

Gas riches galvanise interest

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When Shell announced its £1.1 billion cash offer for the East Africa-focused UK-listed oil company Cove Energy in February of this year, Mozambique finally shed its under-the-radar status as one of the world's most significant prospective new oil and gas provinces.

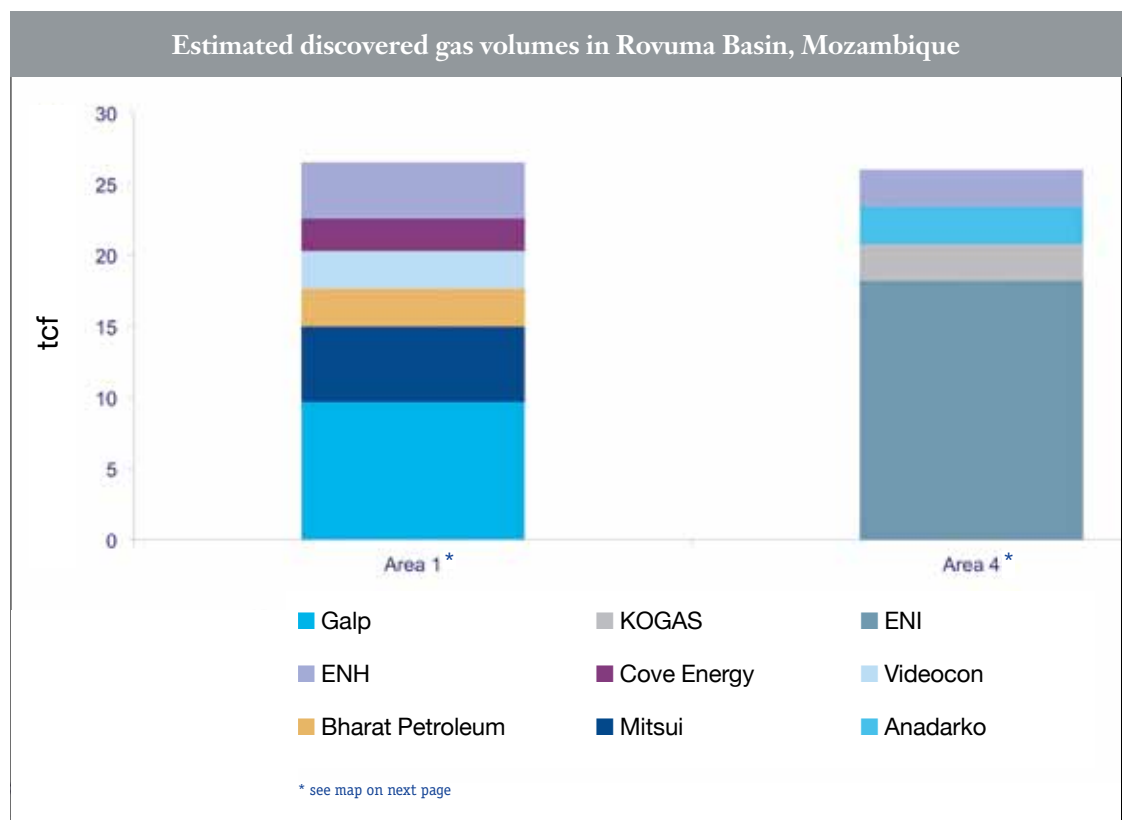
The Anglo-Dutch supermajor's move to acquire a company holding a prime position in Mozambique's major offshore natural gas region, the Rovuma Basin, heralds a seismic shift in the east African country's economic fortunes.

Though experienced international oil companies like Italy's Eni, the US super-independent Anadarko, and South Africa's Sasol have been exploring and developing hydrocarbons in Mozambique for a number of years, the potential entry of a supermajor with interests in building a liquefied natural gas (LNG) project to feed the gas-hungry Asia-Pacific market, represents a step change in

the country's progress from energy minnow to East African powerhouse. With recoverable gas reserves estimated up to 70 trillion cubic feet (tcf), it is not hard to fathom why Mozambique is emerging as Africa's most exciting exploration frontier. Shell's billion-pound plus approach for Cove is only the latest expression of heavyweight interest in Mozambique's hydrocarbons sector.

In November 2011, Eni announced a "giant natural gas discovery" at the Mamba South 1 prospect, offshore Mozambique. The Italian oil company's first well in Area 4 in the Rovuma Basin was only one in a long line of gas finds in offshore East Africa, but is deemed particularly substantial with the operator claiming gas initially in place to be at least 15 tcf. This would make it Eni's largest-ever operated discovery anywhere in the world.

The increased likelihood of further substantial finds have encouraged a slew of blue chip oil and gas companies to focus on the region, including Statoil,



Source: Wood Mackenzie, correct as at 1 May 2012

The government is willing to do what is needed to be become a centre of oil and gas investment

ExxonMobil and the UK's BG Group.

With more wells to be drilled at Rovuma, the success rate is expected to continue. Anadarko, which operates Area 1 (across the block boundary) together with exploration partner Cove Energy, has reported a series of important gas discoveries since 2010. Eight exploration and appraisal wells have revealed significant gas plays.

The results of its Barquentine-3 appraisal well showed its fields had recoverable reserves of 15 to over 30 trillion tcf. The combined reserves from Anadarko's Areas 1 and 4 are put at 60 tcf, more than enough to support a major LNG plant on its own. A 10-million tonnes a year LNG plant on Mozambique's coast would be well positioned to service the booming Asia-Pacific market.

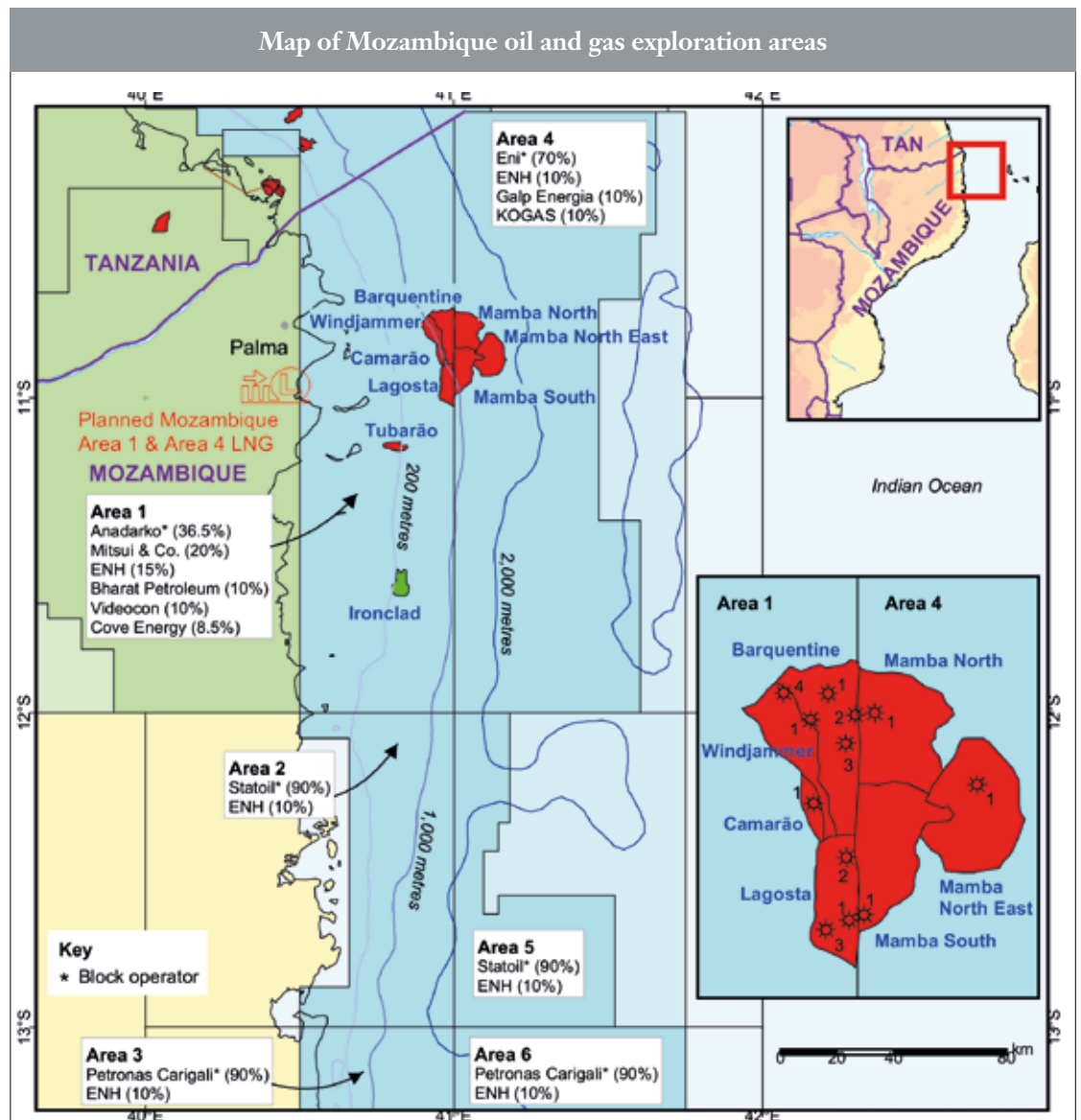
As Anadarko CEO James Hackett recently told

a company conference call, there are still some exploration wells still to drill in Rovuma. "In terms of capturing value we are still away from the maximum value period and as you get more long dated in terms of the of reserve life, some of our investors would like that collapsed forward. We'll keep that in mind, but for now we are just thrilled about a validation stamp being put on this in terms of what it's worth and we are very excited about the five exploration wells we have to drill this year," he said.

Rovuma is clearly going to exert a dramatic impact on Mozambique's hydrocarbons industry. Putting together Eni and Anadarko's efforts, the Rovuma Basin can now be regarded as a world-class gas province.

"What we've seen in Mozambique over the last 24 months is fantastic exploration success," says Martin

Map of Mozambique oil and gas exploration areas



Source: Wood Mackenzie

Kelly, an analyst at Wood Mackenzie. “We are estimating just over 50 tcf of gas has been discovered in that timeframe, which by anyone’s standards is an exceptional exploration performance.”

“The Republic of Mozambique is certainly at the forefront of East Africa exploration activity and is likely to remain a key focus for the companies that are positioned there at the moment, as well as those companies which would like to build a position in East Africa – they will certainly be taking a good look at Mozambique,” says Kelly.

With the discoveries in Area 1 and 4 of Rovuma in close proximity (operated by Anadarko and Eni respectively) the impetus is on collaboration in order to reduce capital expenditure costs. The challenge then is to ensure that reserves can be “unitised” effectively – and that demarcation of gas plays do not cross block boundaries, which might precipitate lengthy negotiations between the relevant companies.

Unitisation may prove critical to ensuring the best use of resources. Areas 1 and 4 boast sufficient gas reserves on their own to justify a standalone liquefaction plant, but combining resources would beef up the commercial viability significantly.

“Eni and Anadarko are in the early stages of discussion over unitisation and it is going to take a bit of time to really finalise the structure of an agreement, but at the same time the companies have negotiated unitisation agreements elsewhere in the world. It’s still at the early stages, but these issues are likely to be resolved some time in 2012,” says Kelly.

LNG is the key attraction behind the proposed acquisition by Shell of Cove’s portfolio, given significant potential for new LNG from recent gas discoveries offshore Mozambique, and further complementary exploration positions in East Africa. Adding Cove’s assets to Shell’s current portfolio would strengthen and further diversify Shell’s existing global LNG portfolio of production and development projects.

The Shell bid for Cove is not a done deal – Cove’s board of directors has recommended shareholders accept it, and a final decision was still awaited at the time of going to press, with a rival offer under consideration from Thai state-controlled oil firm PTT Exploration and Production (PTTEP) in February.

But there is little doubting Shell’s appetite for Mozambique gas. “Our strategic direction broadly speaking is to move more into gas and we’re looking at a variety of opportunities. There’s been a significant increase in exploration activity offshore East Africa in recent years and we are certainly looking to build up our interest in that area,” says Shell spokesman John French.

Shell has interests in Tanzania and if the Cove deal

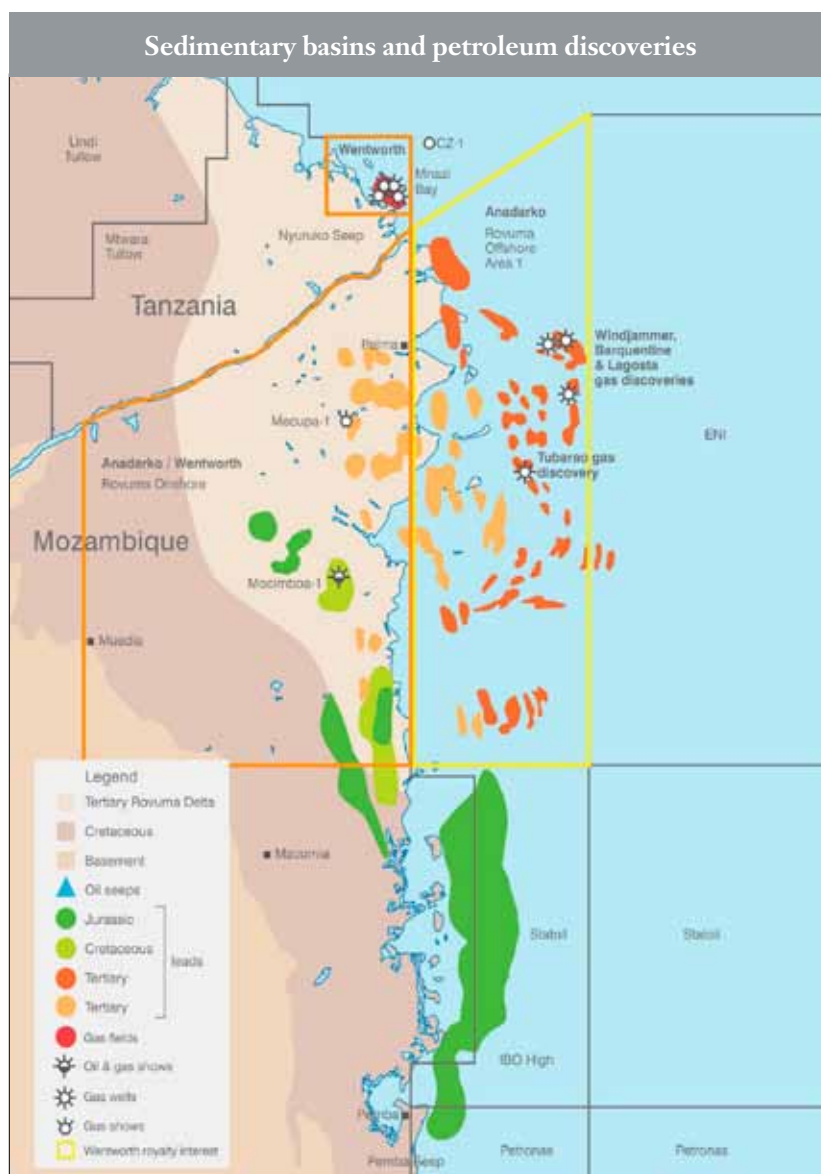
does go through, it would mark the company’s entry into promising new provinces both in Mozambique offshore and in Kenya which is the other asset that Cove hold – though the Mozambique blocks are far and away the greatest in terms of size.

Rovuma may hold more gas than official estimates, and though Cove only has an 8.5 per cent stake in the Area 1 block, it may move to increase its stake if the bid is successful. “If we are ultimately successful in the Cove bid then we will look to other opportunities to increase our stake in that play. Typically our holding in LNG ventures globally is between 10 to 30 per cent – even if we buy Cove, we won’t be the operator.”

Shell is making much play of its experience as the global LNG leader. “We believe that the advantage to everyone involved of having Shell become part

Tax exemptions to potential new investors at the moment are very beneficial

Source: Derrick Petroleum



of this project is that we bring a huge wealth of experience in the full LNG project and leadership – from the design and construction of large scale LNG facilities through to the project financing that you need for that project to get off the ground and then ultimately on to the shipping and marketing side which is an essential part of taking the project forward,” says French.

The speed with which the various gas projects have got off the ground in the past two years belies the fact that the Mozambique energy sector is still nascent.

More work needs to be completed to firm up and consolidate the investment climate.

Though inexperienced, says Robert Besseling, South Africa-based senior Africa forecaster for political risk consultancy Exclusive Analysis, there is a real will in the country to increase the capacity of ENH – both to increase its funding and to give it a bigger role in the oil and gas sector.

The Mozambique state energy company Empresa Nacional de Hidrocarbonetos (ENH) holds a 25 per cent interest in oil and gas blocks but there have been calls to increase this to 40 per cent.

“The increase to 40 per cent only affects companies that are likely to enter the market at the end of 2012 and doesn’t apply to existing players like Eni, Anadarko or Statoil. These companies are unlikely to have contacts renegotiated. However, new companies are likely to have form joint ventures in which ENH will take a 40 per cent stake, but they will still benefit from tax exemptions,” says Besseling.

If the increase in the state energy company’s stake is confirmed, additional challenges will have to be overcome, say analysts. “If ENH gets these percentage stakes, the question is will the government have enough money to move into the next phase of development, because now the exploration phase is coming to a close the challenge is whether the government can raise enough funds to keep the present percentage, never mind increase its stake in the Rovuma Basin,” says Ichumile Gqada, a researcher at the Governance of Resources Programme of the South African Institute of International Affairs.

Cove Energy required clarification over the position on capital gains tax (CGT) from the Mozambique government. However, there is a clear commitment to maintain an investor friendly fiscal regime.

The overall tax regime is favourable to investors, with the 12.8 per cent CGT comparing favourably with other African countries such as Uganda which last year levelled a 30 per cent CGT on Heritage Oil.

“Because it is such a nascent oil and gas sector it has brought in quite a bit of tax incentives – tax exemptions to potential new investors at the moment are very beneficial. Sasol, for example, only pays a 1

per cent sales tax,” says Besseling.

Importantly, the fiscal terms in Mozambique are supportive of major upstream developments, says Kelly. “The upstream part of the fiscal terms are set in stone – these were awarded as part of the licensing round when Anadarko and Eni gained operatorship of these blocks. What hasn’t been finalised is the LNG fiscal terms – they are still being negotiated between the international companies and Mozambique’s government. We do expect them to be finalised in due course – given the scale of capital being spent and the level of investment actually in the country, these terms are expected to be supportive of a large scale upstream and LNG developments.”

In order to attract oil companies, Mozambique needs to find the right balance between ensuring enough revenues are accruing to the government but also that there is enough to entice investors. Some other countries in the region have fallen prey to the curse of resource nationalism – with Zimbabwe’s mining sector expropriations proving an example of how badly things can go wrong.

“Mozambique’s resources sector is far more favourable to invest in than others in the region and is likely to remain so as investors just aren’t going to go into areas of high regulatory uncertainty. The authorities are trying to make sure the tax position is made clear from the beginning. And companies which have expressed interest receive a faster turnaround in terms of their applications. That’s an indication that the government is willing to do what is needed to become a major centre of oil and gas investment,” says Besseling.

While the Rovuma Basin has made most of the running, Mozambique is also offering some other interesting oil concessions too. Though long considered more of a gas prone province, Anadarko drilled an oil prospect in Mozambique in 2010. Excitement has been registered at the acreage being offered later this year, some of which lies along the Rovuma Basin.

“The blocks further to the south of Anadarko’s Area 1 are owned by Statoil and Petronas, and may hold some oil potential. Those two firms are planning to drill exploration wells in 2013 so there is some hope that there may be some oil, although all success offshore Mozambique has so far been on the gas side. We haven’t seen many wells targeting oil prospects at this stage – it’s very much focused on gas,” explains Kelly.

But with the gas potential inflating by magnitudes of tens of tcf a year, Mozambique will be more than happy with a focus that promises to deliver a step-change in the country’s economic fortunes for decades to come.

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