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## Australian gas companies need a new strategy as they enter a declining market

- *After decades of growth, Australian oil and gas companies face a sudden shift to a declining market as major customers reduce demand, and replacement markets face an uncertain future.*
- *For Australian oil and gas companies such as Santos and Woodside, the main strategic options in a declining market are “quick divest” and “harvest” – which focuses on reducing costs to maximise cash flows.*
- *Australian oil and gas companies have high costs and growth plans, and will need a swift change in focus if they want to succeed in this new environment; this will likely require new capabilities in their executive teams and boards.*

### Australian gas companies are entering a declining market

In its latest [World Energy Outlook](#), the International Energy Agency (IEA) predicted that global gas demand will start declining this decade even in its most conservative scenario – the Stated Policies Scenario (STEPS), aligned with about 2.4°C warming. The IEA’s outlook for global gas use has been continually reduced over the past five years due to expected competition from renewables and recent shifts away from gas following Russia’s invasion of Ukraine.

Japan, Australia’s [largest](#) liquified natural gas (LNG) buyer, is already experiencing significant declines in LNG demand. LNG imports [have declined](#) by 25% since 2014, due to increases in nuclear and renewable generation. In 2023, Australian LNG imports to Japan [amounted](#) to 29Mt and represented 43% of total LNG imports for the country. As a result of the declining demand, Japanese utilities have found themselves [over-contracted](#), and are increasingly reselling surplus LNG overseas. In FY2020, FY2021 and FY2022, they sold more than 30Mt of LNG a year, peaking at 38Mt in FY2021. This resold volume is larger than Australia’s total exports to the country.

South Korea, Australia’s [third-largest](#) LNG buyer, is also experiencing slight declines in LNG demand, which are expected to accelerate in the coming decade. LNG demand is expected to [fall from](#) about 45Mtpa in 2023 to 37.7Mtpa in 2036, a 16% decline. This will be largely driven by a declining role in the power generation sector, where LNG’s share in the electricity mix is



expected to decline from 27.5% today to 9.3% in 2036.

There is also significant uncertainty about the future LNG demand levels from China, Australia's [second-largest](#) LNG buyer. The Australian government [expects](#) Chinese LNG imports “to increase from 72 Mt in 2023 to 92 Mt by 2029, with growth picking up towards the end of the outlook period”. However, [the IEA's](#) Announced Policy Scenario (APS), which reflects China's updated Nationally Determined Contributions (NDCs) targets, expects gas demand in that country to start declining in 2030. In addition, the IEA expects China to have an oversupply of gas in 2030, based on its existing gas contracts. Recent [IEEFA analysis](#) also suggests that China's new policies designed to limit gas dependence could reduce LNG demand.

A [number of barriers](#) are likely to constrain demand growth from emerging Asian markets, which the industry expects will compensate for the decline in mature Asian markets. These include: the long time it takes to negotiate and develop LNG-to-power projects; the cost of LNG compared with other energy sources, and; the financial challenges LNG presents for state-based utilities.



**While demand for LNG faces challenges in the region, global supply is increasing at a rapid pace.**

While demand for LNG faces challenges in the region, global supply is increasing at a rapid pace. The IEA's recent [World Energy Outlook](#) report stated: “Projects that have started construction or taken final investment decision are set to add 250 billion cubic metres per year of liquefaction capacity by 2030, equal to almost half of today's global LNG supply [...] The strong increase in LNG production capacity eases prices and gas supply concerns, but [...] comes to market at a time when global gas demand growth has slowed considerably since its ‘golden age’ of the 2010s. Alongside gas contracted on a longer-term basis to end-users, we estimate that more than one-third of the new gas will be looking to find buyers on the short-term market.”

[IEEFA](#) was the first to announce that these new market conditions would lead to an LNG supply glut in the second half of this decade. This unprecedented investment in new gas supply means that the IEA expects existing investments will be enough to meet gas supply needs under their most conservative scenario, aligned with 2.4°C of global warming. The level of investment is much higher than that needed to meet gas demand under Paris-aligned scenarios.

Australia is a relatively [high-cost](#) gas producer compared with other countries such as Qatar and the US, which dominate upcoming capacity increases. Under those global conditions, it is likely that Australian gas companies are entering a declining market for their LNG. This was reflected in the government's latest [Resources and Energy Quarterly update](#), which forecasts export revenues to drop by 38% in the next five years, “as volumes edge down and prices ease”.

This is a very sudden shift in context for LNG producers. In 2000, the global industry [produced](#) slightly less than 100Mtpa. In 2023, it [produced](#) about 400Mtpa, and in 2030, it will produce nearly 600Mtpa with projects under construction. This represents a continuous growth in volume sold of about 6% a year over that period. Suddenly moving from this high-growth environment to a declining market will present significant challenges for the industry.



## Successfully navigating a declining market environment

Harrigan and Porter’s work is still a reference for successful corporate strategies in declining markets. They identified four key “[end game strategies](#)”:

- **Leadership:** gain a dominant position through cost leadership or differentiation, and accelerate retirement of other players, to achieve an above-average profitability.
- **Niche:** focus on a segment with more stable demand and high returns.
- **Harvest:** cut costs and investments to maximise cash flow before selling or liquidating the business.
- **Quick divestment:** sell business in its early stages of the decline to maximise investment recovery.

The last two strategies are also represented in the Boston Consulting Group’s [Growth Share Matrix](#), a portfolio management framework, as the “cash cow” and the “pet” respectively. A “cash cow” is a low-growth, high market-share activity which companies should milk for cash to reinvest. A “pet” is a low-growth, low market-share activity which companies should liquidate, divest or reposition.

The proceeds from such strategies can be reinvested in higher-growth industries supporting a diversification, or “[corporate entrepreneurship](#)” strategy – moving “businesses into new market opportunities as the value of current market domains inevitably begins to fade”.

The main [factors](#) that determine which strategy will be most effective are whether the industry structure is favourable for decline, and whether the company has competitive strengths for the remaining demand pockets.

**Figure 1: Strategies for declining businesses**

	Has competitive strengths for remaining demand pockets	Lacks competitive strengths for remaining demand pockets
Favourable industry structure for decline	<p><b>Leadership or Niche</b></p>	<p><b>Harvest or Divest quickly</b></p>
Unfavourable industry structure for decline	<p><b>Niche or Harvest</b></p>	<p><b>Divest quickly</b></p>

Source: [Harrigan & Porter](#)



Exit barriers are a key criteria in assessing how favourable an industry structure will be for decline, as [Harrigan and Porter](#) state: “The higher the exit barriers, the less hospitable the industry is during the industry’s decline.” In the case of the oil and gas industry, exit barriers are very high. This is because most of the costs associated with oil and gas production are incurred upfront, the assets cannot be used for any other purpose, and there are significant costs associated with [closing them down](#). As a result, the industry structure is unfavourable for decline.

Additionally, as a commodity business, the industry doesn’t present significant opportunities for “niches” offering higher returns. Competitive advantages will be mostly derived from the ability to drive costs down to offer lower prices than competitors. Australian producers are unlikely to compete on cost in price sensitive emerging markets, the main markets currently expected to [sustain](#) demand over the longer term. This means the two available strategies for Australian oil and gas companies are “harvest” or “divest quickly”.

## Adapting quickly will be critical for Australian oil and gas companies

A key criteria for success is the ability of managers in those companies to [recognise](#) decline and to view it as an opportunity, making objective decisions to maximise their returns. There are famous examples of companies that failed to adapt to a declining environment. For example, Blockbuster, a video rental leader, [declined](#) to acquire Netflix for US\$50 million in 2000, and continued to pursue an [expansion](#) strategy despite increasing competition from digital alternatives. This strategy exacerbated its financial challenges, with declining revenues unable to compensate for the costs of new expansions. The company filed for bankruptcy in 2010 and closed its remaining stores in 2014.

In Australia, BHP is an example of a diversified company that already chose a “divest quickly” strategy. It [divested](#) its oil and gas division in 2022. Examples of a full divestment approach also exist for pure-play companies, such as Pioneer Natural Resources which was [acquired](#) by Exxon Mobil in October 2023. Companies can also choose to divest part of their portfolio, in particular new projects. Origin Energy for example [sold off](#) its interests in the Beetaloo Basin in 2022, and announced “an intention to exit its upstream exploration permits, as the company focuses on its strategy and ambition to lead the energy transition”.

## “ Australian LNG producers are among the highest-cost producers globally, and will likely face challenges in this environment

For companies that choose to continue their oil and gas operations, high exit barriers, falling sales and oversupply are likely to lead to “[fierce price warfare](#)”. As mentioned previously, Australian LNG producers are among the highest-cost producers globally, and will likely face challenges in this environment.

They are also much [smaller](#) than many of their global competitors. Larger companies typically do [better](#) under competitive pricing environments, in particular due to their ability to capture economies of scale. The oil and gas industry is already preparing itself for the new environment through its biggest-ever wave of consolidation, as [Business Insider](#) reported: “Merger and acquisition activity among exploration and production companies hit \$144 billion in the fourth quarter alone and \$190 billion for 2023, both setting records.” In Australia, Santos and Woodside also engaged in merger [discussions](#) recently but those concluded earlier this year.

In addition, recent [research](#) by the Australian Centre for Corporate Responsibility (ACCR) found that even in a positive context, Australian LNG producers failed to generate returns above the



cost of capital. This was largely due to cost overruns, which ranged from 3% to 82%, and averaged 35%. In 2023, IEEFA [identified](#) that Santos and Woodside were in the top six regional companies with the highest outstanding borrowings and significant investment plans for oil and gas growth, which will keep future costs high.

There seem to be material opportunities to cut costs, improve free cash flows and increase shareholder distributions (through share buybacks and/or dividends) for those companies. For example, [ACCR](#) found that Woodside's unsanctioned projects, as well as acquisitions and exploration, require large expenses and offer low net present values (NPV). It estimated that the company would be better off if it allocated its capital to share buyback offers rather than production growth.

Moving from a high-growth to a low-cost focus will require a significant shift in strategy, processes and culture. For example, Santos' CEO still has a [growth incentive](#), and growth is a key component of the [performance scorecard](#) for Woodside's CEO and executive remuneration. Now would be a good time for companies to review the [skills and capabilities](#) of their management teams and boards to assess how well equipped they are to manage this transition. Given the poor performance to date on cost management, and the recent focus on growth, it is likely that new mindsets and capabilities will need to be brought into the existing management teams and boards.

## About IEEFA

The Institute for Energy Economics and Financial Analysis (IEEFA) examines issues related to energy markets, trends and policies. The Institute's mission is to accelerate the transition to a diverse, sustainable and profitable energy economy. [www.ieefa.org](http://www.ieefa.org)

## About the Author

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