2013
February
Issue N° 3

ISRAEL'S OIL & GAS INDUSTRY NEWSLETTER

We are pleased to send you this newsletter about the latest developments in Israel's Oil and Gas sector. This publication contains mostly newspaper articles from the Israeli press and does not represent the views or opinions of the U.S. Commercial Service.

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A service provided by:
U.S. Commercial Service - Israel
Department of Commerce
19/02/2013

Published by Globes, Israel business news on February 14h 2013

IEC sees electricity rate hike without second Tamar pipeline

IEC: Electricity rates will rise from 2015, unless the Natural Gas Authority's decision on the distribution of gas from the Tamar pipeline is changed.

Electricity rates will rise from 2015, unless the Natural Gas Authority's decision on the distribution of gas from the Tamar pipeline is changed, the Israel Electric Corporation (IEC) (TASE: ELEC.B22) warned today. On of November 29, 2012, the Natural Gas Authority ruled on the distribution of gas to customers because of the limited capacity of the pipeline from the rig to the Ashdod terminal.

IEC claims that this decision worsened its relative position because it increases gas allocations to other consumers, which have priority over IEC in the event of a gas shortage. IEC says that in the absence of a satisfactory solution, beginning with the construction of a second gas pipeline, implementation of the gas distribution decision will greatly increase its electricity production costs beginning in 2015, because of increased use of alternative, and more expensive, fuels. The utility provisionally estimates these higher costs at hundreds of millions of shekels a year from 2015, and says that the Public Utilities Authority (Electricity) will have to recognize these costs, resulting in higher rates.

IEC also says that the decision creates many difficulties in laying a second pipeline from the Tamar gas field, let alone a pipeline from another gas field, to a second onshore terminal. Use of a single pipeline from Tamar affects the reliability of gas deliveries and therefore the reliability of IEC's electricity production, as well as the survivability of the system in the event of a breakdown.

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Published by Globes, Israel business news on February 14h 2013

Turkish companies want to buy Leviathan gas

Energy market sources say that gas deliveries to Turkey by pipeline could begin by 2016.

In the past few weeks, the partners in the Leviathan gas field have received queries from some of Turkey's biggest companies and Western multinationals operating in the country interested in buying natural gas from the reservoir. Sources close to the Leviathan partners believe that there is a potential of 10 billion cubic meters (BCM) of gas sales a year to Turkey at $10-11 per million BTU. The price currently paid by Turkey for pipeline gas is $11-15 per million BTU. Energy market sources also say that gas deliveries to Turkey could begin by pipeline as early as 2016.

However, Israeli sources admit that uncertainties over Israeli-Turkish relations are a big question mark about such a project. "In principle, letters of intent could be signed tomorrow on gas sales to Turkey," an Israeli source told "Globes".

In addition to Leviathan's partners - Noble Energy Inc. (NYSE: NBL), Delek Group Ltd. (TASE: DLEKG) and Ratio Oil Exploration (1992) LP (TASE:RATI.L), the Prime Minister's Office, Ministry of Foreign Affairs, and the Ministry of Energy and Water Resources have been informed about the contacts. Signals from Turkey, first reported by "Globes", come from top government officials, although President Recep Tayyip Erdogan has been silent on the issue.

While the Turks are interested in buying Israeli gas, they refuse to buy Cypriot gas, but any pipeline from Israel to Turkey would run through Cyprus's exclusive economic zone. An Israeli-Turkish undersea pipeline would be 600 kilometers long and cost an estimated $2 billion. This would be the most worthwhile export channel for the Leviathan project, and the pipeline cost could be repaid within 2-3 years, assuming gross gas sales of 10 BCM a year for 7-8 years on a take or pay basis.

The Turkish market, which currently consumes 50 BCM of gas a year, is growing at 5-6% a year. Israel would not replace Russia as a source of gas imports by Turkey, so Israeli sources believe that Russia would not object to any Israeli gas deal.

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Published by Globes, Israel business news on February 11th 2013

ILDC Energy misses out on Cyprus license

The Cypriot government told ILDC subsidiary Emanuelle International Energy that its consortium will not be awarded a tender

Israel Land Development Company Energy Ltd. (TASE: IE), controlled by Ofer Nimrodi, today announced that it believes that it will not win a Cypriot oil and gas exploration tender. ILDC Energy subsidiary Emanuelle International Energy Ltd. has been notified by the Cypriot Ministry of Commerce, Industry and Tourism that the consortium in which it is a party will not receive a license. The license will be awarded to the ENI-Kogas consortium. Another license will be awarded to a consortium organized by France's Total SA (NYSE: TOT; Euronext: FP).

ILDC Energy therefore believes that it will not be awarded another license.

ILDC Energy's partners in the consortium are Canada's GeoGlobal Resources Inc. (AMEX: GGR), and Rosario Energy (Cyprus) Ltd.

In February 2012, the Cypriot government published tenders for 12 offshore oil and gas exploration licenses. Sources at the time believed that Israeli companies had good chances of winning licenses, after several oil majors decided not to participate in them, due to concerns about a confrontation with Turkey or because the licenses were not worthwhile.

Alon Natural Gas Exploration Ltd. (TASE: ALGS), a subsidiary of David Wiessman's Dor Alon Energy in Israel (1988) Ltd. (TASE:DRAL), also notified the TASE today that it received notice from the Cypriot government that the consortium in which it is a member did not win a license. Alon Gas owns 4% of the Tamar license.

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Published by Globes, Israel business news on February 4th 2013

Treasury: Israeli electricity prices relatively low

Finance Ministry energy coordinator Oren Moshe: Prices are at a level that cannot meet the needs of whoever builds the grid.

4 February 13 14:33, **Amiram Barkat**

"The price of electricity in Israel is relatively low, compared with other countries," said Ministry of Finance energy coordinator Oren Moshe today. "Prices are at a level that cannot meet the needs of whoever builds the grid. Israel Electric Corporation's (IEC) (TASE: ELEC.B22) capital has eroded and it struggles to raise capital. You are paying for this through taxes, because the Israeli government allows IEC to raise government-backed debt, and you pay for the risk."

Moshe added, "The damage to IEC's ability to carry out its job as the provider of a critical service is our motivation for reforming the utility."

Moshe declined to say whether the IEC reform will result in lower electricity tariffs, saying only, "Having a market of independent power producers is justified to reduce the range of regulations on the price. At the end, there are 2-3 or 10 skilled officials whose ability to build rates that will cover costs is very limited. In some cases, someone will make a lot of money, and in other cases, someone's capital will fall."

Moshe added, "In the natural gas supply sector, we appear to be headed for a market with few competitors." He hinted that the government was considering allowing the Shimshon licensees to use the infrastructures of other suppliers to make gas field's development worthwhile. He said that the government hoped that gas would be found at the Ishai and Yoad wells in the Pelagic licenses.

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Published by Globes, Israel business news on February 3rd 2013

Modiin Energy's Gabriella partners refuse payments

Canada's Adira Energy and Brownstone Energy have not deposited their letters of credit for the hiring of a rig to drill at the license.

Modiin Energy LP's (TASE:MDIN.L) partners in the Gabriella offshore exploration license, Canadian companies Adira Energy Corporation (TSXV: ADL; Bulletin Board: ADENF; XETRA: AORLB8) and Brownstone Energy Inc. (TSX: BWN; Bulletin Board: BWSOF) have not deposited their letters of credit for the hiring of a rig to drill at the license according to the company's notices to the TASE today. Adira Energy is due to provide a $5 million letter of credit and Brownstone a $10 million letter. Noble Corporation (NYSE: NE) unit Noble Drilling is due to provide the rig.

The 392-square kilometer offshore Gabriella license is located 10 kilometers northwest of Tel Aviv, in water ranging from 100 meters to 425 meters. Modiin Energy owns 70% of the license, and Adira Energy and Brownstone Energy Inc. subsidiary Brownbarb (Israel) Ltd., each own 15%.

Modiin Energy added that it has successfully raised more than $85 million over the past two months for its share of the two letters of credit for the rig. It also says that it has met its work plan and timetable set in the agreements, and that it was in talks to bring in an operator and partner into the license.

Modiin Energy said that, in early January, it provided a $12 million letter of credit for the rig, and that it had the full $11.2 million needed for tis share of the second letter of credit. It said that it was reviewing the business and legal aspects of its partners' failure to provide their letters of credit, as well as possible remedies. It added that in view of their failure, it has asked Noble Drilling for a week's grace to provide it the second letter of credit.

The licensees estimate the cost of the Gabriella drilling at $96 million, excluding production tests, which will cost an additional $34 million.

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Published by Globes, Israel business news on January 24th 2013

Gas flow from LNG buoy begins

***Israel today inaugurated the LNG buoy and the docking of an LNG tanker*.**

Israel National Gas Lines Ltd. and Israel Electric Corporation (IEC) (TASE: ELEC.B22) today inaugurated the liquefied natural gas (LNG) buoy and the docking of an LNG tanker. Israel one of the few countries in the world that uses an LNG buoy to import natural gas. The buoy uses a submerged turret loading buoy system to dock with LNG tankers and transfer their cargos to the national gas pipeline network. The buoy has an annual capacity of 2.5 billion cubic meters of gas.

The LNG buoy is a strategic facility to ensure steady gas supplies for power stations and industry, in the event of a gas shortage and to improve the country's energy security. Within the buoys first few weeks of operation, it will save Israel NIS 500 million by replacing more expensive diesel.

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Published by Globes, Israel business news on January 23rd 2013

Israel mulls alternatives to diesel buses

Converting buses to compressed natural gas could save NIS 1.25 billion annually.

A sensitive explosion will be conducted at a test site in southern Israel in a few weeks. It will not be a test of a state-of-the-art weapon system or sophisticated missile, but of a simple bus. Actually, two buses to be precise, one with a compressed natural gas (CNG) engine, and the other with an ordinary diesel motor. Both buses will be bombed by Israel Police sappers to test precisely whether a terrorist bombing of a

CNG-driven bus causes more casualties and property damage than an identical bombing of a diesel powered bus.

The results of the test may not affect Israel's strategic standing, but it will have repercussions on the country's public transport budget and on the quality of air breathed by the people. If the test shows that the bombing of a CNG powered is less damaging than the bombing of a diesel powered bus, the way will be open to Israel's bus fleet to CNG. If the test goes the other way, we will probably be stuck with a diesel fleet for years to come.

Earlier this month, a conference at the Holon Institute of Technology discussed the conversion of Israel's bus fleet to alternative fuels. This is no fantasy or futuristic plan, but a revolution that is just around the corner. Thousands of electric and hybrid electric-diesel buses are in use around the world. China is the biggest user of electric buses, and 20% of buses now sold in Europe are hybrids. Volvo AB (SAX: VOLV), the world's biggest bus maker, has announced that it will halt the manufacture of diesel buses altogether in 2014.

Israel's first hybrid bus is already in the country, and was inaugurated at gala event by Minister of Transport Yisrael Katz. It is one of six hybrid buses ordered by Dan Public Transportation Co. Ltd. for Haifa's Metronit Bus Rapid Transit (BRT) network, in which it is a partner, and which will have a fleet of 90 high capacity buses. The Metronit will begin operations in May.

In addition, Israel's first all-electric bus will arrive in April, and will be made available to Dan for a one-year trial. The bus, built by China's BYD Co. Ltd. (HKSE: 1211; Shenzhen: 2594), will be supplied by BYD's Israeli representative Clal Motors Ltd. BYD has delivered hundreds of electric buses to customers in China, the US, Finland, Germany, Italy, and the Netherlands in the past two years. At the Holon Institute of Technology conference, Clal Motors CEO Doron Vadai said that investing in electric buses is economically better than the use of diesel and CNG buses, even though they cost twice as much as a diesel bus. "The maintenance cost of an electric bus is less, mainly because it does not have an actual engine," he said. "The energy cost of electric buses is also lower."

"Globes": How much cheaper?

Vadai: "If you calculate the total energy cost from the well to the wheel, the cost per kilometer of an electric bus is a third of the cost of a diesel bus."

Dan and Egged the unready

Dan and Egged Israel Transport Cooperative Society Ltd., Israel's two largest bus companies, are quick to pour cold water on expectations of electrified urban bus fleets. At the conference, Egged technical division chief Yossi Cohen said that the bus cooperative lacked the skills to maintain a fleet of electric buses.

"We can barely find the skilled staff to maintain our current fleet," said Cohen. "Electric buses require us to completely reorganize, such as technicians' safety and protection from electric shocks. As far as we're concerned, this is a whole new world, and we're really not there."

Dan, too, is dubious about electric buses. Its representatives at the conference said that they did not know how to deal with them. "There is no chance that we'll hybrid or electric buses in the coming years," a professional source at one of the bus companies told "Globes". "We'll stick with diesel."

The remarks by the Dan and Egged officials were backed by Robert Steimer, the representative of MAN SE (DAX: MAN), the main supplier of buses to the two companies. He says that MAN does not manufacture electric buses because the battery is not yet efficient enough. "Batteries on the market are very expensive and very heavy. An electric battery can weigh three tons or more, and instead of carrying passengers, the bus carries a battery," he says.

Besides current battery technologies there are other power systems, such overhead electric cables and pantographs. Elbit Systems Ltd. (Nasdaq: ESLT; TASE: ESLT) is developing a super capacitor system which can recharge a battery in seconds every time a bus stops at a station. But these are not yet commercial systems.

"Battery prices are falling steadily," says Prime Minister's Office National Program for Oil Alternatives the acting director Sagi Dagan. "Electric buses are the best solution for urban transport, mainly because of the reduced noise and pollution, but probably another 6-7 years will pass before cheap and efficient enough batteries will come on the market. It is therefore important to begin learning about the technology now."

Saving NIS 1.25 billion a year

The main competitor to electric and hybrid buses are CNG buses. CNG is a technology first developed in the 1930s, and converting buses to CNG does not involve the massive conversion needed for electric and hybrid buses, as CNG engines are quite similar to diesel engines. World leaders in CNG use for transport are countries such as Armenia, Bolivia, Iran, and Pakistan. In 2000-09, South Korea's government pushed a bus and truck CNG conversion policy to fight severe air pollution in cities. The Korean government spent an estimated $539 million on tax breaks and financial incentives and saved $1.5 billion to date from reduced air pollution, as well as creating a $600 million CNG for transport industry.

CNG is not especially environmentally friendly, producing only 15% less pollution than diesel, but it has a critical advantage in fuel costs and because natural gas can be produced domestically. Prime Minister's Office Alternative Fuels Administration director Eyal Rosner says, "The cost of fuel for one diesel bus is NIS 160,000 a year, and the cost of fuel for a CNG bus is only NIS 90,000. Converting Israel's 18,000 buses from diesel to CNG can save NIS 1.25 billion a year."

"We're prepared to switch to CNG buses tomorrow," says a top official at a bus company. "The problem is that there is no standard for CNG for public transport."

Surprisingly, the main reason for the lack of a CNG standard is security. Three years ago, a test similar to the one described at the start of this article was conducted by Dan and Nipko Energy Ltd., and the results were abysmal. The explosion tore open the CNG tanks on the bus's roof, spreading the gas everywhere. A source involved in the test told "Globes" that, in retrospect, the test was not prepared properly. "The gas tanks should have been strengthened or protected. The test blocked progress for two years," he said.

The Ministry of Transport will carry out the new test to blow up an electric bus, probably in April. But some government officials believe that the results should not seal the fate of the alternative fuel revolution. "We must balance different public interests," a government official told "Globes". "The huge advantages to the economy and city dwellers on one hand against the fear that in the event of a terrorist attack, God forbid, there will be two or three more fatalities. In the end, a brave decision is needed."

Published by Globes, Israel business news on January 23rd 2013

Israel Opportunity in talks to buy Gabriella stake

Modiin Energy is seeking to sell 10% of the offshore license.

Israel Opportunity Energy Resources LP (TASE: ISOP.L) is in talks to acquire 10% of the rights in the Gabriella offshore license from Modiin Energy LP (TASE:MDIN.L).

The 392-square kilometer Gabriella license is located 10 kilometers offshore along a strip paralleling the coast between Ashdod and Netanya, and has an average water depth of 150 meters The licensees are due to drill a well offshore from Herzliya by mid-year. Modiin Energy owns 70% of the license, and Canadian companies Adira Energy Corporation (TSXV: ADL; Bulletin Board: ADENF; XETRA: AORLB8) and Brownstone Energy Inc. (TSX: BWN; Bulletin Board: BWSOF) subsidiary Brownbarb (Israel) Ltd. each own 15%.

Netherland Sewell & Associates Ltd. (NSAI) gives the reservoir a best estimate of 110 million barrels of oil. The high estimate is 264 million barrels and the low estimate is 30 million barrels. It estimates the contingent resources at 17.4 million barrels of oil with a geologic probability of 24% and 0.64 trillion cubic feet of natural gas with a geologic probability of 15%.

"Israel Opportunity's cash reserves enable us to consider investment oil and gas exploration opportunities, as part of our strategy to build a diversified portfolio to diversify risk," said CEO Eyal Shuker.

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Published by Globes, Israel business news on January 15th 2013

Netanyahu exaggerates gas royalties expectations

It is unclear why Prime Minister Benjamin Netanyahu implied in an interview that there would be higher than expected royalties.

The government's natural gas royalties will not exceed $125 million in 2013, according to a calculation by "Globes". The figure cannot be larger because of the technical impossibility of delivering more gas through the pipeline, so it is unclear why Prime Minister Benjamin Netanyahu implied in an interview yesterday that there would be higher than expected royalties.

Asked by "Channel 2 News" if tax hikes will be needed to plug the NIS 40 billion deficit, Netanyahu said, "I see no problem for which we will have to raise taxes for a simple reason: the gas royalties may be higher, maybe the markets will recover, and exports increase."

A recovery on foreign markets may increase the Israeli government's revenues, although no recovery is on the horizon. What is obvious today is that Netanyahu cannot rely on gas royalties.

Energy market sources today noted Netanyahu's previous promises that gas royalties would be invested in a sovereign wealth fund, and would not be used to finance the current budget deficit.

Israel currently receives minimal quantities of gas from the depleted Mari B field owned by Delek Group Ltd. (TASE: DLEKG) and Noble Energy Inc. (NYSE: NBL) joint venture, Yam Tethys. Gas flow from the Tamar field, owned by the two companies together with Isramco Ltd. (Nasdaq: ISRL; TASE: ISRA.L) and Alon Natural Gas Exploration Ltd. (TASE: ALGS), is due to begin in April, with deliveries gradually increasing.

The government's take from the gas comes in two ways. The main source is the Petroleum Profit Tax Law (5771-2011), also known as the Sheshinski Law, initiated by Minister of Finance Yuval Steinitz. The law should generate $2 billion in future revenues, but taxation will only be levied after a gas field's developers make a 230% return on their investment in discovering and developing a field. The government will see no revenues under the Sheshinski Law before 2018.

The government's sole current source of revenues from gas is through royalties under the Petroleum Law (5712-1952), which begins from the start of gas flow. The official royalties rate is 12.5%, but Clal Finance analyst Yaron Zar notes that, in practice, after deducting expenses, the rate is 11.4%. On the basis of the flow rate through the Tamar pipeline from April through the end of 2013 - 5.2 billion cubic meters (BCM) - the government's royalties from Tamar will total $125 million.

The royalties will increase to $184 million in 2014, when the gas flow increases to 7.5 BCM, and to $253 million in 2015, when the gas flow will increase to 10.4 BCM.

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