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Shell gives China an opening in Arrow play

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GAS BOOM

'On the measure most likely to be scrutinised first by investors, the bid would look to be very underpriced.'
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Royal Dutch Shell has enlisted energy major PetroChina in a $3.3 billion-plus takeover offer for Arrow Energy, marking China's biggest move into Australia's emerging coal seam gas industry.

In what could be a major test of the Foreign Investment Review Board's toughened guidelines on investment by state-owned enterprises, Shell has formed a 50-50 joint venture with PetroChina to pursue Arrow.

As revealed yesterday by *The Australian Financial Review*, Shell is leading a $3.3 billion cash takeover for Arrow's Australian coal seam gas assets in a major endorsement of the fledgling coal seam gas to liquids sector.

Shell and PetroChina will offer $4.45 cash for each share in Arrow, plus one share in a new spin-off of Arrow's international assets.

Arrow shares surged almost 50 per cent yesterday to a high of $5.15 as investors bet Shell and PetroChina would be forced to improve the offer.

While Shell provided little detail of the structure of its offer or its plans for the Arrow assets, the *AFR* understands Shell and PetroChina will be equal partners in the acquisition, a move bound to put the proposed transaction under heavy scrutiny by FIRB.

The deal is by far the biggest transaction in Australia's coal seam gas sector since an acquisition frenzy

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Shell gives China an Arrow opening

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swept through the sector in 2008 and early 2009.

It comes despite widespread concern over the ability of the international liquefied natural gas (LNG) market to absorb the large number of LNG projects proposed for development in Australia.

The move by PetroChina, if successful, will be China's largest investment to date in Australian coal seam gas.

Fellow Chinese energy giant CNOOC struck an agreement last year with BG Group to buy a 5 per cent equity stake in selected tenements plus a 10 per cent stake in one of two LNG trains (or processing lines) planned by BG for Curtis Island.

PetroChina last year signed an agreement to purchase from ExxonMobil LNG worth a purported $41 billion over 20 years, but in January allowed a separate LNG agreement over Woodside Petroleum's Browse LNG project to lapse.

Major transactions involving state-owned enterprises, in particular those in which a state-owned customer can gain control of an asset, have come under greater scrutiny following the release by the FIRB of new guidelines last year.

That, combined with the size of the Arrow deal and the perceived importance of the coal seam gas to LNG industry to the Queensland economy, means the offer is likely to be closely scrutinised by the FIRB.

Another state-owned company, Malaysian energy giant Petronas, bought a 40 per cent stake in Santos's Queensland coal seam gas assets for $2.5 billion in 2008, before the recent toughening of conditions for state-owned enterprises.

Shell is no stranger to the FIRB process, having previously had its 2001 offer for Woodside rejected by then treasurer Peter Costello.

A spokesman for Treasury yesterday declined to comment on the offer.

Arrow declined to comment yesterday beyond a short statement describing the offer as a non-binding, indicative and conditional proposal and recommending its shareholders take no action.

The soaring Arrow share price also reflected the perceived value of the new international spin-off, which analysts have estimated would be worth around 55¢ a share.

At its recent half-year profit result, Arrow announced plans for an eventual spin-off of its overseas assets, which comprise a suite of early-stage coal seam gas assets in China, India, Vietnam and Indonesia.

Arrow's biggest shareholder with a 17 per cent stake is New Hope Corp, which is in turn 60 per cent owned by Washington H Soul Pattinson.

The chairman of Washington H Soul Pattinson, Robert Millner, told the *AFR* yesterday he was yet to be contacted by Shell or PetroChina to discuss the share holding.

"It'll make it difficult for them if we don't accept," Mr Millner said yesterday.

New Hope bought its initial stake in Arrow for 58¢ a share. At yesterday's peak, the stake was worth $625.7 million.

"It's an investment that goes back to the year 2006, we've been there for a while and obviously we're just sitting at the moment waiting to see what happens," Mr Millner said. "The market's reaction tells you there's more in it yet."

Queensland Premier Anna Bligh welcomed the offer, saying she believed it would fast-track development in the burgeoning $50 billion Queensland LNG industry.

"This bid is potentially very good news for the LNG industry," Ms Bligh said.

"If this can be secured on an agreed basis it seems to me it provides for guaranteed off-take contracts that will underpin a massive investment into the LNG industry."

Ms Bligh said, while the deal was up to the companies involved, it could accelerate final investment decisions in the LNG industry in Queensland.

Shell is already a 30 per cent partner in Arrow's Australian assets and a 10 per cent partner in the overseas projects, having paid $776 million for those stakes in June 2008.

This bid is potentially very good news for the LNG industry.
Queensland Premier Anna Bligh

Since then the company has consistently been touted as a likely bidder for Arrow.

While Arrow has been pursuing the development of a small LNG plant at Fisherman's Landing, near Gladstone, Queensland, Shell has independently been planning a far larger LNG facility at Curtis Island, across the bay from Gladstone.

While Shell does not have enough reserves to support its plans, diverting Arrow's reserves to Curtis Island could validate the project.

A successful takeover of Arrow could spell the end of plans for Fisherman's Landing, with Shell believed to be far more interested in the larger scale that its Curtis Island plans offer.

Arrow had previously indicated Fisherman's Landing was likely to cost more than $2 billion to develop, with the company likely to fund the cost through debt, equity raisings and, potentially, asset sell-downs.

Deutsche Bank analyst John Hirjee said he believed Shell was making its offer to protect its interests in the permits it shares with Arrow.

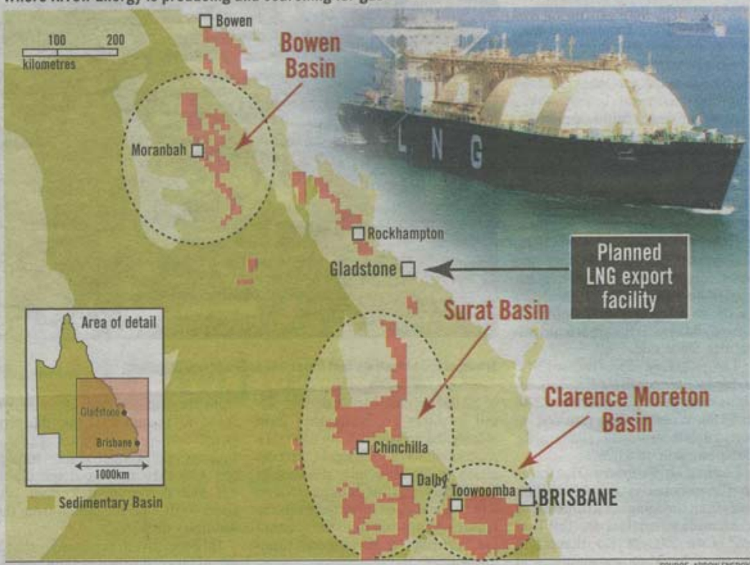
"We do not view Shell as necessarily interested in Fisherman's Landing," Mr Hirjee said.

"More likely is that Arrow's gas resources could be utilised for Shell's LNG project on Curtis Island," he said. "Given the joint bid nature, we believe FIRB may review the bid closely."

with Mark Ludlow

Going with the flow

Where Arrow Energy is producing and searching for gas



SOURCE: ARROW ENERGY

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