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Arrow aims for joint output, Pure deal

Consolidation is likely in the crowded coal seam gas sector, writes **Paul Garvey**.

Arrow Energy chief executive officer Shaun Scott can feel the target on his back.

Following a gangbuster performance in 2008, the company enters 2009 as the last independent Queensland coal seam gas play of any note.

As several billion dollars in deals swept through the Queensland coal seam gas sector last year, Arrow's peers either disappeared or hitched their wagons to multinationals.

Arrow did not miss out on the action – it secured a $776 million deal to sell a 30 per cent stake in its Queensland assets and 10 per cent of its international coal seam gas business to Royal Dutch Shell. But the company is now surrounded by cashed-up international giants such as ConocoPhillips, BG Group and Petronas.

Adding to Scott's sense of vulnerability is the near halving in Arrow's share price since peaking at $4.00 last June.

He describes the prospect of an unwanted advance as "one of our biggest concerns at the moment".

"There's plenty of hungry sharks out there," he says.

"There are other smaller coal seam gas opportunities out there that will get mopped up in next 12 months or so, but in terms of a material portfolio with a material reserve base, we're the last of the independents."

Arrow's attractiveness would have also been enhanced on Friday when it confirmed it would post a record $350 million half-year profit and that its 3P reserves – proven, probable and possible reserves – had risen by 81 per cent.

While it does have its existing relationship with Shell, there are none of the change-of-control clauses that so tied QGC's fate to BG and killed off any chance of an auction after BG moved. The structure of the Shell partnership – the interests are held through numerous 70-30 joint ventures over individual leases, rather than through stakes in a single special-purpose subsidiary – also ensures Arrow retains as much independence as possible.

Hungry sharks are about, says Arrow's Shaun Scott. Photo Glenn Hunt

That said, the pair are beginning to pull together a co-ordinated strategy for the development of the assets – a process that has proven drawn-out. (Owing to the joint venture structure, some 121 parties have needed to sign consents for the deal.)

The first secondees from Shell have arrived at Arrow's Brisbane office, and Scott hopes to have a concrete plan in place by the end of March.

"What we want to do this quarter is really resolve what our short-, medium- and long-term strategy is for monetising the gas – including Shell as our new joint venture partner – and get some clarity around how that's going to work," he says.

The key piece to determine is how the pair expect to ultimately crank up liquefied natural gas production. Arrow has already advanced plans to supply gas to the comparatively small Fisherman's Landing LNG plant proposed by Perth-based LNG Ltd, but Shell is likely to be interested in something far bigger.

"Fisherman's Landing is a good starting point, but it is certainly only the starting point. The medium to long term is about monetising the 70 [trillion cubic feet] resource we've got," Scott says.

Assuming Shell ultimately wants something bigger than the 1.5 million tonnes-a-year Fisherman's Landing plant, their proposal will have already conceded a head start to the three other major LNG proposals.

Scott is prepared for Arrow and Shell to join in a round of co-operation and, potentially, project consolidation among the various proponents, to ease cost and logistics pressures.

"While from a resource and market perspective there's no reason all the projects can't happen, just logistically it doesn't seem sensible for them all to be executed at the same time," he says.

Hands may be forced in the project-level consolidation if low energy prices persist and projected revenues fail to materialise.

While the current lows in energy prices are unlikely to smother enthusiasm for coal seam gas, given the decades-long views companies are taking on the sector, Scott admits the low prices are not without implications.

"One of the big challenges is [the majors] have just got so many opportunities, whereas there are lots of smaller companies that, because of their size, will have difficulty accessing capital. Part of the exercise [the majors] are going through is high grading the best opportunities."

Scott hopes the downturn will help ease capital costs while Arrow moves through its costly development phases.

Arrow is also working to finalise its $673 million cash and scrip acquisition of junior coal seam gas explorer Pure Energy.

Scott says the move on Pure was hastened by mounting suspicions that other parties could beat Arrow to the punch in grabbing Pure's handy resource base.

The offer will provide a key benefit in allowing Arrow to claim much of the acquisition cost as exploration expenditure, easing the tax bill it faces from its deal with Shell. Arrow expects it could claim as much as $140 million of the price as a deduction.

Along the way, Scott will look to add another 40 staff to the 280 already with the company.