Egypt Macro Update
Suez Canal Daily Traffic Hits a Record, What's Next?

Suez Canal Reports a Record High Number of Crossing Vessels

Daily two-way traffic along the entire Suez Canal hit a new record of 70 vessels on Tuesday. It was reported that 34 ships passed through the Canal from the north convoy and 36 ships passed from the south through the new stream, with a total load of 4m tons. The tonnage figure is relatively high when compared to the average daily net tonnage of 2.6m in 2014. The 1st of September also witnessed the passage of two mega-size ships, Mathilde Maersk and Barzan, each carrying 200k tons.

We remind readers that the average number of ships passing through the Canal per day was 47 in 2014, out of a total maximum capacity of 78 ships a day. The Suez Canal Authority (SCA) estimates that the average number of ships per day will rise to 97 by 2023 and the annual revenues will increase from USD 5.5bn in 2014 to USD 13.2bn by 2023 after the addition of the "New Suez Canal".

Eyeing August and September Suez Canal Revenues to Assess the Impact on FX

Several analysts have cast doubt over the potential economic benefits of the New Suez Canal, deeming the 2023 targets "unlikely" due to slower global trade growth. Indeed, some analysts noted that the average number of ships crossing the Canal 1) was well below the daily capacity of 78 ships in 2014 and 2) has so far not recovered to 2008-levels after it had dropped by cc 20% in 2009.

However, it is important to note that while the average number of ships has declined, cargo tonnage has increased materially both in absolute terms and relative to the number of ships crossing the Canal. The average net tonnage per ship has increased by 32% from cc 42.5k tons in 2008 to cc 56.1k tons in 2014, mainly due to the ongoing trend of utilizing larger vessels to reduce energy consumption and transportation costs per ton.

Moreover, the timing of launching the new Suez Canal has been optimal. The Panama Canal, which is competing with the Suez Canal for the Asia-East US traffic, is currently undergoing expansions that will increase its depth and width significantly by April 2016. Despite the shortness of the route through the Panama Canal, the Suez Canal has been able to attract a significant portion of this traffic over the past ten years due to its ability to accommodate larger ships. In response, the launch of the New Suez Canal has maintained the competitiveness of the route versus the Panama Canal, via reducing transit time to 11 versus 18 hours for southbound traffic. The shorter transit time has also helped maintain the competitiveness of the Canal versus the longer but toll-free alternative route around Africa, which is particularly feasible at present given the plunge in bunker fuel prices over the past 12 months.

Based on the above, we view the surge in the number of ships crossing the Canal and in tonnage transported, if sustainable, as strictly positive to Egypt's balance of payments. We remind readers that the average monthly revenues of the Canal stood at USD 423.4m in H1-15. Accordingly, we will be eyeing Q3-15 revenues to assess the potential impact on FY-16 Canal foreign currency inflows and hence on the near-term outlook for the USD/EGP.

3 September 2015

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Egypt Macro Update
The Truth About Eni's Stake

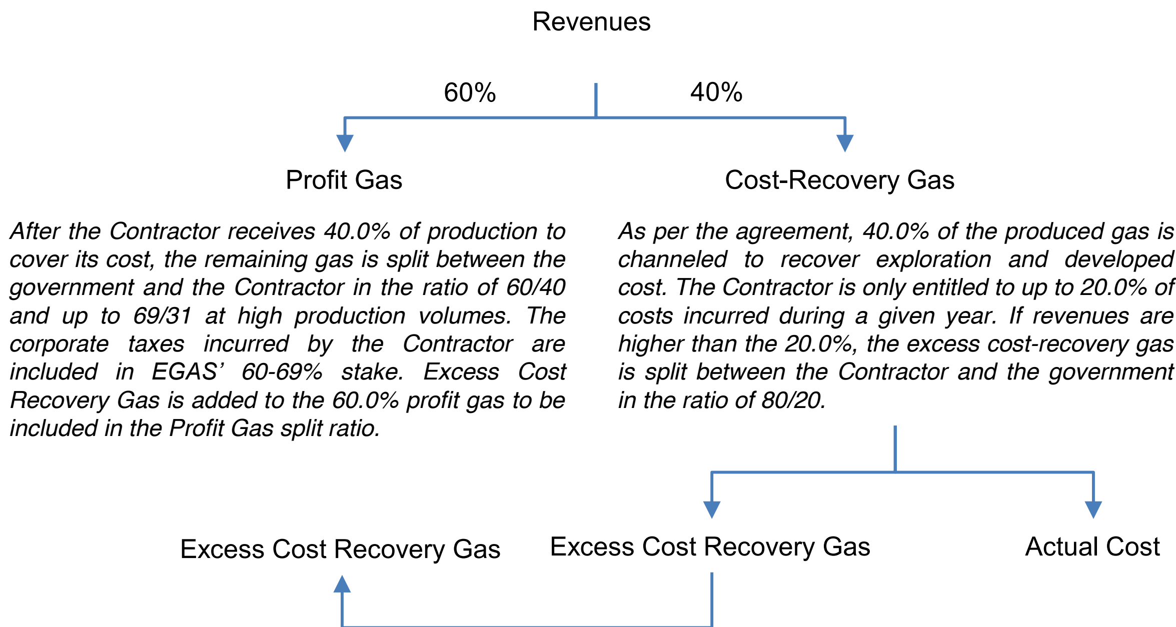
The Truth About Eni's Stake

After listening to the comments of the Minister of Petroleum on Eni's deal, reading the concession agreement signed back in 2014 and reviewing a sample deal structure published by Apache Corporation, we depict what we understood to be the effective stake of Eni in the recently discovered 30 trillion cubic feet (TCF) Zohr field.

The Deal Structure as Per the Concession Agreement

According to the concession agreement signed in 2014, Eni (The Contractor) is entitled to "up to" 40.0% of production to cover exploration and development expenses (the so called cost-recovery gas). In case actual investment cost fell short of what is implied by the 40.0% stake, the Egyptian Natural Gas Holding Company (EGAS, but not the listed EGAS*) and Eni split the excess cost-recovery gas at the ratio of 80/20, respectively. The government is then entitled to 60-69% of the remaining 60.0% of field reserves (so-called profit gas) whereas Eni is entitled to the remaining 31-40%. The government's share increases from 60% to 69% when the daily production volume increases from 100 million cubic feet (MMCF) to higher than 500 MMCF, respectively.

The Deal Structure in a Chart



3 September 2015

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Apache Corporation Example in Figures

In February 2014, US-based Apache Corporation published an explanatory note titled "Understanding Egypt – Production Sharing Arrangements and Tax Barrels" to explain to its shareholders the mechanics of the agreements and its cash flow implications. We adjusted the CAPEX and operating cost figures to focus on natural gas operations, because the original presentation included the costs and revenues associated with crude oil production as well. Apache used the following numbers to explain how the agreement works:

Gross Gas Production: 900 MMCF/day
Realized Gas Price: USD 3.9/MMBTU
Revenue/Annum: USD 3.9/MMBTU x 900 TCF/day x 365 days = USD 1.3bn
Capital Cost Amortization: USD 300m/annum
Operating Cost: USD 50m/annum
Cost Recovery Gas: 40.0%
Profit Gas: 60%
Profit Gas Split: 80 EGAS/20 Apache

Revenues
USD 1,281.2m

60%
USD 768.7m

40%
USD512.5m

Profit Gas

Profit Gas: USD 768.7m

Plus

Excess Cost Recovery Gas: USD 162.5m

Total Profit Gas: USD 931.2m

Apache's Share (20%)
USD 186.2m

EGAS Share (80%)
USD 745.0m

Cost-Recovery Gas

Actual Period Cost

Cost Recovery Gas: USD 512.5m
Less:
Amortized CAPEX: USD 300m
Operating Cost: USD 50m
Total Period Cost: 350m

Hence, Total Cost Recovery Gas: USD 350m

Excess Cost Recovery Gas: USD 162.5m

Two Observations: Eni's Stake in Profit Gas is Obviously Higher than Average

First, based on Apache's presentation, the firm's stake in profit gas is 20.0% whereas Eni's stake as per the concession agreement is 40.0%, and declines to 31.0% if daily production volumes exceed 500.0m cubic feet. The higher share allocated to Eni probably reflects the deep-water nature of the field and hence its higher exploration and development cost, as we had noted in earlier notes.

Second, based on the presentation and the assumptions, Apache received a net of 42.1% of production, split into USD 350.0m as cost-recovery gas and USD 186.2m as profit gas. Obviously, after exploration and development costs have been fully amortized, a greater pool of revenues will be channeled to profit gas, which in turn will increase the government's share in production if the field reserves significantly outlive the cost-recovery period.

Concluding Remarks: Maintain our Positive Views on the Economy and the Equity Market

Based on the first and second conclusions, it is obvious that the effective revenue split in Eni's deal will depend on 1) the total size of E&D cost, which will determine whether the firm will receive part or all of the 40.0% cost recovery gas, 2) life of the field and its production volume post full cost recovery, and 3) EGAS' stake in profit gas as set in the original concession agreement.

We understood from several press releases that Eni will incur around USD 7.0bn in investment cost (according to Egyptian government sources) to bring the field to operations but it is not clear whether the USD 7.0bn will cover the investment cost of the whole discovery (30 TCF) or only part of it. Based on the fact that BP will develop the nearby North Alexandria Concession (5 TCF in reserves) for around USD 10.0bn, we believe Eni's figure refers to one of several phases.

In any case, we maintain our views expressed on 31 August 2015 (See: "Update on Eni's Natural Gas Discovery in Egypt") that "*the discovery will unlock the value of capacity expansions across Egypt's industrial sector…and…(reduces) the duration of any significant selloff (in the equity market)*".

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