27 October 2016

Annual Meeting 2016, Acting CEO's address

Mr Chairman, thank you for your introduction.

Members of the Board

Ladies and gentlemen

I'm delighted to be able to address you this morning,

I am a Petroleum Engineer.

I first went to university in Sydney. Nine years ago I brought my family here, after sixteen years in Asia and Europe.

I found a land of opportunity, and it is now our home. Three years ago I came to work at New Zealand Oil & Gas, I feel a real sense of privilege to be leading it forward, and hope today to share with you my excitement about our company.

As Rodger has talked you through the Board's strategy, I will sum up how we did last year and go into detail about some of our operations.

Disappointing oil prices over the past year affected the industry the world over.

Asset values were written down across the industry, and we were not spared. This reduction in asset values resulted in a headline loss of $52 million, of which $43 million was from Cue Energy.

Once we net out the loss to the other Cue shareholders, the loss attributable to New Zealand Oil & Gas shareholders was $29.8 million.

However: our producing assets continue to generate a heathy cash flow and, combined with a firm control of our costs, we are in a position to turn the dividend tap back on.

Looking underneath the result, earnings from operating and investing activities were up from $7 million to over $21 million.

When you consider that the average oil price fell by 43 per cent, from US$68 to US$39 per barrel, and average US oil and gas earnings fell 60% our underlying result is strong.

Cash in the group at balance date was around $97 million, which was up from $84 million a year ago.

If we take this cash balance, and add the market value of our holding in Cue, then our share price values our investment in Kupe and Tui at less than $100 million - far below a fair assessment of the true value of these assets given their future ability to generate cash returns and sustain a dividend.

It makes sense to be buying back our own shares when they look this cheap in comparison to a fair valuation.

So let's take a journey through where we are producing returns.

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The joint venture has done significant work to identify growth opportunities at Kupe.

The highlight of the past year was a substantial increase in total Kupe 2P reserves.

Through analysis of production, and well data we found more resources than we previously thought were present, in addition - we can improve our recovery and at the same time we have been able to push out the requirement to invest capital to develop these additional reserves.

Installing onshore compression will help to optimise gas recovery.

Onshore compression is a relatively cheap initiative that, in simple terms, means we suck harder on the straw, and get more out of the reservoir.

We believe additional perforations in existing wells will allow more petroleum to flow from the rock into the wells. This sort of activity has an excellent rate of return.

The other good news from Kupe is the identification of structures within drilling reach of the platform that will be the targets of at least one infill well in the future.

In short Kupe has more gas, with a plateau lasting longer, and costing less to access….more for longer for less…more for longer for less.

A lot to like there!

Our Tui asset, in contrast, is coming to the end of its economic life.

We don't yet know when that will be because we will call time when the cost of getting the oil out exceeds the value we realise from selling the it.

It will be an economic decision.

When oil prices fell into the $30 range we were operating the Tui field at a loss - it was costing us more to get the oil out than we could sell it for.

So that was why we took an impairment on the remaining value in the Tui field, which contributed to last year's loss.

When the oil price rose back to the high $40s again, we couldn't write the value of the asset back up because of the way the accounting rules work.

But we are again selling Tui oil at a profit and it makes sense to keep producing.

When we do decommission Tui, there will still be quantities of recoverable but uneconomic oil, as there is in all decommissioned oil fields. The Tui wells will be the first subsea production wells to be decommissioned in New Zealand, though it is done regularly worldwide.

Work on planning the end of field life has begun. The operator is intending to remove all the production equipment from at least 2 meters below the seabed on up - the well heads, production pipelines, mooring buoy and of course the floating production vessel Umuroa which will restart its engines and sail away.

The joint venture will go through a consenting process with the Environmental Protection Agency. This will take time.

So we need to make decisions looking further ahead, such as whether to renew the lease on the Umuroa.

On our current assumptions we estimate that Tui production will end in 2019.

At the same time as planning abandonment, management and the joint venture have worked hard to cut costs at Tui. Despite unfavourable exchange rates, Tui costs were reduced by more than 20%, a great help to extending field life.

Costs were also minimised during the year in Indonesia.

Overall the group is cashflow positive from Indonesia because of production from the Sampang facility, where more work is planned to extend the life of that field.

By now we hoped to be producing from the Kisaran discoveries, where we have government approval of a Plan of Development, but lower oil prices are a significant headwind in the short term.

There are a few years available before a decision has to be made on commencing production.

For now we are looking hard at how we can maximise returns from our Indonesian portfolio.

As Rodger mentioned earlier, we have concluded our discussions with the government about a change of conditions in the Clipper permit.

To summarise the situation - we need more time to look at new information about the geology of the region.

Our scientists have analysed the Endurance seismic survey we performed in 2014, and identified a prospect called Barque.

To get an idea of its size, we estimate reservoir sands draped over a structure the shape of Banks Peninsula, and looking out the window here, an area equal to twice Wellington Harbour.

We have received some great new information from a well in a nearby permit. Its modern logging is helping fill in the gaps in our knowledge of the rock, resolving uncertainties so we can get to a decision about a well.

Meanwhile we have made promising progress in our other deepwater permits that we hold with Woodside in the Great South Basin and in North Taranaki.

At the petroleum conference in March Woodside revealed some of the technical work they have done at Toroa, which is south east of the South Island.

They are seeing three separate layers of potential resource there, stacked on top of each other. Each layer is itself very large and the permit has seen 2 wells in the 1970’s that had clear indications of an oil and gas system.

We are maintaining exposure to these deepwater permits because they would be game-changers. These are potentially huge fields, each one multiples of Maui and any of them big enough to establish a new industry in the South Island.

A discovery would deliver staggering returns, not just to our partners and shareholders; to the local area in terms well paid jobs, and economic growth; and to the country with money for hospitals, schools, universities, and infrastructure.

But these are frontier basins, where wells are few and little is known about the geology, so we need to be careful to manage our spending in developing concepts while maintaining exposure to profitable new assets.

I am happy to tell you that even in this difficult price environment we are in continuing negotiations with potential partners about joining these deepwater ventures.

As Rodger indicated, we continue to look at potential assets.

Looking for assets in the oil and gas space is similar to fishing….and as John West say “it’s the Salmon that John West reject that makes John West the best”. We have the same excellent team that delivered the value at Kupe, looking at potential assets, and we will be bringing forward the only the best that can improve our rate of return and provide you, with growth.

So, in summary, we have a portfolio that provides hope for a substantial discovery, production that is capable of sustaining our dividend as long as we keep a tight grip on our costs, and the balance sheet strength to look for significant acquisitions at value.

In New Zealand Oil & Gas you have a business that is using our technical, commercial, legal, financial, engagement and management skills to harness these rich opportunities and turn them into returns for you.

I'm proud that we are focussed on safe operations, and on being good partners for everyone who has a stake in our industry. I'm proud of the business we are building, and I'm proud that we are doing it by living our values.

I'll look forward to discussing more of these issues with you as the chairman opens up the floor for questions, and I hope to chat with as many of you as possible over a cup of tea after the meeting.