

Power Talk

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Falcon Oil & Gas has seen success but investors await binary Beetaloo decision

Investors in junior oil and gas are typically unafraid of betting on binary outcomes.

However the proposition for Falcon Oil & Gas Ltd (AIM:FOG) (TSX-V:FO) is far from typical. In theory, chief executive Philip O'Quigley and his team have done the hard part.

Frankly it's done more than most juniors manage: it staked ground with high potential, brought in major partners, convinced them to invest in wells and most importantly the wells were successful (very successful).

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Falcon shares, up about 380% in the year to date, still don't properly reflect the scale of the opportunity. That's because the huge volumes of gas discovered in Australia's Beetaloo basin, in Northern Territory, may potentially remain buried there.

The binary situation is political.

Origin Energy, the lead partner in the shale venture, completed the most recent well just as the political landscape changed, with newly-elected officials launching a moratorium on fracking ahead of a review and a decision on whether it will ban or green-light the exploitation of shale.

Whilst the hiatus began last September, excitement has been building in recent months as weight is seemingly moving in favour of the on-pause shale sector.

A compelling argument for shale

Huge estimates of resources and a purported economic crisis in Australia's Northern Territory have seemingly converged to make a compelling argument for shale. And that bodes well for AIM-quoted Falcon.

News reports out of Australia's least populated and least developed region point to tough times for its inhabitants, with chief minister of the Northern Territory, Michael Gunner, earlier this month painting a picture of a "slowing economy with no direction".

Gunner noted that some US\$2bn of regional funding from the Commonwealth would be stripped back while he also said last year was "as bad as it gets".

At that time, Gunner dismissed calls to prematurely end the fracking hiatus and insisted that the independent review ought to be concluded fully as that would ensure public trust in whichever decision follows the review.

"The purpose behind the moratorium and the independent panel investigating the science of fracking is about more than getting the best advice; it is about ensuring Territorians have faith in the final decision because Territorians know the process followed by Government was rigorous and done right," he said.

"Further eroding trust and confidence in government by breaking key election commitments like this will only make the task of growing our economy and creating jobs harder."

That being said, the NT authority's review is now expected to factor in economics as well as science.

Pressure and potential are key drivers

Amid concerns over the generation capacity and contingencies backing up renewables, Australian economic commentators have called on business and households to consider investment in emergency power sources (diesel generators, batteries and the like).

Indeed, also last month, Australia's energy market operator predicted shortfalls in gas and electricity.

A research report from Swiss bank UBS just last week highlighted the confluence of factors driving up wholesale electricity and gas prices, which threatens industrial activity.

Analyst David Cassidy in a note said: "From either an economic or equity market perspective we believe there are far more losers than winners.

"We expect virtually all manufacturing and mining companies (with eastern state operations) will experience energy related cost pressures over the next few years."

Such pressure is unlikely to sit well.

An awful lot of gas to tap

So could the Beetaloo project help alleviate the looming energy crisis? The short answer is, yes.

Sydney-headquartered Origin is leading the shale venture, which covers a project area spanning some 16,000 square kilometres of the Northern Territory previously staked by Falcon.

Falcon dealt Origin into the project back in August 2014 at the same time as it also brought in South Africa's Sasol. The AIM-quoted firm retains some 30% of the venture and, significantly, it is carried on the drilling costs.

Excitement surrounding the Beetaloo was piqued in February this year when Origin estimated there was a massive 496 trillion cubic feet (TCF) of gas. That equates to a massive 82bn barrels of oil potential .

Now an awful lot of that has yet to be proven, but drilling and testing immediately prior to the fracking moratorium provided the basis for a resource of 6.6 TCF - which is still very much considered a 'world class' class project.

Boost for shareholders

Investors in Falcon were recently buoyed by proposed changes for another unconventional source of gas, which has also been in regulatory hiatus.

The share price sparked 50% higher in the same week that Australia's deputy Prime Minister, Barnaby Joyce, reportedly supported proposals that would see a ban on coal seam gas drilling lifted, so long as landowners are given a better deal on royalties from subsequent gas production.

According to stockbroker WH Ireland, the proposal bodes well for Falcon's planned development of Australian shale resources.

"In our opinion, this is a significant policy shift as the country seeks to avoid a looming gas shortage," WH Ireland analyst Brendan Long said in a note.

"It is important to appreciate that the deputy PM is also agricultural minister and we therefore believe his thinking reflects that of Australia's rural landowning community - the people who count.

"The general idea is to ensure that landholders benefit directly from gas production, which is an incentive that has proven very effective in the USA."

Long added: "We believe this could pave the way for comparatively positive developments for shale gas developer in

Australia, such as Falcon Oil & Gas."

What comes next for the shale players?

For Falcon and its partners what comes next is as binary as any exploration well.

The pressure is there, as we know, for an earlier resolution but the expectation is that the formal review process won't complete till as late as December.

Following the review there will be one of two outcomes.

One real possibility is the NT authorities decide it won't allow fracking, leaving Falcon holding a material stake in some of the largest, unavailable gas resources in the world.

The other possibility is that the moratorium is lifted and the fracking business is given the green light.

In the latter case, Falcon is off to the races.

Even with the uncertainty over the future Falcon's shares price, around 25p (42 Canadian cents), values the company at around £240mIn (C\$400mIn).

In a future in which shale gas production is possible the company worth multiples more (although I leave it to those better qualified to opine on valuations to sketch in the financial detail).

For context, the current value barely accounts for the A\$200mIn of investments in the farm-out deals that came when multiple TCF discoveries were still little more than wishful thinking.

A green light could trigger takeover talk

It is also worth highlighting, at this point, that the green would also likely kick-start interest from parties elsewhere in the industry.

In fact, according to some antipodean speculators, the investments may already be underway under the guise of something quite different, pointing to moves by famous Australian mining boss Gina Rinehart - who has become the largest private stakeholder in the Northern Territory as part of her cattle drive.

Whether or not this particular wrinkle in the story has legs cannot be known, at least not while we all wait in limbo for the fracking verdict.

What is clear, however, is that as the smallest of three direct stakeholders in the massive shale discovery Falcon would very likely find itself circled on a shopping list for anyone looking to get into the Aussie shale gas business.

So, for the time being investors will excitedly watch and wait ...

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