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East Africa emerges as potential competitor for Australia's LNG exports

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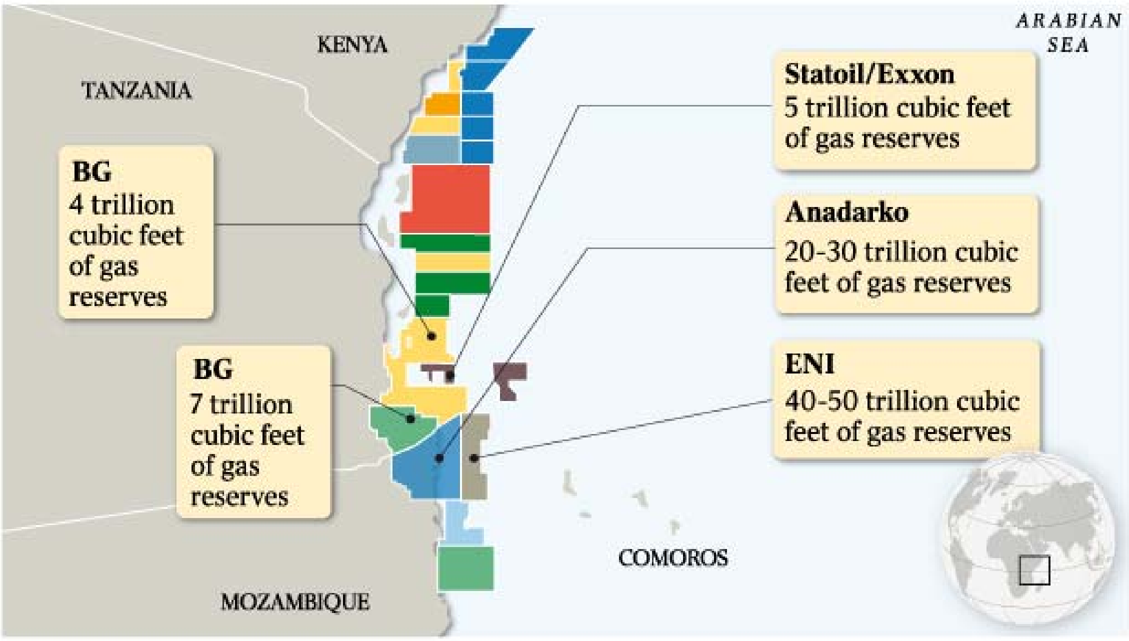

Source: The Australian

East African LNG exploration rigs have had a 90 per cent success rate *Source:* PerthNow

AS a rule of thumb, the probability of a deepwater oil and gas exploration well hitting a discovery in a frontier petroleum region is about 20 per cent.

But offshore Tanzania and Mozambique in the past two years, there have been 24 discoveries from just 27 wells.

This has smashed expectations and rapidly created another potential competitor for Australia's LNG exports as some of the world's biggest energy companies jostle for position there.

While the rise of the prospect of US LNG exports because of a North American shale gas glut has grabbed headlines lately, the equally fast appearance of East Africa as a potential LNG hub to supply Asia has been just as big a blip on the radar of Australian LNG companies and analysts.

A hefty 100 trillion cubic feet of recoverable gas reserves have been discovered in Mozambique and Tanzania since mid-2010, with oil companies involved claiming there is the potential to double this.

To put this in perspective, the massive Gorgon project, Australia's biggest resources development, has been approved with 40tcf of gas.

Plans have already been hatched in East Africa to export 36 million tonnes of LNG a year (Australia exports about 25 million tonnes, but could triple this over the next five years). But the plays remain at early stages, with hurdles to overcome.

"East Africa has been touted as the next major theme in global LNG supply, given the size of the resources and lack of local gas demand," Deutsche Bank energy analyst John Hirjee said.

As well as the discoveries being large and concentrated, development could be aided by the tendency of LNG buyers to continually look to diversify supply risks.

"The search for diversity favoured recent Australian developments as an alternative to over-reliance on the Middle East," Mr Hirjee said.

"However, with Australia now set to be the world's largest LNG supplier by about 2017, East Africa offers a new source of supply to risk-averse LNG buyers."

The hurdles to exports, which are being planned from 2019, are that the African gas is not high in the petroleum liquids that Japanese LNG buyers prize for their high energy content (and which can boost economics); there is a lack of infrastructure and skilled labour in East Africa; and there is a shortage of credible operators in Mozambique.

As with the threat of US gas exports, the East African projects will not threaten existing Australian projects, which have long-term supply contracts with oil-linked pricing, but they could threaten the profitability of expansions and greenfield projects such as the Browse LNG project planned for James Price Point.

Like US LNG plans, they could also weigh on the pricing of existing LNG contracts, many of which are renegotiated every few years.

"Asian buyers (in East Africa) would like a differentiated price -- one not linked to the Japanese crude cocktail; confidence on operators' ability to commercialise projects in a new LNG geography; partner cohesion; low-country risk; and, importantly, equity," Credit Suisse analysts David Hewitt said in a recent client note.

Japan's Mitsui and Korea's Kogas have already taken stakes in Mozambique projects.

The shortage of credible operators in Mozambique, where Anadarko and Eni lead the two big projects being planned, could be strengthened by the entry of Royal Dutch Shell.

Shell was recently outbid by Thailand's PTTEP in a $2bn play for Cove Energy, which has an 8.5 per cent stake in Anadarko's Mozambique Area 1 project.

But Shell has not walked away from its bid and London-listed Cove's share price is indicating expectations Shell will come back.

In East Africa, Mozambique has the biggest resources and planned projects but Tanzania has the best operators, in BG Group and ExxonMobil.

Tanzania has also reportedly locked in the fiscal terms for development.

Cove also has assets in offshore Kenya in which Shell may be interested, according to Hartleys analyst Dave Wall.

Mr Wall also said Shell's small (for a company of its size) tilt at Cove could be a precursor to a bigger move, with entry into the Area 1 project providing a look-in on Anadarko.

Australian investors can also play the East Africa offshore boom to the north of the LNG finds.

Pancontinental Oil and Gas, FAR Ltd and Origin Energy have interests in offshore Kenya, with targets linked to what has been found to the south, but concentrating on oil.

Apache Energy is planning a well next month at the billion-barrel Mbawa prospect, where Origin has a 20 per cent stake and Pancontinental has 15 per cent.

FAR is also planning to drill a prospect it has in partnership with Pancontinental next year.

Hartleys has a six-month target price of 33c on Pancontinental, whose shares closed yesterday at 19.5c, giving it a market value of $213m.

On FAR, Hartleys has a target of 13c, a big jump from yesterday's close of 5c, which gave it a market value of $110m.