

Explorers go to the ends of the earth

News analysis

Oil groups are taking on greater political and physical challenges to exploit resources, writes Christopher Thompson

When Pete Landau went to Somalia – amid a civil war – to search for oil in early 2006, a local adviser gave the chief executive of Range Resources two choices: either travel with enough security to repel roaming warlords or go pretty much alone so as not to attract attention.

Mr Landau rode in a 15-car security convoy to view two oil blocks that he later bought. Last month, the Aim-quoted company raised £20m in part to help develop its onshore Somali assets, in partnership with Sweden's Lundin, with a total resource estimate of more than 3bn barrels.

Range's exploits are one example of how oil companies are increasingly prepared to push the boundaries of political and geological risk in frontier exploration.

According to figures compiled by Wood Mackenzie, frontier basins – or those with no previous discoveries – attracted 6 per cent of the global \$330bn (£200bn) spent by explorers between 2000 and 2009. However, in the same period, they saw the fastest growth in drilling. In 2009, driven by the diminishing prospect of big finds in mature and emerging basins, frontier plays were the only category to register an increase in wells drilled on the year before,

from 81 to 115 in places such as offshore São Tomé, Uganda's Lake Albert and Kurdistan in northern Iraq.

"There is more money that's flowing to exploration in general, so people will push the boat out on some of the geographies they deal in," says Andrew Fry, head of Europe, Middle East and Africa oil at Goldman Sachs.

"Investors are looking for explorers with a proven record of success going to riskier areas. As a result, the majors are now increasing their exploration as low-hanging fruit runs out. That means a greater risk profile generally."

Such was the case with BP's ill-fated venture with Rosneft, the Russian state-owned oil group. In spite of its well-publicised setback, investors' demands for growth and the Arctic basin's estimated 412bn barrels of oil equivalent mean that analysts expect other western oil majors to try to team up with Rosneft – and possibly BP to try again.

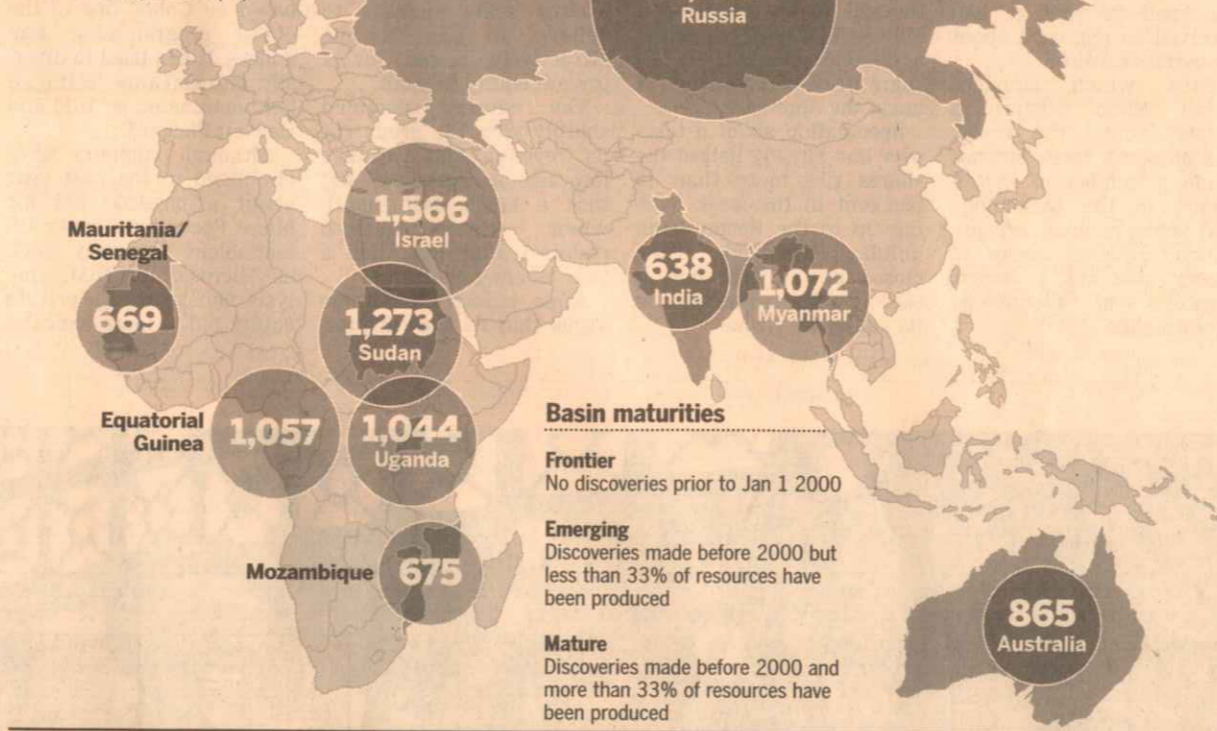
On the other side of the Arctic frontier, Cairn Energy, in a statement on Thursday, says it has approval from Greenland's government for a \$500m drilling programme to target several billion-barrel prospects.

What constitutes frontier risk varies considerably. For Cairn, according to the company, it is the logistical challenge of "managing and provisioning two rigs, at least 12 supply boats and 600-odd people". For Range in Somalia, according to Mr Landau, it is the "odd chance" of terrorism.

Although Somalia is still an outlier – for now – the oil industry regarded Uganda in much the same way until oil was struck

The new frontiers

Countries with largest frontier discovered volumes
Barrels of oil equivalent (m)



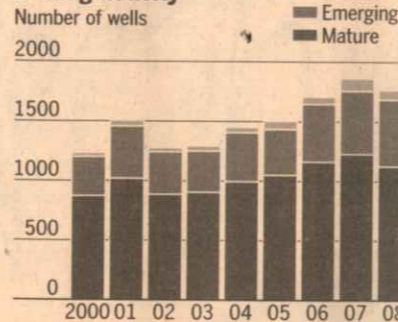
Basin maturities

Frontier
No discoveries prior to Jan 1 2000

Emerging
Discoveries made before 2000 but less than 33% of resources have been produced

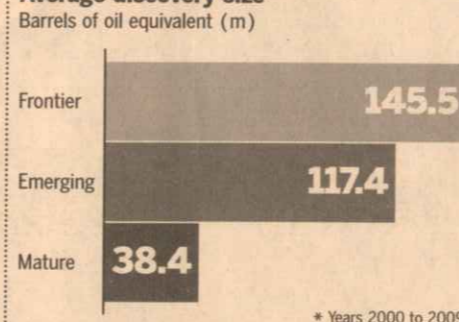
Mature
Discoveries made before 2000 and more than 33% of resources have been produced

Drilling activity



Sources: Wood Mackenzie's Exploration Service; Thomson Reuters Datastream

Average discovery size*



* Years 2000 to 2009

Oil price



in equatorial Lake Albert. Heritage Oil, a Ugandan pioneer, sold its Lake Albert stake for \$1.45bn to Tullow Oil last year. Tullow brought in China's Cnooc and France's Total in a subsequent \$2.9bn deal.

"Today's mature basins were yesterday's frontier basins," says Richard Rose, an analyst at Oriel Securities. "What you've seen over the past five years is the trend of frontier

'Today's mature basins were yesterday's frontier basins'

Richard Rose
Oriel Securities

exploration increasing as investors are more willing to provide funding."

Apart from established explorers such as Cairn, Tullow and Premier Oil, it is smaller companies that typically lead the most extreme frontier plays.

"At the exploration stage, there is not a huge amount of risk capital – and the potential rewards are huge in the event of success," says Keith Morris, an analyst at Evolution Securities.

"Small explorers will look to exit before the big development capex spend comes in. Then countries usually look to change the rules when the cash starts to flow – by which time the small companies are long gone."

Aminex, which has substantial operations in east

Africa, has an offshore concession in a highly prospective market considered politically forbidden: North Korea.

"You have to push out to politically and physically difficult places," says Brian Hall, chief executive.

A year ago, Aminex signed a production-sharing contract in the Korean East Sea but western sanctions against the North Korean government mean it has to tread lightly. Aminex is deferring bringing in a partner until the geopolitical situation improves.

"North Korea doesn't sit well with our US assets politically at the moment," says Mr Hall. "If this acreage were off the coast of Angola or Brazil there would be a rush to go

there... Because of the politics, it may as well be on the moon at the moment."

Are there any places still out-of-bounds? According to Alex von Sponeck, director of emerging market debt financing at Goldman Sachs, it depends on where companies are based.

"The markets are as supportive as they could be at the moment. If western companies could do business in, for example, Syria or south Sudan or Somalia, there is a strong likelihood that the markets would finance them," he said.

"So I think the real hurdle at present is a regulatory one, not a markets one. You can find a way to attract investors for 'frontier' frontier markets in the ongoing hunt for yield."

Cairn Energy pushes back Vedanta date

By Amy Kazmin
in New Delhi

Cairn Energy has extended the deadline for completing the \$9.6bn (£5.9bn) sale of its Indian unit to Vedanta, the London-listed, Indian-focused mining company, while awaiting New Delhi's blessing for the deal.

In a statement, the British oil explorer said it was not setting any new deadline but that the two companies had agreed to "extend the closing date on their sale and purchase agreement in order to secure the necessary consents and approvals from the government of India to complete the transaction".

At Thursday's annual meeting in Edinburgh Sir Bill Gammell, Cairn's founder and chief executive, told shareholders he "hoped to get a satisfactory conclusion in a short period of time". He added: "In India you need the three P's: positive, patience and perseverance."

In August Cairn agreed to sell to Vedanta – the metals mining company founded by the Indian-born self-made billionaire Anil Agarwal – up to a 51 per cent stake in its strategically important Rajasthan oilfields. But the deal became bogged down by the process of obtaining government clearance, due to an unresolved royalty dispute between Cairn and the state-owned Oil and Natural Gas Company, a joint venture partner in the Rajasthan fields.

The Congress-led government is to decide whether it should require a settlement of the dispute as a precursor to the sale, or rather to allow Vedanta to take over the company, and then to let ONGC contend with the new owners to settle the dispute.

New Delhi has been dithering over a decision, forcing Cairn and Vedanta to

extend their deadline for closing the deal repeatedly. Sir Bill had previously described the proposed sale as a litmus test of whether foreign companies can exit from Indian investments in a time and manner of their choosing.

The two companies had hoped New Delhi's cabinet committee on economic affairs was poised to make a decision in early April. Instead, the cabinet referred

18.5%

Vedanta's stake in Cairn India acquired this month

the issue to a group of ministers, which has yet to meet but is expected to do so this month, prompting the latest extension. The most recent deadline was May 20.

Over the past month, Vedanta has acquired an 18.5 per cent stake in Cairn India, picking up a 10.3 per cent stake in a block deal with Malaysia's Petronas, and another 8.1 per cent holding by a mandatory open offer to minority shareholders of Cairn India.

The companies have agreed that Cairn will sell a 40 per cent stake to Vedanta, retaining a 21.7 per cent interest in the business.

Cairn Energy

Share price (pence)



Source: Thomson Reuters Datastream