Madagascar Oil brings tar sands project to London market

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Children forced to scavenge from a rubbish tip in Madagascar. The IMF ranks Madagascar as the 170th poorest among 182 countries. Photograph: Siphiwe Sibeko/Reuters

The arrival of Madagascar Oil on the Aim market today allows investors to buy into what are likely to be among the dirtiest oil sands projects – benefiting from the lowest tax rates – anywhere in the world.

Oil has been seeping through the ground in the impoverished and politically unstable African island, which rebuffed another attempted coup this month, for centuries. But Madagascar has never before produced oil in commercial quantities. Until now the oil sands were considered uneconomical, moreover companies were put off by the risks involved in doing business there.

Higher oil prices make the projects viable and the government is desperate to get production going, possibly as early as next year. It is ready to entice Madagascar Oil and its French partner Total with an extremely generous tax regime. Operators are being offered 99% of the revenue for the first 10 years while they recoup their costs, with just 1% for the government. Platform, a campaign group that monitors oil companies' activities around the world, said the offer was "unheard of".

An area of 29,500 sq km covers five main oil sands blocks. Extracting the fuel is controversial because it uses far more energy and water than more conventional production processes.

The most advanced project is Tsimiroro – owned and operated by Madagascar Oil – holding a "best estimate" of almost 1bn barrels. It could produce 90,000 barrels a day for 30-40 years and breaks even at just under $50 a barrel. The larger field, Bemolanga, holds a best estimate of just under 1.2bn barrels of oil, and could produce a much larger amount, although costs are higher. Operated by Total, with Madagascar Oil holding a 40% stake, they would have to spend about $9bn (£5.7bn) to build the upgraders and other facilities to get production started.

Madagascar Oil's stock market valuation of £183m is more typical of small oil explorers than a company holding such quantities of proven reserves. Madagascar Oil's chief executive, Laurie Hunter, described the company as "an execution, not an exploration, play".

It's unlikely to be plain sailing. The World Bank ranks Madagascar as 138th out of 193 countries in its "ease of doing business" ranking. Corruption is rife and the country is unstable. The government came to power in a military-backed coup last spring, which overthrew the democratically elected leader.

The companies have negotiated an extremely attractive deal. At Tsimiroro, after the first 10 years taking 99% of the revenue, Madagascar Oil is being offered 80% during the second decade, with the government taking 20%, followed by a 70%-30% split the following decade and so on.

For a country ranked 170th poorest out of 182 by the International Monetary Fund, these revenues will be much needed, but Mika Minio-Paluello from the democratic and environmental campaign group Platform said the government's take should be much higher. "Oil companies go into these kinds of chaotic situations and negotiate immensely profitable terms. It's understandable that companies want to protect their investment but this goes much further and Madagascar could be stuck with these contracts for decades."

Environmental regulations are also unlikely to be onerous in an island famed for its biodiversity. The Voahary Gasy, an alliance of Madagascan environmental groups, complains that the government has released very little information. But the first projects are likely to use up more energy than the world's only other existing oil sands projects, in Alberta in Canada. The Tsimiroro project will use an "in-situ" method, which involves injecting vast amounts of steam into the ground to heat up the oil and allow it to surface. According to industry estimates, to extract five barrels of oil at Tsimiroro will burn up one barrel of oil, although any excess electricity produced to generate steam could be used at the other project. According to the Pembina Institute, an environmental group, for every barrel of oil used in similar oil projects in Alberta, about 5.5 barrels of oil are produced on average.

The Bemolanga field, one of the world's largest untapped oil sands fields, could also be more energy - and carbon - intensive than equivalent projects in Alberta. The project would use open-cast mining to dig out the oily sand and rock. Because the material's bitumen content is lower at 5.5% – compared with 11% in Alberta – it would be harder to separate. However, it is thought that a higher proportion of the oil in Bemolanga could be recovered than in Alberta, so this would reduce the comparative energy intensity.

In Canada, the federal government has threatened to force companies to use carbon capture and storage (CCS) to reduce emissions, although it's not clear if this will ever become law. Hunter said Madagascar has "a very attentive environmental regulator" but admits: "Requirements to use CCS at some time in the future has not come up in conversation. The Madagascar government is very keen to get on with production with the fields."

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