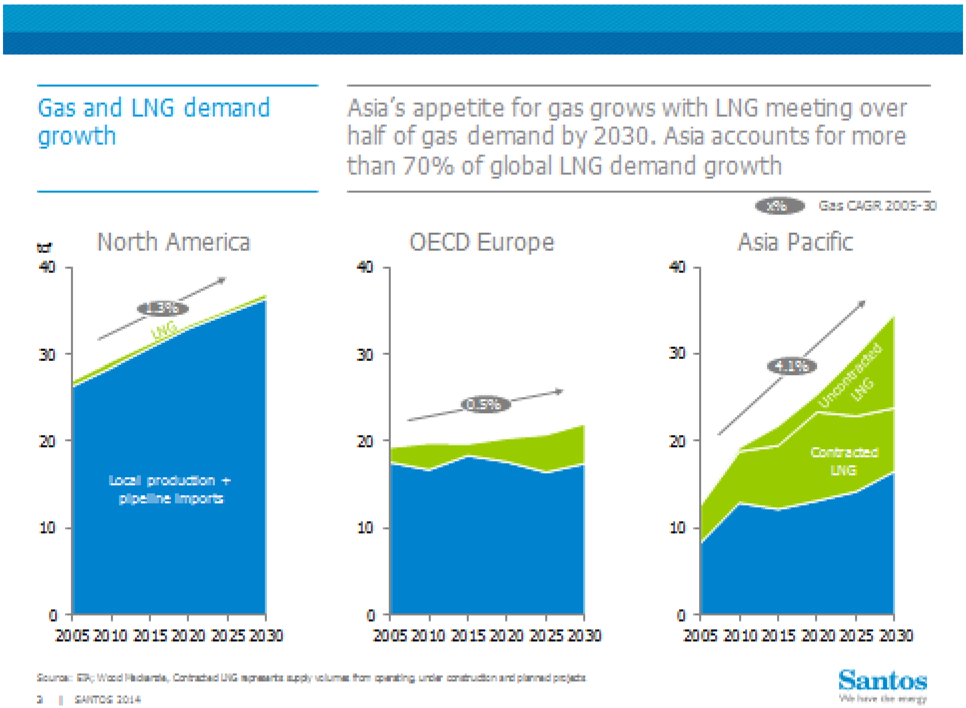
And, I also ponder the pressure in that country to seek to lower its energy costs. This pressure is understood further when you contemplate the devaluation of the Yen that has taken place, increasing the cost of imported energy supply by 20%.

Thirdly – I could not stand up and talk to you today without making some acknowledgement of the deal that Russia has just secured to supply gas to China. An agreement that has been decades in the making.

All three of these developments are useful reminders to any country or company seeking to develop an LNG project. A reminder that the market we operate in is a very competitive one. And that those who operate in that market must demonstrate vigilance in all areas that provide a competitive advantage.

For Australia, this means a continued drive to increase productivity, to explore and adopt new technologies in both the development of onshore and offshore projects, and to continue our combined efforts to reduce the regulatory burden facing both developers and operators. All of these factors can and will continue to drive down the cost of developing projects in this country – providing increased incentive to invest here, and increased returns to shareholders.

Despite this need for vigilance, I am confident in the strength and stability of the LNG market. Not because of ignorance as Mark Twain would have you believe is the key to success. But, because of the opportunity that Asia continues to provide.



Despite a slowing in growth in Asia, urbanisation continues to see the equivalent of 10 cities the size of Brisbane being created each year. And this growth drives investment, consumption and energy demand to the point where it is estimated that Asia's energy demand will surpass the rest of the world combined by 2030.

Today technology is increasing the world's ability to access previously uneconomic sources of gas. This together with the growing need to address environmental impacts and the constant push by nations to diversify their supply point towards natural gas remaining the fastest growing fossil fuel for decades to come.

And in Asia this growth is even more pronounced with gas demand projected to grow at just over 3% per year out through 2030, which is more than double the rate of the rest of the world combined.

These global developments together with Asia's growing reliance on imported fuels is expected to lead to LNG's share of total Asian gas supply to grow from 35% to 52% by 2030.

That is to say that over half of Asia's gas needs will be supplied by LNG, this is a staggering forecast.

As each Asian country observes its neighbour secure its own energy future, building new import terminals, securing long-term LNG contracts and investing in resources and projects offshore, it is energy insecurity too that is driving the strength of this market.

Insecurity can get the better of anyone. And, so the talk I hear about Asia moving towards a so called 'cheaper' US Henry Hub price and away from the oil linked contracts we have secured in Australia – deserves a brief mention.

What I will point to is a simple comparison. If you use a Henry Hub Price of say US$6 to US$7 in 2020, by the time you add the 15% capacity mark up, the liquefaction and transportation, and the cream that traders will take on top of that – then you will see that you have landed US LNG into Japan or Korea at around US$14 to $14.50. Now this landed price is pretty close to the price of a conventional oil linked project, which at a $100 oil price is circa $14.50.

So I think that despite the US being a new source of LNG, the perception that Henry Hub or the US Gulf Coast LNG is going to provide a cheaper source of LNG and therefore undercut Australian supplies or other new supplies from the region is not as strong or as believable as most people would wish.

At the end of the day - the result is a large and growing market for LNG where the gap between supply and demand by 2025 is around 100 million tonnes of LNG per annum.

The end result is not a market where demand will be met or can be met by one or two countries alone. US LNG will be important but not a silver bullet. And pipeline gas from Russia will also play a role but will only meet around 6% of China's gas demand by 2030 – so context is important.

The end result is therefore one where buyers will seek diversity – both in the origin of supply, and in price. A market which will continue to welcome cost competitive LNG from Australia, and remain a focus for Santos.

This leads me to my next topic – which is the company's strategy.

Eight years ago, as a domestic gas supplier we were facing a market that lacked sufficient scale and hence a business with low growth prospects and unsustainable sales margins.

To grow we turned to Asia. We realised that if we could tap the opportunity that Asia was creating, it would provide us with the scale required to unlock the company's vast reserves and resources in Australia – to service both domestic and export markets.

To capture the opportunity as we envisaged it, Santos embarked on a three-pronged strategy – to build our domestic base business, to deliver a transformational LNG portfolio and to build a portfolio of assets in Asia.

This strategy has not changed. We remain confident that it is the right one and it is beginning to bear fruit.

It is increasing Santos' exposure to global prices. A few years ago only 30% of Santos' portfolio was linked to the oil price. Today it is 40%, and by 2015 we will have three LNG projects delivering cargoes at oil-linked prices to Asia – Darwin LNG, PNG LNG and Queensland's own GLNG. This will lift that number to around 70%, growing the revenue we make per barrel and the company's operating margins.

Santos' strategy is also delivering critical pieces of infrastructure. Be it from Darwin, from PNG or Gladstone – these LNG plants are a channel to market that is incentivising increased exploration for gas.

It has created the incentive for Santos to invest in the Cooper Basin to unlock the gas that exists in the tight rocks and shale that reside there. It is allowing us to explore the underexplored resources in the Northern Territory. It is increasing our commitment to explore for gas in the central highlands of Papua New Guinea.

And it is this existing infrastructure that could be so important for us and others – in allowing us to remain competitive in supplying new sources of gas to Asia.

Finally, let me now turn to how we are delivering on our strategy, and in particular our LNG projects. Projects that are truly transforming the company.

PNG LNG is the first of our new LNG projects to come on line, with the first cargoes being shipped to Japan just last week on the Spirit of Hela tanker. To try to give the sense of scale of this ship, the LNG cargo on board, in petrol equivalent, could fill around 2 and half million cars with 50 Litre tanks.

We expect the project to ship a cargo every 4-6 days, for 30 years to buyers in China, Taiwan and Japan.

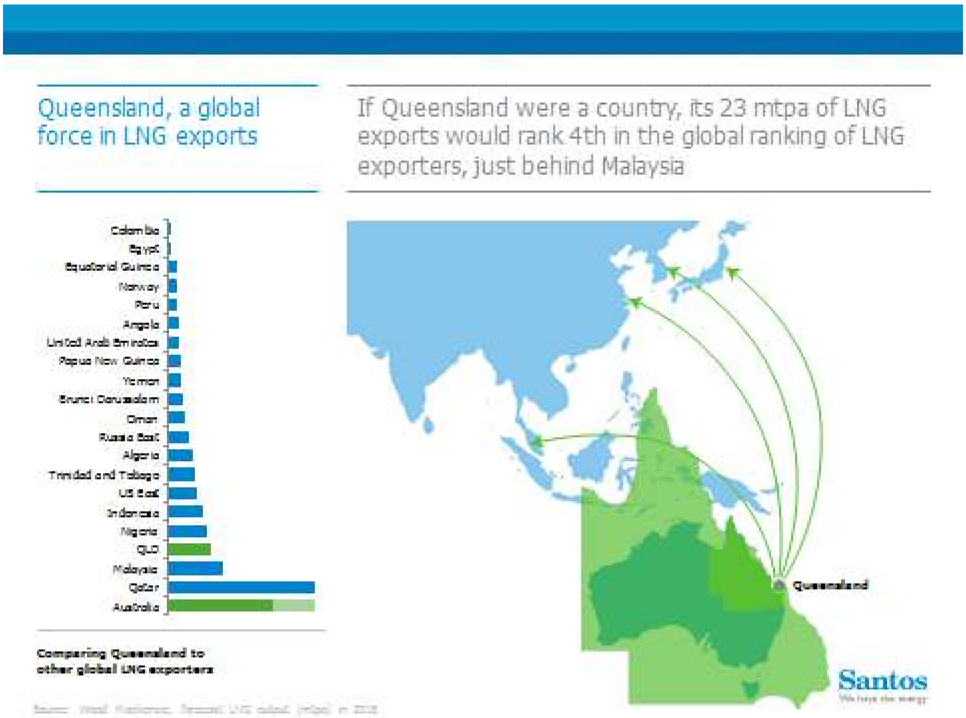
Back home – and Gladstone LNG will be our first operated LNG project – and for Santos represents the largest investment in the company's history. The Santos share of this investment is around US$5.6 billion, and with this – comes great responsibility to deliver.

Today we are at the peak of our construction activity at GLNG.

The project is now over 80% complete, we're very much on track for shipping first cargos in 2015 – and ultimately delivering about 11% of Korea's domestic gas needs and around 9% of Malaysia's gas needs for the next 20 years.

As you can see Ladies and Gentlemen, Santos will play an important role in delivering energy to our region for many years to come. And there is every reason to remain confident in the market to sustain this industry.

Queensland is of course at the heart of this industry. With three projects in construction and nearing completion, this state will be a significant force in global LNG markets.



In fact if Queensland were a country its 23 mtpa of LNG exports would rank 4th in the global ranking of LNG exporters, alongside Malaysia and Nigeria.

Nationally, the suite of LNG projects under construction represent around $180 billion of investment and contribute around 1.5% of Australia's GDP. On the back of the surge in production that will result from these projects, the industry is projected to contribute over $12 billion in tax revenues annually, a number no doubt, of interest in Canberra at the moment.

But this would not be possible without the determination of companies, the commitment of investors and the resolve of governments. It is this united approach that has paved the way for Queensland and Queenslanders to benefit from the LNG industry, and it is this that will ensure our industry remains competitive for the foreseeable future. A future I for one am very confident in.

Thank you.

ENDS.