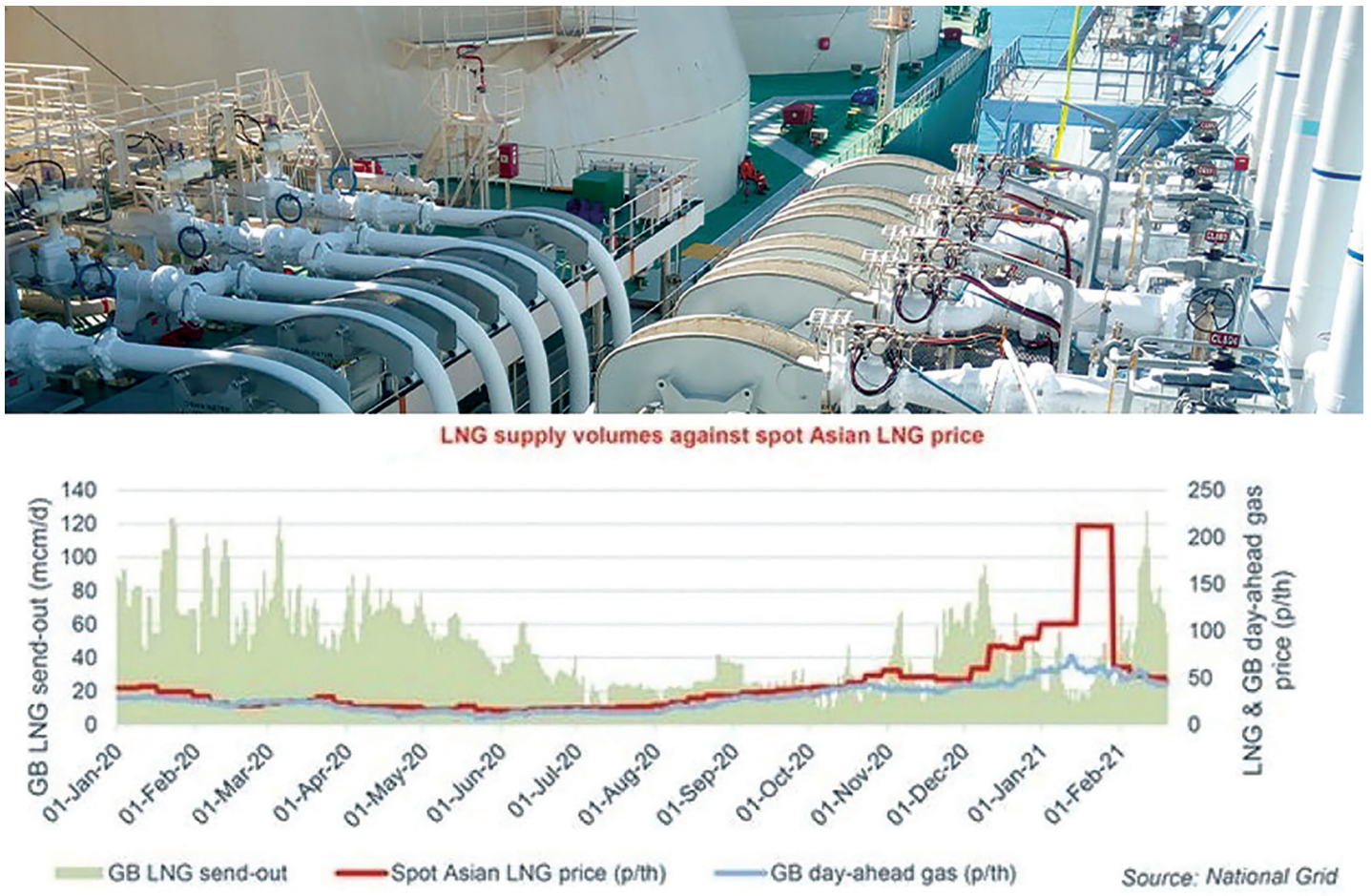
# How to navigate customers through volatility?

*CEO of MET International, György Vargha talks to LNG Journal's Markets Editor Anja Karl about why it is so important to manage risks in an integrated way.*

LNG exporters and gas utilities operate in an ever more volatile energy sector – with climate and economic risks, due to the ongoing Covid-19 pandemic, all adding up and leading to a greater sensitivity of oil and natural gas prices. How does MET International assist its customers with this?

"Our customers have three key pricing challenges. First, they want to achieve a price that is better than what their competitors can get. Second, they have a budget from an energy procurement perspective that they need to stick to and third, they need to keep an eye on the prices of their end product in relation to their energy costs," Vargha said, explaining the most direct link is to be found in the fertilisers market, where the feedstock is natural gas; but also, to a lesser extent, in companies that make things for consumers where the output is linked to the general inflation. "They need to manage all three in tandem in a volatile and often illiquid and untransparent environment," he said, calling the conundrum a "big challenge" for customers.




## Rising gas-on-gas competition

Gas prices have become more volatile in the past years as oil indexation has been replaced by gas hub indexation in most long-term import contracts. Rising gas-on-gas competition, in turn, has boosted the role of CCGTs in the energy mix with gas peaking plants assuming a price-setting function for electricity wholesale markets and a central element in a nation's gas demand profile. On a macro-economic level, the role of Europe as a 'last resort LNG buyer' has increased considerably, making prices at UK's NBP gas trading hub or the Dutch TTF much more volatile. For example, when spot LNG prices in Asia soared this winter, day-ahead gas prices in the UK reached their highest level in three years, hitting 73.50 pence per therm (p/th) on 12 January, while gas contracts along the forward curve also saw prices rise significantly.

Looking at Europe's largest suppliers, traditional contracts that Russia's Gazprom and Norway's Statoil had with large importers like E.ON and GDF Suez were linked to the oil price with 3 to 9 months lag and kept that fix price for 1 to 3 months. "These contracts usually had some inherent flexibility for the buyers, meaning that for 1 to 3 months there was an important fix price anchor in the market to price against," Vargha explained, noting "much of these contracts have been replaced by hub indices without flexibility, and as such large import volumes are only linked to the fundamental dynamics of the gas markets without fix price anchors."

Global LNG prices, on one hand, but also wholesale electricity prices and the influence of rising intermittent power supply from renewables all have an impact on a nation's gas demand and prices. LNG prices are much more volatile than gas prices: in the last year alone, the price has moved from around €5 per Megawatt-hour (MWh) in the summer to as much as €100 per MWh this winter.

Pointing out the reasons for this, Vargha said: "LNG markets feature huge quantities in single cargo shipments, largely unpredictable demand and inflexible supply patterns. Europe is extremely important for the LNG markets to place cargoes not needed by Asia. This, nevertheless, exposes Europe to the huge volatility of global LNG prices and can remove substantial amount of supply destined for Europe in case other markets need the LNG."

**MET has booked firm capacity at Croatia's first LNG terminal on Krk island**

## Gas helps overcome 'intermittency challenge'

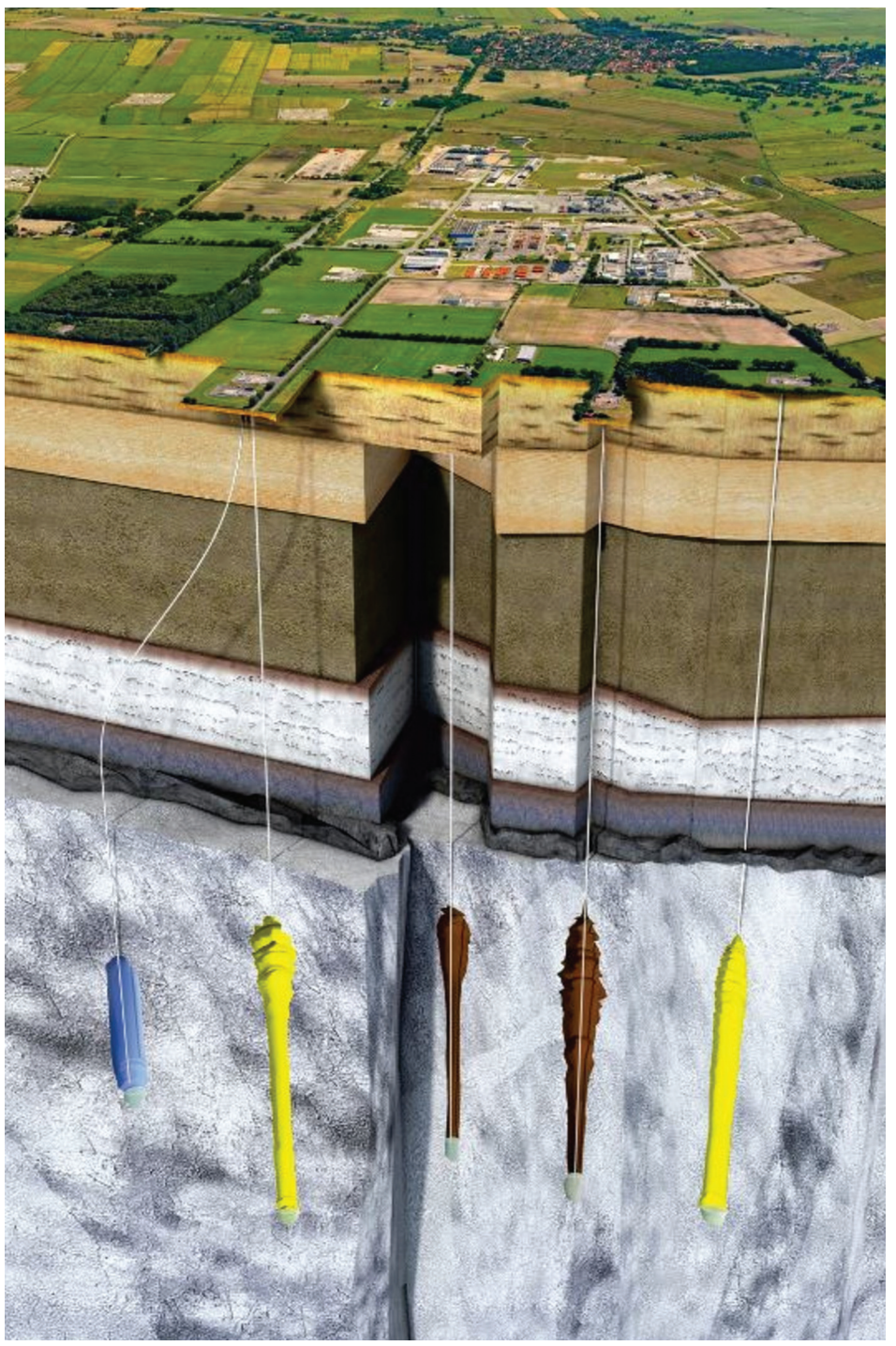
Wholesale power prices are also extremely volatile due to rising supply of wind and solar power, produced at zero variable cost, which are starting to outcompete fossil fuel-based power generation amid higher emissions pricing.

"As such, when substantial amount of wind is blowing, power prices can easily fall to 0 or become negative, whereas in low wind scenarios power prices have been moving between €40 and €60 per MWh. However, in the very short term, prices can even be + or - €1000 per Megawatt-hour (MWh), – insane compared to gas pricing," he said.

Gas peaking power plants are dispatched to balance an ever growing volume of intermittent renewable energy supply, hence flexible LNG supply and gas storage is getting more and more important. At the same time, gas production profiles are becoming less flexible at a time of comparatively low oil prices so the market's need tor flexible spot LNG and the removal of oil formulae as fix price anchors have made gas prices spiral to unprecendeted levels.

As an integrated energy company MET manages customers' risk exposure to natural gas, power, LNG and oil prices across all European hubs. Asked how it helps customers address this volatility, the CEO said MET strives to help them navigate through the rough times of volatility and illiquidity. "We are well-positioned to manage liquidity risks in an intergrated way and help our customers understand the driving forces behind the price moves in the liquid markets – being a major participant ourselves," he said. "We are eventually building bridges – between liquid and illiquid markets, between traders and originators, between professionals coming from different cultures, between physical assets and commercial feasibility."

For example, MET can arrange gas sales in the Mediterranean region in countries such as Spain, Italy, Hungary, Slovakia, Croatia, Bulgaria which are illiquid from a physical gas perspective. "Local markets don't have depth and customers don't necessarily see what prices are. Many of these markets are dominated by state-owned companies," Vargha said, stressing: "One way we are able to help our customers there to manage risk is by connecting them to the European markets with sufficient liquidity to hedge their exposures and provide an understanding to the price movements enabled by being active in the LNG and power markets as well as being fundamental drivers of the gas markets."



Scheme of Etzel gas cavern storage near Wilhelmshaven, Germany.

## Offering regas capacities at Croatia LNG

"We recently booked capacities in the Croatian LNG terminal for a three-year period, amounting to 1.3 billion cubic meters overall. We will process 6 to 9 cargos per year there (the first full cargo this April) and if the price dynamics allow it, we can divert these cargos to other global LNG markets or even to Northwest Europe. We can also book some further slots on a short term basis. So we can import into Italy, Spain, Greece and Turkey to feed our portfolios. It makes us a Mediterranean buyer of LNG into almost all markets there, creating a portfolio effect and hedging tools into all our illiquid gas markets," he said, noting this would give MET an exposure on how LNG players think – a knowledge it is willing to share with its partners.

"LNG traders work in a different way compared to power or fundamental gas traders, or hedge funds. By being active on a variety of markets impacting the European gas markets – as well as the majority of the local European gas markets themselves – we get an increased understanding on the overall dyamics and a good basis to proxy hedge exposures within this pan-European cross-commodity portfolio," Vargha said.

MET decided to book capacity in the Croatian LNG terminal "because the price was right, and it gave us the means to manage risk for Mediterranean customers," he said.

In terms of physical assets, the Hungarian company just completed the acquisition of Gas-Union's gas storage activities at four sites in Germany – Reckrod, Etzel, TGE and KGE – with a total working gas capacity of 3.4 TWh. These storage assets complement the build-up of gas sales to end consumers through the company's subsidiary, MET Germany. "All of these asset positions, be it direct asset investment or mid term positions, allow us to have a good trading understanding of the whole gas market in the most relevant regions," Vargha concluded.

## Stragic focus shifts to renewables, energy storage

Looking to the future of gas risk management in the energy transition, the MET CEO underlined that "we will keep 'our feet on the ground'. We are very pragmatic in terms of investment." In the medium to long term, the company's seeks to significantly grow its renewables portfolio in the CEE region. To this end, it bought a 100% stake in Enel Green Power Bulgaria in January this year, and in October 2020 brought a new solar power plant in Hungary which produces green electricity to more than 23,000 households in the town of Kaba.

"But we are practical right now, and we know that power grids are struggling with the surge of renewable production because it is too volatile – the weather is unpredictable and day production is very different to that produced at night," he said calling on European policy makers to first solve power grid stability problems before decommissioning lignite power plants. "Gas peaking plants are a possible solution," he noted, "if hydrogen-based peaking technologies are well supported, if an early decomissioning of coal-fired plants is supported, if new-built peakers are incentivised by the governments, then they have their role." In the meantime, MET will continue with "opportunistic investment" in areas such as gas-based generation or gas storage, production or regasification.

György Vargha, CEO of MET International

## No bet on hydrogen

Hydrogen is not part of MET's growth drivers just yet. "Because we are strategically focused on renewables in the long term and opportunistic on investment into gas-based infrastructure assets, we will not be getting into the hydrogen market just yet, where we see investments still in in the R&D phase. We do not think we have the size or the experience right now for major research and development in this area," Vargha said.

Hydrogen is one of the solutions for the gas industry's future, and it is a greener, cleaner fuel that has had a lot of support in Germany and Italy, he acknowledged but stressed that MET can and wants to add value in other places. "We have strong local management on the ground so our partners can connect to real professionals locally. Nevertheless, we are coordinating our efforts centrally to share perspective and enjoy the synergies together," he said, concluding: "Managing this cultural complexity is a key competitive advantage that we leverage on, however difficult it is. Yet with the right mindset, it can add true market value." ■