THE EXPLORERS
NEW ZEALAND OIL & GAS

news release

26 August 2014

Investor briefing, CEO's Address

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Auckland Investor Briefing

Great Northern Room, Ellerslie Auckland Racing Club, 80 Ascot Ave

12 Noon Tuesday, 26 August 2014.

Operational performance over the last year has been excellent.

This is reflected in the strong production and operating cash-flow results.

The cash-flow from operations result, year on year, is very strong: Up by 62 per cent from about 54 million to 88 million dollars.

The primary driver of that was our success in getting more value out of our existing assets.

Kupe production was steady throughout the year. One reason for increased performance was that there was a maintenance shut-in at Kupe in the previous year.

Alongside the steady production this year, gas sales contracts have been accelerated.

Sales from Tui would have declined much more this year as the reserves in the field deplete. But in fact Tui performance has been another part of our success story after we increased our share of the Tui fields from 12.5 per cent to 27.5 per cent by buying some of Mitsui's interest.

Overall, revenue for the year was up by 4.7 per cent, from $99 million to $104 million.

The major contributors to that revenue were production from Tui and Kupe, offset by some foreign exchange losses caused by the strength of the New Zealand dollar.

There was also a positive impact of just over ten million dollars from the settlement of the Kupe overriding royalty.

The history of Kupe — and of the overriding royalty - is a diverting story with a few lessons for us today about successful exploration, and the timelines involved in recovering revenue. So I'd like to take a minute to cover it.

Kupe-1 was first drilled in 1975 by Shell, BP and Todd. They had some hydrocarbon shows, but Kupe-1 was assessed as sub-commercial and plugged and abandoned, and the licence was handed back.

In 1981 New Zealand Oil & Gas started up, won the prospecting licence over Kupe and listed on the stock exchange.

The company farmed out a share in the Kupe prospect to the state owned oil company, Petrocorp. It's illuminating to see that the seismic surveys conducted back then indicated oil and gas reserves that were about ten per cent the size of the currently proven reserves.

Anyway, New Zealand Oil & Gas as operator drilled Kupe in 1986 and had a discovery. Other companies bought an interest in return for promise to pay an extra share of future production. In the midst of all this there were corporate restructurings and reorganisations. For example, Petrocorp was sold to Fletcher Challenge, which was also later broken up and sold.

The end result of it all was that two of the current partners in Kupe, Origin and Genesis, had an obligation to pay an extra share to New Zealand Oil & Gas - called an over-riding royalty. Origin's obligation relates to 10 per cent of its 50 per cent share in Kupe; The Genesis obligation relates to 20 per cent of its 31 per cent share.

This year we were able to agree a settlement with Genesis, and talks with Origin are at a sufficiently advanced stage that we have included the anticipated settlement in this year's accounts.

The settlement is worth around $10 million and it will add about a further $1-2 million a year to the company's revenue in future.

Looking back over the Kupe story we can see some familiar patterns.

It took a long time from when they first started exploring in Kupe in the early seventies, to first production in 2009.

It was a long time from the agreement to pay an overriding royalty to its impact in our financial statements today.

We can also see that exploration is an uncertain business. Initial failure was followed by persistence, and persistence produced success.

Kupe is a fantastic asset for us, and it will continue to produce for many years. Only the gas and light oil prospects in the permit are producing, but we are still looking in the permit for oil as well as further gas and gas condensate.

What the founders of New Zealand Oil & Gas knew was that you can't give up at the first set back. You have to keep investing in exploration to succeed. Kupe would not have become the valuable producing asset it is today without investment patience.

This is why, in the past year, we have recorded a high level of investment in exploration and evaluation - up 77 per cent from the previous year, to just under $75 million, and up from $9 million in 2012.

Exploration investment has had an impact on net profit, but we have been able to sustain the dividend even while we accessed the opportunities that exploration can bring.

Exploration is an exercise in balancing investment risk. If we don't take risks we can't replace and grow our reserves and asset base.

There were two exploration successes during the year.

The Pateke-4H well will by tied back to the Tui FPSO and it will increase production from the Tui fields from next year. We are still working on the size of the reservoir there. Engineers are modelling the porosity of the rock (that is, how fast the oil flows from it) and the pressure they are getting (which gives them idea of the size of the resource.)

The joint venture hasn't come to a shared view yet. Our own calculations are consistent with the operator's public, pre-drill estimates of around 2.5 million barrels of oil, or somewhere between 650,000 and 700,000 barrels net to us.

We also had drilling success at Kisaran, in Indonesia. The plan of development has been drafted there and it's being worked through with the regulator. In a production sharing contract, the joint venture gets 85 per cent of the revenue from the field until it has been able to recover its development costs (and a margin). After that it receives 15 per cent of the production profits. So you can see that the regulator has a strong interest in the cost of development, and it has to be worked through.

If a final investment decision is made later this year, production will begin next year. It would involve a series of low cost wells each accessing a modest resource.

We have been strengthening our position in Indonesia because it offers opportunities that are complementary to our New Zealand portfolio.

The onshore prospects are lower cost to access, although they are often smaller targets. They are similar in many ways to onshore Taranaki opportunities.

The Indonesia opportunity-set compliments the extension of our New Zealand portfolio into deepwater permits.

Peter Griffiths spoke earlier about our ability to attract Woodside as a partner. When other global majors look at New Zealand, they are seeing an attractive prospect in our frontier basins:

Shell and Statoil are looking off the north west of the North Island and out towards New Caledonia.

Woodside is with us in deepwater off Taranaki.

Anadarko is in Pegasus east of Wellington. They drilled outside our permits off South Canterbury last summer.

We are joining Woodside in the Great South Basin; and

Shell is intending to drill there too.

Interest in New Zealand's frontier basins is elevated. It's a matter of time before someone has some success. I want us to be positioned to be part of success when it comes.

But operating in deepwater frontier basins requires considerable expertise and careful management of our portfolio to ensure we don't get over-exposed. We need to invest enough to keep up.

We also need to be able to add value to our partners in these frontier basins. We are always looking for further opportunities to grow our production - as we did when we bought more production at Tui.If we find further opportunities to buy assets at value, and they fit our portfolio, we will need to take them.

So this review illustrates three key components in our strategy to grow shareholder value:

- First, looking to optimise current assets. We have been successful this year in getting more value out of both Kupe and Tui. There is more to do in Kupe, in particular.

- Second, we need to keep exploring across a range of geological, jurisdictional and investment risk-types.

Our portfolio in Taranaki is looking full, and we have exposure in frontier basins in New Zealand. In Indonesia we have a portfolio of assets at a range of stages in the pipeline, including appraisal, seismic underway, and early stage evaluation.

As different prospects get churned out of the portfolio we will look to add new exploration acreage in places where our New Zealand identity and values can provide a strategic opportunity.

- Third, we intend to be open to new opportunities to extend the asset base where there is value to be extracted. In the Kupe gas contracts and in our Tui extension we have proved we can be successful at this.

I believe we are well-positioned, with a strong balance sheet, and a value set that allows communities and commercial partners to want to work with us.

The next year will be about leveraging these advantages.

We will use our strong cash generation capability and our enduring community partnerships to deliver growth through exploration investment.

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