

# Bill Newman: As Argentina Backpedals, Will Oil and Gas Companies Step on the Gas?

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## COMPANIES MENTIONED

- Americas Petrogas Inc.
- BP Plc
- Canacol Energy Ltd.
- Chevron Corp.
- ConocoPhillips
- Exxon Mobil Corp.
- Gran Tierra Energy Inc.
- **Madalena Energy Inc.**
- Repsol
- **Royal Dutch Shell Plc**
- Total S.A.
- Yacimientos Petrolíferos Fiscales

**Argentina's nationalist seizure of YPF's assets last year stunned markets, but loss of foreign investment compromised the nation's energy self sufficiency. Now, says Bill Newman of Mackie Research, the government is taking steps in the right direction. In this interview with [The Energy Report](#), Newman outlines the political landscape and identifies promising plays in the region.**

Source: [Peter Byrne of The Energy Report](#)

**The Energy Report:** How is the news that Argentina holds the fourth-largest shale oil reserve in the world affecting business plans for companies that operate there?

**Bill Newman:** The U.S. Energy Information Administration (EIA) report that was released in June 2013 showed that Argentina has a technically recoverable shale oil resource of 27 billion barrels, so it reaffirms the large potential of Argentina. Although the shales plays are in an early stage of appraisal, we don't believe the potential of the shale is the key issue for oil and gas companies investing in Argentina. The political risk is still the chief concern. However, this year the government started to move away from its nationalist policies, so we think the political climate is slowly improving.

**TER:** When we talked last year, Argentina had recently expropriated the assets of [Yacimientos Petrolíferos Fiscales \(YPF:NYSE\)](#) (YPF) from Spain's [Repsol \(REP:MC\)](#) without compensation. And the government temporarily froze the Argentinean assets of [Chevron Corp. \(CVX:NYSE\)](#) in response to a \$19 billion (\$19B) judgment in Ecuador. Has the danger of nationalization of foreign owned oil and gas assets receded or increased?

**BN:** We believe that since the nationalist events that occurred late in 2011 and in early 2012, the Argentina Government has realized that it needs foreign investment in order to achieve its energy self sufficiency goal. We believe the likelihood of additional nationalization of oil and gas assets is small. In fact, with oil and natural gas declines accelerating, we believe that commodity prices in Argentina will continue to rise and that the government could introduce new incentives to promote investment similar to Decree 929, announced on July 15, 2013.

**TER:** YPF has access to prime drilling properties in the Vaca Muerta shale formation. Is that good or bad news for foreign drilling concerns?

**BN:** I believe YPF holds about 50% of prospective land in the Vaca Muerta shale, so if a major or supermajor company wants to establish a large position in the Vaca Muerta, it will likely have to deal with YPF, as was the case with the recently announced \$1.24B Chevron joint venture. Repsol has already filed a lawsuit against Chevron and this is going to be an ongoing issue until YPF and the Argentina Government compensate Repsol for its YPF shares that were expropriated. Repsol has asked for \$10.5B in compensation, which is far more than what has been offered so far. However, [Madalena Energy Inc. \(MVN:TSX.V\)](#) and [Americas](#)

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[Petrogas Inc. \(BOE:TSX.V\)](#) are both in early-stage discussions to farm out an interest in high-working-interest blocks in return of a significant carried work program. Neither of these companies have the baggage that comes with the YPF and Repsol dispute. As for the Los Moles and Agrio shales, a lot less is known about these plays, and the near-term focus will be on the Vaca Muerta, but in time we expect these plays to get more attention, just like what happened in North America with the development of the Barnett shale and then the Bakken and so on.

**TER:** What is the drilling infrastructure situation in the Neuquén Basin? Is there infrastructure to transport product into domestic and/or export markets?

**BN:** Argentina does have a big advantage over other shale basins in that the country has good production infrastructure. So the timeline from exploration to appraisal and full scale development is much shorter. Argentina used to be a net exporter of natural gas to Brazil and Chile but now has to import about 20% of its natural gas from Bolivia at about \$11 per million British thermal units (\$11/MMBtu) and liquified natural gas [LNG] at \$17/MMBtu. The high cost of imports is hitting Argentina's foreign currency reserves, so the country is motivated to stop the production declines and eventually become an exporter again. Argentina has strict foreign currency exchange policies and this has definitely been a deterrent to investment. But Argentina realizes this is a problem. The new Decree 929 allows companies that invest over \$1B over a five-year period to sell 20% of the production at world prices and without paying export taxes, and the proceeds can be kept outside of Argentina. That's a step in the right direction.

**TER:** Do you have any names in that space of firms that already have well-placed land positions?

**BN:** Madalena Energy Inc. is an oil and gas exploration and production company with an interest in three blocks in the prolific Neuquén Basin in Argentina, and 92,800 acres in Paddle River Alberta. Oil and natural gas prices are expected to continue to rise in Argentina and we are hopeful that the government will implement additional investment incentives that could be beneficial to Madalena. The shale plays in the Neuquén Basin of Argentina offer world-class resource potential and Madalena is well positioned to capitalize on the unconventional plays. The company continues to make progress on all three of its blocks located in Argentina.

Americas Petrogas Inc. is another junior international exploration company in the Neuquén Basin in Argentina. In September 2012, Americas Petrogas and partner [Exxon Mobil Corp. \(XOM:NYSE\)](#) completed a five-stage frack of the Vaca Muerta shale in the Lte.x -1 well. The following December, the companies drilled and cased the ADA.x-1 well on the Los Toldos II block. An independent assessment of the unconventional shale resource on its properties is expected to be released in early Q3/13. In addition, Americas Petrogas has secured two loans equivalent to US\$9.4M from the Commercial Bank of China. With cash and cash flow, Americas Petrogas does not expect to issue a new equity in the short term.

**TER:** Are vertical wells the status quo technique for accessing the petroleum reservoirs in this and similar formations, or will horizontal fracking play an increasing role in Argentina?

**BN:** Currently, most wells targeting the shales are vertical because companies are still assessing the best methods to complete and produce the wells. In most cases the shale zone is so thick that it might be more economical to drill, frack and complete vertical wells versus drilling horizontally, but the jury is still out on that. As for the juniors operating in Argentina, the cost to develop the plays, whether using

vertical or horizontal wells, will be in the billions of dollars, so most smaller companies will likely sell down to a much smaller working interest or just sell the entire block—or even the company. Argentina does require foreign fracking expertise and ExxonMobil, [Royal Dutch Shell Plc \(RDS.A:NYSE; RDS.B:NYSE\)](#), Chevron, [BP Plc \(BP:NYSE; BP:LSE\)](#) and [Total S.A. \(TOT:NYSE\)](#) are already operating in Argentina and provide that expertise.

**TER:** As times goes by, how is government's control of the oil and gas sector likely to evolve as the shales are opened up? Will this be a gradual or a long-term process?

**BN:** We think the government of Argentina now realizes it needs to attract capital in order to reverse its production declines and return to energy self-sufficiency, so we expect commodity prices will continue to increase over time and that the government will slowly introduce new incentives for oil and gas companies. It's not going to be a complete turnaround to a free market, but given the potential of the prize, we think as the political and investment climate stabilizes, investment will come back to Argentina.

**TER:** Are there other countries and jurisdictions that you find attractive in the South American oil and gas space?

**BN:** There is an interesting shale play developing in the Middle Magdalena Basin in Colombia. [Canacol Energy Ltd. \(CNE:TSX\)](#) has signed agreements with [ConocoPhillips \(COP:NYSE\)](#), ExxonMobil and Shell to explore the potential of the La Luna and Tablazo shale oil plays. Colombia offers much better fiscal terms than Argentina, but because these policies have been so successful in increasing investment, the production infrastructure is nearly full and it will take some time to expand capacity. Also, [Gran Tierra Energy Inc. \(GTE:TSX; GTE:NYSE\)](#) is exploring a new oil resource play in the Recôncavo Basin in Brazil, which is at an early stage.

**TER:** Decree 929, which you touched on earlier, provides new incentives for explorers and producers in the Vaca Muerta shale. What is the content of these incentives and how could they improve the situation for foreign and domestic companies with large stakes in Argentina?

**BN:** Argentina's expropriation of Repsol's share in YPF in 2012 was a bit of a shock and it forced oil and gas companies to step back a bit to wait and see what the government's next move would be. But I think the government quickly realized that it couldn't fund growth internally and that it needs foreign investment to reverse its production declines. So I think the threat of additional expropriation in the oil and gas sector is remote. The new investment incentive brought in with Decree 929 somewhat confirms that the government understands that it needs foreign investment. The Decree makes it more likely that the major and super major oil and gas companies will continue to invest in Argentina and this is good news for Americas Petrogas and Madalena because both companies are in the process of farming out highly prospective block. Madalena hopes to find a partner for its Curamhuele block before year-end and Americas Petrogas is looking to partner on the Loma Ranqueles block and probably the Totoral blocks. The new Decree increases the probability that this will happen.

**TER:** Do you see the decree turning around the import/export ratio in Argentina?

**BN:** Reserves and production of both oil and natural gas in Argentina is in steep decline and Argentina is even more dependent on imports to satisfy demand. The energy deficit is depleting Argentina's foreign currency reserves, which is a problem, especially because the government has limited access to external sources

of capital. It will take a large amount of capital just to reverse the production decline, and I think the government understands it can access some of this capital by providing incentives to international oil and gas companies. Again, Decree 929 was a step in the right direction.

**TER:** Can the government be trusted not to reverse its liberalizing course once it has weathered its current set of energy problems?

**BN:** That's a good question. Unfortunately, history has shown that this is not the case. Hopefully, Argentina will look at the turnaround that happened with Colombia over the last 10 years after the government overhauled its fiscal terms, which stimulated investment and helped production to almost double to approximately one million barrels of oil per day.

**TER:** Are the majors looking harder at possible acquisitions in the Argentina shale plays, or are they going to play coy for a while longer? Any names there?

**BN:** I think it's more likely that the majors will joint venture than acquire companies at this stage. But as the shale plays mature, it's likely that the smaller companies will be acquired. Madalena and Americas Petrogas have a large land base in the heart of the shale play, so they are natural targets.

*[Bill Newman](#) is vice president of international oil and gas with Mackie Research Capital Corp. He has been an energy analyst for 16 years. He holds a Bachelor of Commerce from the University of Calgary and has a CFA designation.*

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