Participants

Meg Gentle, CEO at Tellurian Inc. (TELL)

Nate Abercrombie, The Stock Podcast

Interview Transcript

Nate: Meg Gentle, thank you so much for coming onto the podcast. It's going to be a pleasure talking about your business and your industry.

Meg: Thank you, Nate, for having me.

Nate: Could we first just start off talking about your background? How'd you get into the industry and how did you find yourself at Tellurian?

Meg: Sure. Gosh, I've been in the natural gas business now for about 25 years, so I don't like to admit it's been that many years. I actually started working for Anadarko Petroleum, and did a lot of international gas projects for them and worked for about 13 years with Shinier Energy through the import terminal days and the export terminal days. I was the CFO of Shinier when we raised all the capital for Sabine Pass, so about $20 billion of capital equity and debt. And then I moved to London to build Shinier Marketing, which I think is now the 13th largest LNG marketer on a worldwide basis. And when I came back from London, I decided to join the team at Tellurian to start a new company, and build LNG infrastructure in the Gulf coast. So that brings us to today.

Nate: Could you just tell me a little bit about what Tellurian does?

Meg: Tellurian was formed in early 2016 to build a new company for LNG Terminal infrastructure and also other infrastructure development on the Gulf coast. We have plans to build a 28 million ton LNG facility in Louisiana, and we're actually developing that on a joint venture partnership basis. So we are raising the equity for that terminal by selling partnership interest to the rest of the LNG market. And we're ready to start construction this year and deliver our first LNG in 2023

Nate: So for listeners who don't really know what LNG is or they're not familiar with the industry, it'd be really great to have just an overview of what LNG is, what does it stand for, first of all. And then just if you could just talk about the history of the industry, that would be really helpful.

Meg: Oh, well back to the stone age days. No, I'm just kidding. LNG stands for liquefied natural gas, and it's actually natural gas that is transported on ships at very cold temperatures, negative 260 degrees Fahrenheit, which reduces the mass of the gas, and allows it to be transported and in much larger volume. And the industry has been in existence for about 60, maybe almost 70 years now.

Meg: Originally the very first producers of LNG were Indonesia and Alaska, actually. And the industry grew by transporting from the producing area directly to the customer. And then the ship would come back to the producer and back to the customer. So it was very point to point, we like to say, and since it takes a lot of

capital to build a liquefaction plant to basically super cool the gas, that capital investment was supported by long term contracts that were very strict in what each of the counter-parties could do.

Meg: If we fast forward many decades, the US started increasing its natural gas production in excess of what the US and frankly North American market can consume. And so we built some LNG export terminals. The first one was Cheniere Energy's terminal. In the lower 48 in Louisiana, that came online in 2016. And that has really changed everything about the market, because the gas from the US is destination flexible. So instead of point to point, the big LNG traders are taking the gas and they can put it on their vessel, and move it to whatever is the country or market willing to pay the highest price for it.

Meg: So today we like to talk about the LNG market as finally becoming a grownup commodity, like the oil market trades. And in that context we, the LNG producers, have had to start thinking about different business models for selling that gas. So with the birth of Tellurian as a new company, this is some of the work we've been doing to try to bring LNG to the market with greater flexibility, and frankly lower and lower costs.

Nate: Just one quick question, and this is something that I was, I've always been curious about, but is an LNG molecule the same no matter where it's produced? So if the import terminals and the regasification terminals, can any given regasification terminal accept LNG from any point across the globe? Or are they calibrated in such a way that they need to have one specific type, you know, say it's from the Permian basin or whatever?

Meg: It's about 90% fungible. So the only difference from one vessel carrying LNG to the next is actually how much propane might be co-mingled with the natural gas. So, natural gas is really a almost pure methane, but it's naturally produced out of the ground actually, associated with even oil sometimes. But often the propane, butane and ethane, which are very similar molecular structure to methane, are left together with a methane.

Meg: So some producing areas in the world send everything together in the vessel. And so the vessel has higher energy content when it reaches the destination country. And some countries prefer that kind of high energy content, but the equipment can usually handle any of the vessels that come in as long as the birth is large enough to accept the size of the vessel. So it is much more standard than the oil business from that respect.

Nate: Okay. No, that's really helpful. And that was something I early on when I was learning about the LNG industry, it's something that I didn't fully understand, so thanks. I didn't realize it was 90%. That's a much higher number than I first thought. But anyway, could you talk about just what the export potential is? Like how big of a deal is LNG exports in the United States?

Meg: Right now, the terminals that either are producing LNG and exporting them, or are under construction. So within the next couple of years they'll be finished and producing LNG. They will export about 90 million tons of LNG, which is just over 10 billion cubic feet a day of natural gas. And that will represent about 20% of the worldwide LNG market. We are increasing natural gas production in this country.

Meg: We're actually the largest natural gas market in the world, the North American market. And as a nation we produce about 80 billion cubic feet a day of natural gas. So we are, our exports are really just over 10% of our total production, once we finished construction on the terminals. We do expect that natural gas production in this country is going to grow by another roughly 25% by 2025, so in the next five years. And that will bring total US production to about 100 billion cubic feet a day.

Meg: Almost all of that gas is going to have to get exported. And frankly all of that production is actually coming to the market because it is associated with oil production. So you mentioned the Permian Basin earlier. The Permian Basin is drilling a lot of oil and natural gas comes out of the well at the same time. And to handle that gas we're gonna have to increase our export capability.

Meg: So we view the need for additional export capacity at just over double the capacity that is producing and under construction today, which should make the US the largest exporter of LNG in the market at about 200 million tons, or even approaching 30 BCF a day of total gas exports. So that'll take us until sometime after 2025, but it's going to be really important in order to sustain the overall energy business in this country, not only for gas but also for oil and oil exports.

Meg: And when we think about, okay, well why is that so important? Not just for the energy companies, right, who are making a product and selling it, but there are very important geopolitical implications. We're actually changing the entire geo political balance of energy on a worldwide basis because we are now an exporter of oil and natural gas from this country. So we have the ability to support our allies, have energy security for ourselves and for other parts of the world and really bring a balancing factor, and greater freedom to worldwide economic growth.

Meg: And then the second, you know, major non-industry imperative is bringing frankly clean air to some of the most polluted cities in the world. So natural gas fired power generation and use in the transport sector has zero particulates. So the polluted air that we see can be essentially cleaned by changing from oil and coal to natural gas consumption.

Meg: So at Tellurian where I would say really impassioned by that larger mission, right, to bring clean air to some of the most polluted cities, and to support the overall global initiative for de-carbonization.

Nate: Yeah, I appreciate that. Where's the gas going? Where are the big demand centers?

Meg: 75% of the LNG is consumed in Asia today. And about 20% in Europe, and the rest in South America and the Middle East. We do see the Middle East increasing as a consuming center and of course predominantly expect Asia to to still be roughly three quarters of the market.

Nate: And with all of this concern around trade wars, what are your kind of high level thoughts on just what's happening between the United States and China, and some of the threats that have been aired around increasing tariffs on LNG imports from the United States to a country like China?

Meg: China is so interesting because we expect them to be about 100 million ton market. So China itself will be about 20% of the total LNG market. Sometime after 2025. Today, the largest consumer of LNG, as you know, a single country is Japan and they consume about 75 or 80 million tons. And China will be larger than that at at roughly a hundred million tons. And of course, potentially growing from there as natural gas continues to support Chinese economic growth.

Meg: So this will occur because of indigenous things happening in China as they try to reduce pollution, reduce carbon, change from coal fire power to gas fire power, support their own energy growth with natural gas. And China today only has gas as about 6% of their total energy consumption. Whereas you compare that to US or OECD Europe at about 30% natural gas as from the total energy mix.

Meg: So these kind of market factors in China will be there no matter what the particular trade policy is between China and the US. So for overall support of the LNG business, that's very strong. We have seen a curtailment of natural gas going to China since some of the tariff discussions began and we anticipate that the market will re-optimize around China, maybe actually sub-optimize and supply will go to China from other places. And then US gas will go to a non Chinese markets until the two governments come to an amicable solution.

Nate: Maybe within that context it's good to talk about just the cost competitiveness of US LNG. So could you just sort of help listeners understand how much does it cost to buy the natural gas, then liquefy it, then transport it? And then how does that compare to call it, you know, our next two or three closest competitors?

Meg: Yeah, and Nate, that's a great question. The cost to produce gas in this country today in many basins is now less than a dollar per MMBTU. We know that we can produce gas from our own fields in north Louisiana for roughly $1.50 an MMBTU. So we take that gas cost and then it costs about a dollar to operate pipelines and the export terminals. So just from an operating costs about another dollar. And then it's about, well it depends on shipping rates on kind of a long-term return on capital for ships, it costs about $1.75 to get to Asia. Shipping rates are much lower today, so it only costs about a dollar to get to Asia today. So just from kind of a variable cost standpoint, gas from the US can be in Asia for a cost of $3 an MMBTU before you're considering cost of capital.

Meg: That's actually very competitive compared to any other producing area of the world. Even traditionally the Qataris are seen as one of the lowest cost basins and finally with Permian gas coming on an associated basis, the US can compete with any other producing area. So that's actually been a very exciting development for the market, that US gas not only provides a better security of supply for buyers, but it also competes every single day.

Meg: As you might imagine, you need some return on capital. So especially in a business like ours, which is very, very capital intensive. Just by way of example, the driftwood LNG terminal Tellurian's project in Louisiana, just the terminal by itself will require about $17 billion of capital to just construct the terminal. Right.

Nate: Wow.

Meg: Yeah. So from a capital standpoint, actually, the US is also, thankfully very competitive in large part because it's easy to get materials in and out from the US terminal sites. And the US has a pretty ready labor force that can be mobilized quickly to build the terminals in. And that's very different from some of the international projects which are in extremely remote areas that need a lot of greenfield construction and labor that comes and has to live in camps for three or four years during the construction period.

Meg: And you know, periodically flown home to their families and things like this. So the construction costs in the US is also very competitive. And to give you some kind of comparison, the driftwood LNG terminal will cost $550 per ton of LNG. And by contrast, some of the recent Australian construction projects have been roughly $3,000 a ton. So you can see how the, how that compares where the US really has a true competitive advantage going forward.

Nate: Yeah. And so all in including the cost of construction, cost of capital, what's a good range for listeners to just sort of think about when they think about LNG landing in Asia, for example?

Meg: Yeah, reasonably our return on capital, which will include a mix of debt and equity. Yeah. Where we're able actually to finance these projects with a lot of project finance debt from the bank market and we generally take roughly 70% debt and 30% equity to finance the project. So I would say when all markets are healthy, a good return on capital would be probably another $3 an MMBTU. So we talked about $3 landed in Asia just on a variable cost basis. And I would say that would make it roughly $6 landed in Asia with full long term return on capital.

Nate: Wow. That's pretty amazing. Especially in the context that gas was $15 back in the early 2000s, here in the US, right?

Meg: Yeah. Oh, you're so right. And that actually points to the variability or the volatility in gas prices, not just here in the US but, but worldwide. When you are talking about $15 in the US the price of gas in Asia was $21 an MMBTU. So all things are relative, you know?

Nate: Yeah, yeah. So I guess, one of the things that I would imagine you get a lot of push-back from just in terms of the growth story, is the dynamic between LNG demand and the growth of renewables. Could you just talk about that a little bit?

Meg: Yeah, we are actually so excited about the growth and success of renewables for obvious environmental benefit reasons. Ironically, you probably would not expect this to be my answer, but as we are increasing renewables, we find that that actually increases natural gas demand. And I'll tell you why, because renewables and natural gas actually kind of go side by side and work in partnership. As you think about renewables, you would imagine sometimes the sun isn't shining, the wind isn't blowing and the rain isn't making rivers for hydroelectric capacity.

Meg: So that reliability that you need to sustain an overall electric power grid is so critical that many economies as they're installing renewable power, make sure that they have natural gas backup power side-by-side. So one great example when environmental meetings happened in Paris, the Moroccan government had intended to make a commitment to their renewable power, and the energy folks were planning to build an LNG import terminal for roughly four million tons of of LNG. And then the Moroccan government committed to double what they were expecting in terms of renewable power as they were really bringing power to everyone in Morocco.

Meg: A country that only a few years ago had very low power saturation and so the gas folks came back to us and said, "Okay, now instead of four million tons of LNG, we're going to need 8 million tons." Right? So it's a little counter-intuitive. You would think, wow, they're double doubling renewables so they're not going to need any more gas. But they actually came also with a doubling of gas. So we actually enjoy what we view as a very important partnership that enables the renewable sector to come into the market in a safe and reliable way for the power grid.

Nate: Yeah, no, I appreciate that explanation. And My background is actually in renewables before I went to the buy side. And so I completely agree with you in terms of the intermittency of the resource and the need for something else to provide fuel for generation facilities when, as you said, the wind's not blowing and the sun's not shining. So thanks for that.

Nate: So could you talk about a little bit more about the asset portfolio, Tellurian's asset portfolio, and what I think is really interesting about your business is that most LNG companies, they own a liquefaction terminal and within your asset portfolio you've got a lot more than just a liquefaction development asset. You've got assets that you're building across the Gulf coast. Could you just sort of describe what Tellurian in his building and just describe the mouse trap?

Meg: Yes. Happily. So like we talked about a little bit at the beginning. The Tellurian is building, you know, overall the driftwood LNG project, which is almost 28 million ton LNG facility, and that'll consume about four BCF a day of natural gas. What we recognized is that today the infrastructure picture on the Gulf coast is very, very different from when we were developing the earlier terminals, when pipeline capacity had a lot of spare capacity and it was very easy to get gas to the terminals. Even on a short term interruptible basis. That is actually no longer true, for a couple reasons. One, the LNG terminals have been contracting at capacity, but also gas is coming into the Gulf coast from the Marcellus Utica and the northeast, from the scoop stack in the Midwest and from west Texas from the Permian.

Meg: So the pipeline infrastructure that has been on the Gulf for, you know, decades is now fully subscribed and fully utilized. So we need, in order to properly interconnect the Driftwood terminal with all the low cost basins, we need to develop a network of pipelines and we have designed roughly a thousand miles of pipelines that will reach back to the Permian, the Haynesville in North Louisiana, and a point called Perryville interconnect, which is where the Marcellus and Utica gas comes in.

Meg: And we also would like to produce some of our own gas for the project really so that for a portion of our gas, we always know what our cost of production is. So we have a producing position in the Haynesville, which is the gas field in north Louisiana and we'll interconnect that gas with the plant. So it's really an integrated project, in total about $28 billion of capital for the LNG terminal, the pipelines, and a small amount to increase our position in the Haynesville.

Meg: And that package is what we're offering on a joint venture partnership basis to the other LNG buyers. So they will buy LNG from the plant, they will be our partners, and ultimately Tellurian will be left with about 14 million ton LNG portfolio that it will manage. And that's really the future of Tellurian. And we expect that the earning power of Tellurian on that book of LNG will be roughly a $2 billion a year of free cash flow.

Nate: Wow. That's pretty significant, especially when you compare it to your market cap of $2 billion.

Meg: Yeah. In fact, if you think about $2 billion of free cash flow, right? 10 Times cash flow is a $20 billion company and this is the entire goal. So you're exactly right, Nate. Today we're a $2 billion market cap company. We've completed all the development phase of the project, we're finalizing our financing to be able to begin construction, and that will put us on the path to a $20 billion company. So since we're all shareholders were looking forward to that 10 times return.

Nate: Yeah. I noticed that you guys, you management team, employees together, you all own roughly 50% of the equity, which I thought was really impressive. You don't see that very often with public equities. So I would like to just ask about sort of the process. So Driftwood should come online in 2023 what are the steps that that you need to take in order to hit that target of first LNG in 2023?

Meg: Yeah, some really important milestones that every LNG project has to achieve. And I'll kind of go through them and tell you which ones we've completed and which ones we have left. So first step is secure a site with a substantial amount of acreage. We have over a thousand acres and this is what we've done on the Calcasieu River in Louisiana. So that's complete.

Meg: The second is obviously designed the plant. Do all your engineering and select the contractor who is gonna build the facilities for you. And in our case we have completed the design with Bechtel, and Bechtel will be the engineering procurement and construction contractor. And we've entered into a lump sum turnkey engineering procurement and construction contract with them. And that really means that they are guaranteeing a fixed price bid for the project and also guaranteeing the schedule for the project.

Meg: So four to five years of construction and also guaranteeing the performance of the project, fully on their balance sheet. So we're very proud of that contract. I would actually say that the relationship with Bechtel is a competitive advantage for the company and we look forward to continuing our partnership with them.

Meg: And then third, we have to complete a very rigorous regulatory process, which is coordinated by the Federal Energy Regulatory Commission, but involves many local, state and federal agencies that review the project for safety and environmental impact. And that permitting process we completed a few months ago. So we are now authorized to begin construction on the facility and also to export LNG from the terminal when it is operating. So those are all complete. Fourth thing that every project has to do is determine what its commercial model is going to be and secure, its either customers or partners.

Meg: In our case, our customers will be our partners, which leads us to item number five, which is we have to close all the financing including for our phase one about $15 billion of debt in the bank market. And so we've been preparing all the project finance banks to get that finished.

Meg: That'll take us a couple, three months, after we conclude with the partners. And that leads us to a beginning of construction in 2019. So then we spend the next four years under construction at the terminal and with the interconnecting pipelines, and we produce our first LNG in 2023.

Nate: I know that you spent a lot of time talking to investors about your business, but from your perspective, what's the most important question that never really gets asked, and why?

Meg: You know, Nate, I'm always amazed of all the investors that I've met. Nobody, the new ones, right, because a lot of people know us, but when we sit and meet with new investors, nobody asks, have you ever done this before? Right? So we come and we tell them we're gonna spend $28 billion and nobody says, "Have you ever done this before?" And I'm always astonished and actually so proud of the team that we've built here at Tellurian, because we have now I think, 50 years of experience in the LNG business.

Meg: And we have built terminals everywhere in the world representing more than 15% of all the terminal capacity on a worldwide basis, including many of the plants here in the US. The only ones that have finished construction on time and on budget. So I'm always like really proud for the opportunity to kind of be boastful about the team, because I think that experience really matters in getting the company to a successful completion.

Nate: Yeah. And so what do you think is the biggest misconception the market has about your company? I mean clearly if your equity is valued at two billion and you could be generating two billion of free cash flow over the next five years or so, what do you think the market just misunderstands? Is it just their misunderstanding about the risks in your ability to execute or is it something else?

Meg: I find when we talk to people, we have to continually remind them of kind of the big picture simple model that we're employing, right? So we have roughly $28 billion of assets to put in the ground, we're offering about 60% of that partnership to the international community. We'll retain 40% of the ownership. So Tellurian is actually a very simple, over time it owns 40% of the asset base, and it manages a book of LNG that is about 14 million tons of LNG and everyone can make their assessment of what they think that book of business will earn as a margin.

Meg: We believe that it will earn roughly on average $2 billion a year of cash flow. So that's a very simple picture and there are a lot of details behind completing the terminal and getting the partners in place. And sometimes those details give people the impression that the story is complicated. So I would say that's probably the largest misconception that people walk away thinking, wow, they have a complicated story. And we remind them, it actually is quite simple. It's a 40% of these assets and a book of business that generates $2 billion a year of cash-flow.

Nate: Very last question as to whether or not you had a funny or interesting story from a sell side conference or investor meeting where maybe somebody asks you a goofy question?

Meg: We thought through the question and I'm trying to think like what are the funny stories that happened? We've been in, you know, obviously a lot of sell side conferences and investor meetings, but I don't know, maybe we're boring. I don't have anything that's like ...

Nate: Or you're just talking to all the smart investors because they're interested in Tellurian

Meg: I guess so.

Nate: Well Meg, thank you so very much for coming onto the podcast. It's been great talking to you.

Meg: Well, thank you, Nate. It's good to be connected with you again and really appreciate you having us on the show and taking an interest in Tellurian..

Nate: Definitely, my pleasure. All right, well you all take care and thanks everyone. And thank you, Meg.