

Iran's views on the future of energy relations with China and Asia

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AGENDA

- The backdrop to an evolving relationship
- The ancient silk route revisited inter alia through new upstream partnerships
- Brief review of the development of the Iranian oil and gas industry
- The commercial and political scorecard on past and present relations with the West, and the IOCs
- Lessons learnt despite the missteps?
- Emerging trends and policy reviews
- Challenges and the management of possible re-entry strategies.



Introductory remarks (I)

- Iran is a resource rich country
- Second largest reserves of both oil and natural gas
- Proven oil reserves: 138.4 billion barrels (11.2% of world total)
- Proven natural gas reserves: 981.7 trillion cubic feet or 27.8 trillion cubic metres (15.7% of world total)
- Oil production: 4.4 million barrels per day (5.4% of world total)
- Natural gas production, excluding gas flared and recycled: 111.9 billion cubic meters last year (3.8% of world total).



Introductory remarks (II)

- There are 16 main sedimentary basins
- Note the differing exploration intensity
- Only one basin is relatively well explored
- Arguably three others have had a measure of exploration, but can be considered underexplored
- Remaining basins unexplored
- Remaining potential for exploration, and thus proving up additional reserves are immense
- A vast array of E & P opportunities exist for the participation of both the IOCs and the ANOCs.



Introductory remarks (III)

- The challenges were never “technical”, as the reserves are there
- Need to assess these other “non – technical” challenges
- First and foremost are the political considerations (and thus the assessment of the associated political risks)
- Commercial considerations (how good is “the Contract” and the commercial terms)
- Other issues: the locality (the operational and logistical challenges) and the business culture.



Current upstream opportunities

- Existing E & P Projects
- Exploration Opportunities (off the shelf)
- Further Exploration Options (innovative concepts)
- Field Development Opportunities.



The ANOCs in the upstream sector: The exploration projects

- India's ONGC: Farsi Block (2002)
- China's Sinopec: Zavareh - Kashan Block (2001)
- China's CNPC: Kuhdasht Block (2005)
- Thailand's PTTEP: Saveh Block (2005)
- China's Sinopec: Garmsar Block (2005)

The ANOCs in South Pars and field development projects

- Malaysia's Petronas: Phase II of South Pars (Gas field development), as non-operator partner of Total (2004)
- China's CNPC: Masjid e Suleiman (oilfield development) as non-operator partner of Iran's Naftgaran (2002)
- Malaysia's Petronas : Sirri A & E (oilfield development), as a non-operator partner of Total (1995)

Commercial considerations

- The applicable Contract is the: The "Buy - Back" Contract, essentially a risked service contract
- How the legal framework was shaped, and why?
- The commercial terms are generally considered to be unattractive by the IOCs. What of the ANOCs?
- Issues with the sharing of risk, and the rights and obligations of each party
- The sanctity of the Contract
- Prospects for change towards a PSC format.



The “Buy-Back” versus The PSC

A comparison on risk sharing (I)

- CAPEX -Development costs (cost overrun risks)
- Project completion date (delay risks)
- Reserves (upside and downside risks)
- Production rates (production rate risks)
- Oil prices (price fluctuation risks).



The “Buy-Back” versus The PSC

Further comparisons (II)

- Maximum economic recovery - With no field lifetime involvement, Contractor has scant incentive
- Cost consciousness - Contractor will seek CAPEX approval for a development that will yield maximum front end recovery
- Technological input - Contractor will be risk averter on innovative, state of the art technology, as there would be penalties for missteps and delays.



Emerging trends and policies

- Dominance of oil, and oil income, unlikely to be diminish in the near term. No easy passage, or transition to a non-oil based economy
- Oft stated policy objective: The further development of the oil and gas industry of Iran, whatever it takes
- Any and all partners welcome: The IOCs, the ANOCs and increasingly the domestic companies
- Economic downturn and rising unemployment will continue to fuel this necessity
- Lowered the pass mark and the expectations?



Economic development and the resurgent resource nationalism

- Nationalist movement of the 1950s, and the government of Dr Mossadegh (1951 - 1953)
- Resurfacing in the 1970s and the uprisings that led to the Islamic Revolution in 1979
- The Reform Movement and the election of President Khatami in 1997
- Aspirations on political independence and economic well being, an unhappy partnership, squashed on each occasion, but will undoubtedly resurface whenever opportunities arise.



Macro Economic development: Further challenges

- Young population, with nearly half under 25, and nearly two third under 30
- Job creation lagging behind
- 600 – 700,000 university graduates each year enter a diminishing job market
- Trained professionals seek to leave the country
- Brain drain now a major challenge.



Stagnant economy, inflation and the income gap

- Iran formally in a recession, after a long period of stagnation
- Inflation at over 26%
- Growing income gap between top and bottom 10%
- Promise of the Revolution not delivered
- Falling oil prices, but further cuts in subsidies not a palatable option for the government
- Falling purchasing power, with inflation, and rising unemployment is resulting in what many have called the “Perfect Storm”!



Iran's Nuclear Programme (I)

- Proud history and the ability to unite against foreign threats, real or perceived
- Current objections of the West portrayed as just one such threat
- A history of this tendency to prevent Iran achieve its economic development ambitions (case of Iran's first steel mill, prior to WWII, and now on the nuclear technology issue)
- Recent revelations, after 30 years, of US attitudes, even during the Carter administration, when Iran was an "ally".



Iran's Nuclear Programme (II)

- Strong conviction of a double standard at play
- In the neighbourhood, Iranians see a nuclear India and Pakistan, and more acutely Israel
- Perception that Iran is circled by hostility, with US forces in Iraq, in Afghanistan and with a strong naval presence in Persian Gulf
- At any rate the programme has been presented as one intended for power generation capabilities, and to date the public has given the regime the benefit of the doubt.



The ANOCs and a differing take on the management of risk

- The dominance of the state sector, favours the ANOCs
- Centralisation of decision making and state bureaucracy, familiar to the ANOCs
- On indigenous industry and local content requirements, the ANOCs appear to be the more willing partners
- ANOCs have the edge in terms of cultural similarities, business habits and partnership opportunities with local firms
- Critically the ANOCs have a different take on the cost of capital



Management of political risks

The most likely scenarios:

- Scenario: The gradual resolution of international disputes with the West and a move towards moderation in dealing with domestic political issues
- Scenario: Further turn towards radicalisation and international isolation
- Scenario: Rapid economic deterioration and discontent leading to regime change
- Scenario: An Iranian velvet revolution.



Future competition for the upstream projects (I)

- The eastward turn by Iran would continue, and further investments and inroads by the ANOCs most likely, in the present political climate
- On the ground still no convergence of the “technical / professional view” and the “political view”
- The former would welcome any re-entry by the United States
- Reasons: The superior technical input, and the additional competition for E & P projects
- The latter may still oppose, based on reasons of history, and the real or perceived track record.



Future competition for the upstream projects (II)

- New fluidity is apparent and encouraging
- New administration in the United States, and the recent overtures were well received by the pragmatists
- Presidential elections in Iran next month
- Fresh (innovative) approaches could yield unexpected results, if based on mutual respect and mutual benefit
- No ready, tried and tested recipe exists
- Lesson from the Libya or the China models
- Patience, more patience, and a carefully calibrated building of trust exercise must be the first instalment!

Thank you!

