INTERVIEW

Big fish, small pond

TOGY talks to

Peter BOTTEN
Managing Director
OIL SEARCH

Oil Search dominates Papua New Guinea's oil and gas industry, accounting for nearly 70 percent of the oil business and about half of the gas reserves. The Australia Securities Exchange-listed operator is poised for company-transforming figures in the next few years, with the fast approaching PNG LNG project, a venture with ExxonMobil.

THE OIL & GAS YEAR: *What is Oil Search's history and how did it become Papua New Guinea's premier oil and gas company?*

PETER BOTTEN: Oil Search was established in 1929 and was set up to explore in Papua New Guinea. Between the company's inception and 1959, with a six-year break because of the Second World War, the company kept going back to shareholders for exploration funds and endured a long and difficult exploration process. It was not until Oil Search's first discovery in 1985 that the company took off. Production started from the Hides gas field in 1991 and from Kutubu in 1992 (both in the Southern Highlands province). Throughout those years, many companies have come to Papua New Guinea to explore and some have remained. The UK's BP was a major operator for a long period of time and Chevron stayed and was successful in developing the first oil fields in the country.

In 1992 Oil Search was a small company. It had a market capitalisation of approximately A$200 million ($267.38 million) and owned about 8 percent of the business. Since then, we have reinvested the cash flow generated by oil production back into our Papua New Guinea assets. Oil Search bought out BP's upstream interests in 1997 for approximately A$601 million ($450 million). It then merged with another major Papua New Guinea company and the government acquired a 17 percent stake in Oil Search. In 2003, Oil Search bought out Chevron Texaco and took the operatorship of the main oil fields. Oil Search now has 65 to 70 percent of the oil business and about 50 percent of the gas reserves. Since that time, we have become a A$7 billion ($5.24 billion) market cap company. We are also a consistent top quartile performer on the Australian Securities Exchange due to the success of our Papua New Guinea assets. We hope this value growth will continue with the development of Papua New Guinea LNG trains one and two and further LNG expansions.

TOGY: *Last year your projects represented nearly 15 percent of Papua New Guinea GDP. How have you been able to leverage your contributions to the country's economy for future successes?*

PB: We are a big fish in a very small pond. We have been there a long time, we understand the sensitivities of the politics and we understand the very diverse cultures of Papua New Guinea. We are sensitive to those cultures and our operating business model is designed around managing and understanding their importance to local landowners. This approach is also very useful when you have operations outside Papua New Guinea and has been used by us in certain Middle East countries, where we now have a number of licences.

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TOGY: *Approximately 65 percent of your natural gas reserves are set aside for the Papua New Guinea LNG project with ExxonMobil. How will this venture transform your business?*

PB: The Papua New Guinea LNG project development is what I call the fourth growth iteration for Oil Search. When I joined Oil Search, we had 24 people. We bought our partner BP's upstream interests and that was a significant change. We were a A$400 million ($299.2 million) market capitalised company buying assets valued at about the same as the whole company at that time. The merger with the other main Papua New Guinea resource company, Orogen

Minerals, was again transformational building our asset base and strengthening the balance sheet of the combined organisation. Taking over the Chevron operating role was completely transformational for us, and we were able to increase our proven reserves by 700 percent and commenced optimising Oil Search's Papua New Guinea oil operations.

We anticipate that we will double our value over the next four or five years, as the Papua New Guinea LNG project continues to develop. Further growth opportunities, involving additional LNG trains, will become possible as discovered gas is brought to the market. There is growing confidence amongst the stakeholders that Papua New Guinea LNG will get up and go to the final investment decision by the end of 2009. Being an LNG producer will obviously be a massive change for us.

Papua New Guinea is primarily a gas province and there are substantial discovered gas resources and more exploration potential that can drive even more growth. Oil Search and its partners ExxonMobil have looked at a number of ways of commercialising the gas but the breakthrough came in 2004/2005, with the increase in oil and gas pricing, as well as the expansion of the world market for LNG. LNG is now obviously the most attractive way of commercialising Papua New Guinea's large gas resource.

TOGY: *How have you utilised your local experience with ExxonMobil to serve your interests in Papua New Guinea LNG?*

PB: ExxonMobil will be the operator, and you could not think of a better company to lead this project at this time. We will continue to operate the oil fields, which will make a meaningful contribution of gas to the LNG plant. The Kutubu, Moran and Gobe oil fields will be producing gas for Papua New Guinea LNG. There have much local experience and many local operating techniques that we can contribute to the LNG project and to ExxonMobil's operatorship. And I am pleased to say ExxonMobil recognise that and are using some of our local experience to get the operating structure right.

TOGY: *How much will Oil Search's growth be driven by your assets in Papua New Guinea?*

PB: Clearly, the growth of Oil Search will be driven by the development of the first two trains of Papua New Guinea LNG. We are commercialising as much as 65 percent of our discovered gas resource to underwrite the first phase of this project. There are considerable further discovered gas resources in country to drive more growth and substantial potential for more discoveries in exploration areas. The Department of Petroleum and Energy indicates that there is probably around 50 trillion cubic feet (1.42 trillion cubic metres) of potential in the country, of which only 9 trillion cubic feet (254.85 billion cubic metres) is presently committed to the LNG developments. Exploration potential exists in both the onshore and offshore parts of Papua

Oil Search is the third-largest upstream oil and gas company on the Australian Securities Exchange

New Guinea and I am sure, along with our partners and others, we will be aggressively looking for more gas over the next five years in order to boost LNG train development.

TOGY: *Are your operations in Yemen, Libya and the Kurdistan region of Iraq side projects?*

PB: As the LNG value grows, our Middle East assets are likely to become less material to us. We will continue to look for opportunities in the Middle East and build our relationships there, as we have done in the past. The company is putting aside a reasonable new-venture budget for expansion in those areas. Against the growing materiality of LNG, we will continue to look at

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our Middle East assets and how they stack up against our local Papua New Guinea-based investments. If they continue to grow, as we hope, then we will keep them but if not, we will do what we did last year and sell some of the assets at the right time. You never want to be completely wedded to your assets. If there is a good deal on the table you must be ready to take it.

TOGY: *How did the Kurdistan region of Iraq come to your attention, and why did it appeal to you?*

PB: We have a number of contacts in the region and Kurdistan is a highly prospective area and an area that is being under-estimated in terms of potential and over-estimated in terms of risk to operations. That represents an opportunity for a company of our size and shape.

TOGY: *Are there benefits to being a Papua New Guinea-based but with an office in Sydney and listed on the Australia Securities Exchange (ASX)?*

PB: We are a Papua New Guinea company. Our head office is here and we are proud of that. We are listed on the Port Moresby Stock Exchange, which does not generally attract major investment. Whereas the ASX is the ideal institution through which investors can take a share of Oil Search – that is where we are primarily traded.

TOGY: *How do you maintain shareholder faith during a time of volatile commodity prices?*

PB: Our business is profitable even though our oil fields are mature. We can still produce oil at a very competitive cost and we would be one of the last fields in the region to shut down due to low oil prices. Through the development of LNG, the growth and value of our company overwhelms short-term oil price sentiment. That is why we have performed well against our peers. They don not have the same growth profile. The downturn is an opportunity for us because the cost of construction and staff has also less.

TOGY: *What is your five-year plan for Oil Search?*

PB: There will be a significant increase in corporate value, based on the successful development of Papua New Guinea LNG. This should lead to an increase in market capitalisation, based on a solid, long-term LNG business that will provide us with legacy cash flows for many years. The discussion around the board table is focused on ensuring we deliver the first phase of Papua New Guinea LNG and we are already discussing how the company might reinvest some of the huge revenues that will come to us in 2013 or 2014. We are structuring the company to be able to reward our shareholders. ■

Oil Search as a market capitalisation of approximately $4 billion

Double trouble

While oil and gas super-majors can still finance projects on the balance sheet, the dramatic drop in energy prices since the commodities peak in July 2008 has pushed several small exploration and production companies to the brink of extinction. The industry has dealt with severe fluctuations many times, but extreme price instability combined with the global credit crisis of 2008 and 2009 has created what executives call a "double whammy" of difficulties, leaving many explorers and producers vulnerable.

In Australia, where publicly listed firms rely heavily on investment from their shareholders to fund their ventures, market conditions have forced some companies to freeze or cancel projects, divest their assets or merge with larger cash-rich organisations. Smaller entities like Melbourne-based Nexus Energy have relied on large-cap investors to finance the development of offshore fields. Yet until the market recovers completely, Nexus is reluctant to farm out interests in core assets such as its Crux liquids project, in the Browse Basin. "We don't want to cannibalise our assets in what has been a poor environment in the first half of this year," says Ian Tchacos, managing director of Nexus Energy. "However, the oil price is coming back, confidence is coming back and the capital markets are starting to improve."

The recovery of oil prices to more than $70 per barrel has not yet eased the tight capital market. Approximately $40 billion of equity has been raised on the Australian Securities Market in the second half of 2009, according to the Commonwealth Bank of Australia, but most of it has gone to large corporations. For the foreseeable future, it seems that investor confidence and access to equity will dictate the destinies of energy companies rather than the cost of a barrel of oil. ■