1 April 2011

Seismic reflections

Edison investment research

Taxing matters

Our team attended the North Sea Oil & Gas conference in Aberdeen this week. Without doubt **the** topic of discussion was the tax changes in the 2011 budget and the impact on the oil industry. While the press has jumped on the obvious (projects being put on hold, declining production, less investment and job creation in the North Sea), there are more considered questions that were raised by the industry which we find put the North Sea oil players at a disadvantage to peers operating elsewhere.

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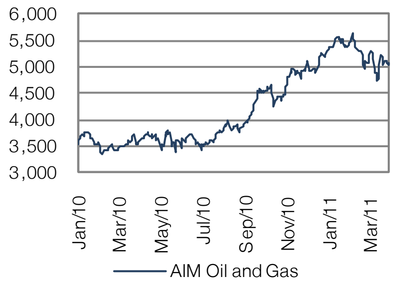

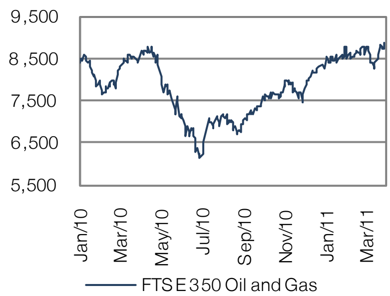

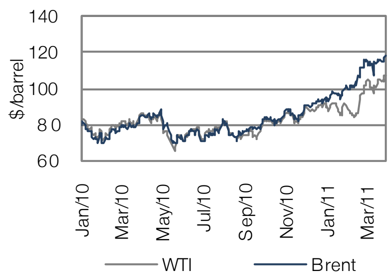

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What do we want: Simple, stable and progressive

Given the length of production profiles and the significant amounts of capex spent in bringing fields into production, oil companies crave a simple, stable and progressive fiscal regime. Within the North Sea, it now appears that we have none of these factors. With the introduction of the Supplementary Charge (SC) in 2002, royalties being abolished in 2003, and the increase in the SC in 2006 and then 2011, there is plenty of evidence of lack of stability. Simplicity seems to be going out the door, with a range of field allowances being introduced in 2009 and the promise of more, almost moving the fiscal regime to a case by case basis. If a separate regime is introduced for gas, the administration of this is likely to be extremely complex. The UK tax regime is also a flat rate regime, meaning that many marginal fields do not benefit from the advantages a progressive tax system would bring. Anne Hojer Simonsen from the Danish Energy Agency gave us a stark contrast: in Denmark fiscal terms are agreed for the life time of a project.

Tax to drop if oil price drops?

The ratchet mechanism is unlikely to work effectively. Oil prices and oil services are set by global factors, fiscal terms are local. High oil prices are coupled with higher rig and service costs, so the full increase in oil price does not fall through to the bottom line. The linkage of the SC increase to fuel duty also raised some concerns. It would take a brave George Osborne to tell the public that he is increasing fuel duty to allow for North Sea oil companies to pay lower tax in the coming years. The volatility in oil prices also means it is highly unlikely that the industry is going to get a timely fiscal response in the event that oil prices fall dramatically.

Decommissioning: Begging for clarity

The restriction in relief for decommissioning costs to 20% SC also raised concern. There is uncertainty if relief is on a pre- or post-tax basis. Given that the increased tax charge is likely to accelerate decommissioning as industry holds back on investment, the lack of fiscal relief on substantial decommissioning costs adds further uncertainty. Many see this as a precursor to PRT being completely abolished, meaning PRT relief will no longer be available.

		1 week			
No.	Best performers	% change	No.	Worst performers	% change
1	VOLGA GAS	11.8%	1	EUROPA OIL AND GAS	(33.5%)
2	HARDY OIL AND GAS	11.5%	2	PRESIDENT PETROLEUM	(21.8%)
3	ENDEAVOUR INTERNATIONAL	11.4%	3	SERICA ENERGY	(19.0%)
4	FALKLAND OIL AND GAS	10.3%	4	GLOBAL PETROLEUM	(18.6%)
5	FAROE PETROLEUM	10.1%	5	GASOL PLC	(12.8%)

		1 month			
No.	Best performers	% change	No.	Worst performers	% change
1	SOUND OIL	99%	1	PRESIDENT PETROLEUM	(47.6%)
2	PETRO MATAD	52%	2	EUROPA OIL AND GAS	(34.8%)
3	FORUM ENERGY	30%	3	SERICA ENERGY	(20.3%)
4	RANGE RESOURCES	26%	4	PETREL RESOURCES	(19.4%)
5	SOCO INTERNATIONAL	17%	5	VALIANT PETROLEUM	(18.6%)

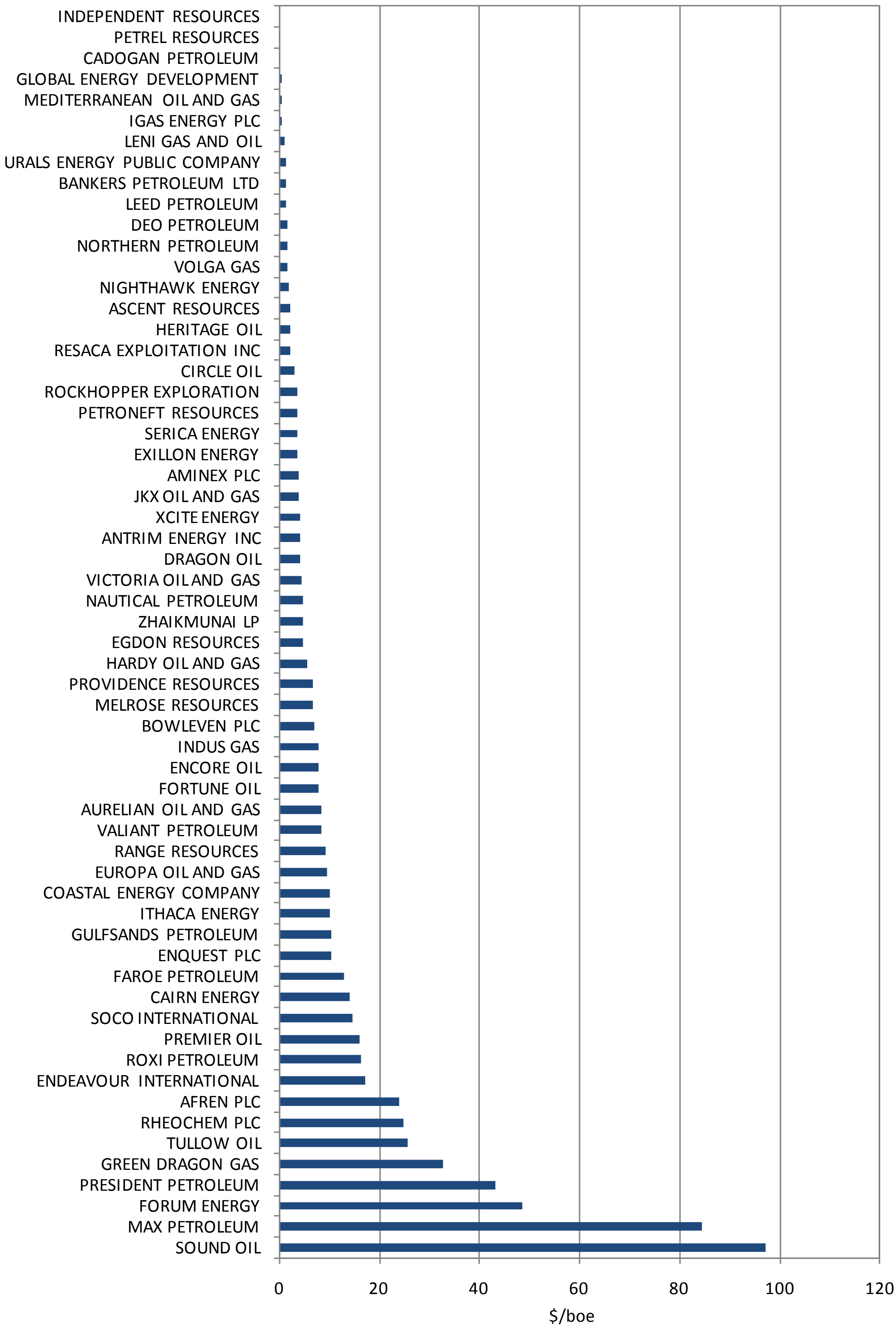
		3 months			
No.	Best performers	% change	No.	Worst performers	% change
1	SOUND OIL	257.6%	1	PRESIDENT PETROLEUM	(62.2%)
2	RANGE RESOURCES	159.4%	2	LEED PETROLEUM	(51.0%)
3	CADOGAN PETROLEUM	104.6%	3	ASCENT RESOURCES	(41.1%)
4	GLOBAL PETROLEUM	88.6%	4	ENEGI OIL	(40.2%)
5	VOLGA GAS	58.5%	5	HERITAGE OIL	(38.1%)

		6 months			
No.	Best performers	% change	No.	Worst performers	% change
1	BPC LIMITED	336.1%	1	DESIRE PETROLEUM	(76.7%)
2	SOUND OIL	270.2%	2	LEED PETROLEUM	(58.0%)
3	RANGE RESOURCES	255.9%	3	INDEPENDENT RESOURCES	(54.1%)
4	XCITE ENERGY	231.1%	4	ROCKHOPPER EXPLORATION	(48.1%)
5	CADOGAN PETROLEUM	125.3%	5	ENEGI OIL	(41.4%)

		1 year			
No.	Best performers	% change	No.	Worst performers	% change
1	NAUTICAL PETROLEUM	767.9%	1	LEED PETROLEUM	(75.3%)
2	ENCORE OIL	573.9%	2	SERICA ENERGY	(63.3%)
3	XCITE ENERGY	557.3%	3	NIGHTHAWK ENERGY	(61.8%)
4	TOWER RESOURCES	454.7%	4	MEDITERRANEAN OIL AND GAS	(59.3%)
5	RANGE RESOURCES	434.8%	5	GASOL PLC	(59.0%)

Source: Bloomberg

EV/2P + 2C rankings



Source: Bloomberg, Company releases, Edison Investment Research

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