29 October 2008

Chief Executive's address to NZOG 2008 AGM

As the fallout from the US financial crisis continues to reverberate around the world, New Zealand Oil & Gas Ltd finds itself in a position of strength to not only weather the storm, but also to take advantage of some of the opportunities it may toss up.

NZOG is on a very secure financial footing.

As part of our ongoing capital management we have during October repaid in full our Kupe debt. We have retained the debt facility of NZ$125m to ensure ready access to funds on attractive terms should we wish to use them.

Following this debt repayment, and the payment of a 5 cents per share special dividend on 1 October, we still have substantial cash reserves. As of today these sit at NZ$245m; that includes US$81m million held in US-denominated accounts, and NZ$96m in NZ-dollar denominated accounts.

We of course also have a reliable income stream from Tui, with Kupe revenue less than a year away. We have cash available for growth, including meeting our remaining Kupe development costs, expected to be around NZ$35 million.

We are debt-free and cashed up – at a time when cash is king. In a distressed market, as debt and equity sources of funding dry up, cash is more valuable. As others suffer, we find ourselves in a very strong position and we are able to pursue a prudent growth strategy.

The management team, with the support and oversight of the Board, is continuing to devote a great deal of time and effort to identifying and evaluating potential new investments. We are taking a very prudent approach, rigorously screening out less attractive opportunities and targeting only those opportunities that are robust and comfortably within NZOG's financial capacity.

Yesterday we announced that we are taking a 40% interest in the permit containing the Barque prospect in the offshore Canterbury basin, and I'll talk more about that shortly.

We are pursuing arrangements for another New Zealand venture and we are also exploring some overseas opportunities.

I know some shareholders have questioned why we are looking beyond New Zealand. Quite simply, we want to cherry pick the best investments – and there are not enough opportunities to choose from in New Zealand alone.

market release

We are running a very thorough assessment process on all opportunities, including the potential overseas investments. We will only proceed if we are confident we fully understand the opportunity, the partners are reliable and capable, and the investment is value-adding and can fit comfortably within our financial capacity.

As tempting as it is to tell you exactly what it is that we have been looking at, I can't do that.

In any of these potential deals there are confidentiality requirements, commercial sensitivities and due processes to follow. And it would not be in NZOG's best interests to publicly discuss what targets we are going after.

I can say that we have looked at quite a long list of opportunities and walked away from most of them. The rejected opportunities have included new permits, farming in to existing permits, acquiring assets and corporate takeovers. In each case, after close examination, it was clear that the investment did not meet our criteria.

NZOG's profile has been raised considerably this year and the strength of our position is well known in the industry. We are frequently being presented with opportunities. We have a number of 'live' opportunities right now that we are carefully examining and I believe that worthwhile investments may become readily available in the coming year.

Those who hold worthwhile assets but are over extended, reliant on debt or equity funding, or in some other way needing assistance to complete their projects, will find it hard in the current environment. Price expectations are lowering. Industry consolidation is starting to happen and is likely to gather pace. It is a time of opportunity to create greater wealth for shareholders and we look to use our strong position to secure attractive new ventures.

Tui

Turning now to our existing portfolio, and firstly, Tui.

The initial proven and probable (2P) reserves for the Tui Area Oil Fields are currently estimated to be 50.1 mmbbls.

Up until yesterday, total production from Tui since start-up on 30 July last year had reached 18.1 million barrels – NZOG's share 2 and a quarter million barrels. That's around double the production level we were anticipating before production began.

The fields continue to perform well. In the three months to the end of September, Tui produced 3.15 million barrels of oil at an average rate of over 34,000 barrels of oil a day.

As expected, there continues to be a gradual increase in the production of associated water and this is now limiting the maximum oil recovery rate to around 32,000 barrels a day.

The joint venture is investigating modifications to the production vessel, the Umuroa, which would increase its fluid handling capacity to 180,000 barrels a day. This would allow more oil to be recovered at a faster rate from the current reservoirs and would also provide the flexibility to tie-in any future nearby discoveries. We expect a decision before the end of the calendar year.

The Tui joint venture is actively considering a significant multi-well drilling campaign. It has pre-invested in some long lead items and is looking to secure a drilling rig, while continuing to refine evaluations ahead of any final drilling commitments, to determine whether these are good investment opportunities.

NZOG's total revenue from Tui crude for the three months to the end of September was NZ$72.3 m. Our total revenue since Tui started production now totals approximately NZ$300m.

Kupe

The Kupe Project continues to make good progress. Overall Kupe is more than 85% complete.

With all of the offshore facilities in place, attention is focussed onshore. Construction of two large condensate storage tanks on land recently acquired at the Omata Tank Farm near New Plymouth has commenced. The tanks will have a combined capacity of 30,000 cubic metres and will be connected by pipeline to existing export facilities at Port Taranaki.

At the Kupe Production Station near Hawera the new electricity substation has been commissioned and the gas sales pipeline installed. Other major items that have been completed include the slug catcher (water/gas separator), all eight pipe modules and all the LPG bullets.

Work is continuing on erection of structural steel, piping and electrical and instrumentation installation. However, overall progress has been hampered by the unusually harsh winter weather. There have also been some slippages in equipment delivery and quality issues with some of the received goods.

As a result, the Operator has recently advised that the target date for first commercial gas sales has been pushed back slightly into the third quarter of 2009. While this is unfortunate, it has to be seen in context – a small delay for a billion dollar project that will be producing oil and gas for the next 25 years.

When Kupe was sanctioned in 2006 the expected development cost was NZ$980m. Since sanction, costs have increased by around 20%. Again, we would prefer that costs had not risen, but this is a major capital project being developed during a period of extraordinary cost pressures across the industry.

We benefited from some good contracts put in place early on, but inevitably we have seen some cost and schedule pressures flow through. Cost increases also reflect some additional capital investment, which replaces use of third party facilities and will reduce operating costs.

We need now to look beyond the development phase to the total life cycle of this project. With regard to what will be produced from Kupe, in volume terms it is dominated by gas, which is sold on a long term contract to Genesis. In terms of value, the liquids dominate – the light oil/condensate and the LPGs. We have seen a significant increase in price expectations for the liquids. As a result, the economics of Kupe have improved since project sanction.

Exploration

NZOG is taking a 40% stake in permit PEP38259, which lies in the offshore Canterbury Basin.

This permit contains the promising Barque prospect.

Over the past year or so, NZOG's technical team has completed a detailed evaluation of many of the New Zealand basins.

Our evaluation has concluded that the Canterbury Basin has proven effective petroleum systems present and the potential to produce commercial quantities of oil and gas.

The Barque Prospect has been independently interpreted, mapped and evaluated on a geological basis by NZOG. In our assessment Barque has potential P50 recoverable resources of 600 billion cubic feet (BCF) of dry sales gas and 58 million barrels (mmbbls) of light oil/condensate.

However, a lot of evaluation work remains to be done to assess the prospect, beginning with further seismic studies. There is no certainty that an exploration well will be drilled or that a commercial development will be the end result.

The Operator, AWE, is planning a marine seismic survey to be undertaken in early 2009. NZOG will participate at 40% through the seismic programme.

We are delighted to have secured participation in the assessment of what we believe is one of the more promising oil and gas prospects available in New Zealand.

We enjoy an excellent working relationship with AWE through the Tui field and we look forward to working with AWE and the other joint venture partners in the Canterbury basin.

In Taranaki, I have already mentioned the possible drilling campaign in the Tui permit.

The Tui partners have agreed to relinquish the neighbouring permit PEP38499, which was acquired in mid 2007.

It lies immediately to the south of the Tui fields and was therefore worth investigating closely.

However, the results from the latest seismic interpretation and related mapping substantially downgraded the potential leads. The partners consider that there are no drillable targets and the permit is being handed back to the Crown.

Although the Hector well drilled in mid-2007 was disappointing, we remain interested in the potential within permit PEP38483. The joint venture partners have applied to Crown Minerals for second five-year permit term.

Within the Kupe permit, following July's decision to plug and abandon the Momoho exploration well, the Operator is undertaking further studies to evaluate the Momoho drilling results and determine whether it may be possible to contemplate a development combining the three discovered accumulations – Kupe South 4, Kupe South 5 and Momoho 1 – along with potential accumulations nearby. The outcome of this work is not expected until some time next year.

It is fair to say that our exploration portfolio is still not as extensive and diverse as we would like it to be. Barque is a first step towards rectifying this. We are pleased that the Government is releasing some more acreage in offshore Taranaki and Canterbury Basin and we are carefully assessing the potential of the areas which are soon to be offered.

The Outlook for Oil
I'd like to comment on the unprecedented volatility that we have seen in international oil prices in 2008.

The main benchmark crudes broke the US$100 a barrel barrier for the first time in January and then kept climbing, touching on US$150 a barrel in mid-July. Prices then started retreating and at the end of September were back around the US$100 mark, and have fallen further since then as global recession fears increase.

While prices have come back from the mid-year highs, it is important to remember that when the Tui project was sanctioned in 2006, oil prices were around US$50 a barrel.

By the time Tui began production in July 2007, prices had moved up to US$75 a barrel. And in the three months to the end of September, NZOG's average sales price for Tui oil was approximately $US120 a barrel.

Price have now moved down, mitigated to some extent by the falling NZ dollar. But it's very important to understand that we don't need prices over US$100 a barrel to make good returns on Tui.

In very general terms, if we sell a barrel of oil tomorrow for say NZ$120, the production expenses will be around $17, marketing costs $7, depreciation and amortisation $16, royalties $16 and tax $19 – leaving around $45 in profit.

So what returns can be expected for the remaining 32 million barrels or so to be recovered from Tui and the oil and LPG expected to be recovered from the Kupe project?

Only one thing is for certain - it is extremely difficult to predict the future!

Production will take place over a long period – we expect Tui to still be producing in 2020 and Kupe until at least 2025. So we need to look beyond the short-term influences that have been in play in recent months.

It is generally agreed that demand for oil will increase, driven by growth in developing countries like China, India and Brazil. Energy is essential to the economic activity that sustains and improves the quality of life and many developing countries are at the point where individual wealth and consumption is accelerating. As a result global oil demand is predicted by international agencies to increase by between 40% and 70% by 2030.

At the same time, on the supply side of the equation, there are a growing number of uncertainties.

There is an increasing concentration of oil reserves in a few hands and nationalism or protectionism could remove resources from the market. New oil and gas sources are more difficult to access; the technology requirements are increasingly complex; industry costs have risen dramatically; massive investment is needed; human resources are stretched; and environmental constraints are still evolving.

It's a complex picture but it is generally agreed that the world is moving from a demand-driven to a supply-constrained system. This means that whatever happens with the world economy in the short-term, in the medium to long term there will be strong upward pressure on oil prices.

Conclusion
The 2008 Financial Year was in many ways, a seminal year for New Zealand Oil & Gas, with a list of notable milestones and achievements to be proud of.

A few months on, and like other publicly listed companies we now find ourselves dealing with issues and concerns thrown up by the financial maelstrom that has swept the world.

Unlike some of those other companies, we are in a position of strength to come through the current period of uncertainty and we are firmly focused on enhancing shareholder value in the year ahead through prudent and well considered investments.

Thank you.

ENDS

FOR FURTHER INFORMATION PLEASE CONTACT:

Chris Roberts
Public Affairs Manager

Telephone: (04) 495 2424 Toll free 0800 000 594

NZOG stock symbols: NZX shares - NZO
ASX shares - NZO