

# CAN YOU SUCCESSFULLY EXPLORE FOR OIL AND GAS IN NEW ZEALAND?

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## Abstract

This paper discusses the motivation of petroleum explorers from a junior's or independent's perspective and, more importantly, whether it is possible in today's environment to create value for one's shareholders. I have approached this challenge from the perspective of an independent operating within New Zealand and in the context of the development of the smaller, marginal discoveries.

In his paper, Chris Scanlon (this volume, p. 39) addressed the greatest challenge (from an industry perspective) that lies ahead for the petroleum industry over the remainder of this decade. I would like to expand upon those thoughts. In particular, his concluding statement that "motivating the explorers to get on with the job was the real challenge for New Zealand".

Motivation of the explorers will only happen if those explorers perceive that a range of opportunities are available and that the risk/reward equation is attractive.

In this paper I would like to explore whether it would be possible to generate that motivation and, more importantly, whether it is possible in today's environment to create value for one's shareholders. I approach this challenge from the perspective of an independent operating within New Zealand and in the context of the development of the smaller, marginal discoveries. It is my view that as New Zealand's oil and gas industry moves towards the year 2000 the role of juniors and independents will become more important.

One only has to look at the structure of the industry in Canada, the United States and, to a lesser extent, Australia for that proof. Juniors and independents have flourished in these jurisdictions as the major oil companies moved to restructure their asset bases by focusing on key areas that provided them with the best potential for the creation of shareholder wealth.

The consequential sale of these non-strategic assets has provided a ready market of opportunities.

Whilst that is not currently happening in New Zealand I am sure that given time such opportunities will arise. Also, I believe that ways will always be found to develop a large discovery irrespective of the environment.

In the past the New Zealand industry has been dominated by the Shell Todd consortium, with the discovery of Maui and Kapuni, and more lately Fletcher Challenge Petroleum through its subsidiary Petrocorp Exploration with their discovery of McKee, TAWN and Kaimiro. In fact, the major companies' involvement is so complete that between them they hold an interest in all of New Zealand's producing fields.

The junior sector within New Zealand currently covers a mere handful of players, with only two (New Zealand Oil &

Gas and Southern Petroleum) holding interests in producing fields. However, a significant number do hold exploration interests and with a licensing round coming up later this year I expect that to increase.

I think it appropriate to look at Southern Petroleum, one of New Zealand's more successful junior companies. In particular I would like to trace its original strategy and the changes that were forced on the company and the results achieved. I hasten to add that I can take no credit for the changes and subsequent success, as the foundations were laid before FCP's involvement. In fact, it was Southern's strategy that made it such an attractive acquisition.

Finally, I look at New Zealand's current environment to see whether it is possible to repeat the Southern story.

## Southern Petroleum

Southern's history goes back to 1983 when it issued a prospectus offering 60 million partly paid shares and 30 million options to the public. Over 23 000 New Zealanders subscribed to that issue which raised an initial NZ\$15 million. I was one of those New Zealanders and to this day I still complain to one of the original promoters, now our corporate lawyer, that along with thousands of others I was restricted to 1000 shares. The legacy of that remains with us, with over 8000 shareholders still on the register within the 16% held by the public.

The partly paid and No Liability financial structure of the company (a structure commonly used in Australia) placed Southern in the position of being able to relatively easily raise further capital funds as the Company's exploration projects unfolded. This flexibility was used to great advantage in the latter stages of Southern's development.

The original objectives of Southern were explicit. I quote from the original prospectus:

"Southern was formed specifically to take advantage of a unique opportunity to acquire from the Hunt Brothers, the right to participate in a major exploration programme in its Great South Basin licence.

Almost immediately Southern would participate in the drilling of two wildcat wells to appraise two major untested structures within the licence.

The size and number of structures within the licence indicated that if a substantial commercial discovery of oil was made it could potentially make Southern petroleum a major producer and New Zealand a net exporter of oil."

As history shows, the outcome of that programme was a sobering lesson to an infant company floated on great expectations and sharemarket hype. Two dry holes and over 50% of shareholder's funds spent within the first two months of operation.

To the credit of the Company and of the original promoters they had always realised that to put your eggs in one basket was courting disaster. As they stated in the original prospectus, "Sufficient finds would be maintained to develop alternative strategies if the Great South Basin failed".

Southern therefore, needed to re-group and establish a new strategy and a new direction if it was to survive its first year of operations. In reviewing the early records of Southern, that new strategy was clear and precise:

- focus where oil had already been found; Taranaki and the west coast of the South Island
- focus on a small group of licences
- actively explore those licences

Other key elements of that strategy were:

- maintain a lean overhead structure
- form a strategic alliance with an Operator that had a proven track record of finding oil within the area of focus
- adopt a brutal policy, in respect of exploration expenditure, to ensure that the company always knew where it was by imposing a strict economic discipline on it (this is still the policy with an excess of \$20M in amortisation relating to the Waihapa Production Station being written off this year)

The outcome of that strategy was quite pronounced with Southern focusing its activities on the Taranaki Basin. A land position was established mostly through farm-ins and other oil and gas financing techniques. An alliance was also formed with the, then, state-owned oil company Petrocorp Exploration, an operator who was assessed to have a proven track record within the Taranaki basin.

Success did not come straight away. It wasn't until 1986, the third year of Southern's existence, that the company's first commercial discovery was made; the Tariki/Ahuroa gas condensate field. The Waihapa field followed in 1988 and then finally, the Kaimiro shallow oil discovery in 1989.

The Kaimiro discovery (the first to produce oil from the Miocene sands) prompted Southern to move quickly in expanding its land position within the prospective shallow horizons by acquiring further interests in PPL38705, PPL38701 and PPL38083.

One of the original objectives of the promoters had come to pass. Southern was now a significant producer.

Remembering that Southern commenced business in New Zealand in 1983 a mere 10 years ago, what has this success meant to Southern? Two major changes in its shareholding were registered. In 1987 Brierley Investments became the majority owner when it merged its subsidiary Payzone with that of Southern's thus increasing Southern's overall interest in the TAWN fields. This was to be followed in 1992 by Petrocorp Exploration who in recognition of the success of the strategy moved to consolidate their position in TAWN and to gain access to Southern's land position by buying out Brierley's interest.

Today Southern's land position is one of its strongest assets. It places Southern in a position to continue in its role of aggressively exploring, appraising and developing all the onshore prospective horizons from the Miocene sands to the Kapuni Coal Measures.

On the financial side Southern also has had remarkable success (figure-1). Oil production driven by Waihapa/Ngaere is expected to reach new record levels of 2 million barrels net to Southern. Over the last 5 years to 30 June 1993 over 3.5 million barrels have been produced. Reserves as at 31 December stood at 11.6 million BOEs.

Total cash flow generated up to 31st December has been \$108 million. Of this cash flow over \$90 million has been re-invested back in the business through exploration, capital developments and reserves acquisitions. Of the \$90 million the most significant item was \$44.4 million that was spent on acquiring the Crown's interest in the TAWN licence (figures 2 and 3).

What has all this meant to the ultimate judge, the sharemarket, of whether a company has operated successfully in New Zealand?

Market capitalisation has increased to \$275 million at today's share price of \$1.20. Share price growth has also showed substantial gains for the shareholders. Although oil prices are having a negative impact and putting our section out of favour the market seems happy.

On the basis of the Southern example it can be quite readily said that history has shown that a junior can operate successfully, within the New Zealand exploration

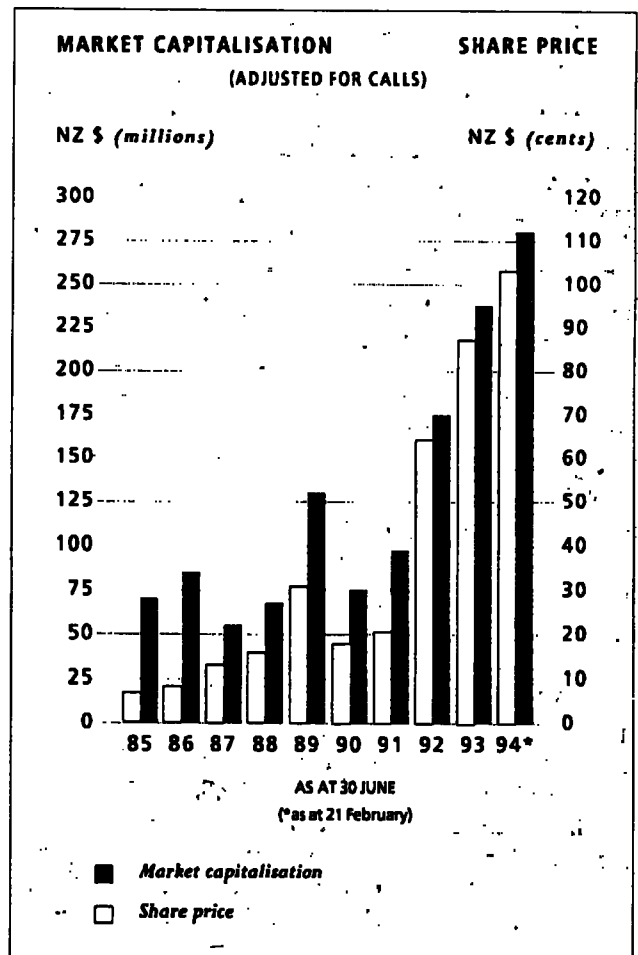


Fig. 1. Market capitalisation and share prices.

environment and provide good returns to their shareholders. However, history is not today. We need therefore, to consider whether the current environment within New Zealand would enable the Southern story to be repeated. Let us look at the important parts of our industry.

#### Land

A significant portion of the onshore Taranaki basin is already under licence. However, a good portion of those licences are in their last 5-year terms and gazettal of the current vacant land is expected towards the end of this year.

The new licensing regime proposed under the Crown Mineral Programme, provides significantly more flexibility for the junior. I do hope that the thoughts of using cash bidding are just thoughts.

Land is still available in New Zealand's other basins, and although oil and gas has yet to be discovered in commercial quantities within those basins, they still provide a fertile ground for juniors.

#### Opportunities

One junior currently about to explore in New Zealand has entered into an arrangement with a member of the petrochemical industry to pre-sell any gas that may be found within the licence even before the first well has been spudded. It is pleasing to note that end users of the gas are prepared to enter into such an arrangement. Other papers in this volume discuss gas opportunities that become available towards the end of this century.

#### Infrastructure

New Zealand now has a well-developed, infrastructure for the production, transportation and storage of oil and gas. Production stations exist at Oanui, Kapuni, Waihapa, Kaimiro and McKee. All are capable of taking a third-party product on a tolling arrangement. Port terminal and tankerage facilities also exist at the port of New Plymouth, and a

steadily growing network of gas and oil pipelines exist throughout the Taranaki region and beyond.

#### Regulatory environment

Considerable deregulation has taken place within New Zealand. Mike Lear and Evelyn Cole (of the Ministry of Commerce) in their respective papers have already discussed this. Other papers in *The Proceedings* develop this theme. Suffice to say that:

The taxation regime has been amended to make it comparable with other regimes within the Asian/Pacific region.

Royalties are currently the subject of review and debate but the proposed removal of direct government participation is a positive one for our industry. Also from a junior's perspective it is worth noting that the regime is more favourable for the smaller marginal field and incremental production.

Gas deregulation provides exciting opportunities as it enables future gas prices to reflect the true market price. The opportunity is also there for juniors to deal directly with the end users.

Gas transmission is discussed in other papers in more detail. It is my expectation and hope that some acceptable forum or common carried access provisions will be established. Discussions with the gas industry seem to be moving in that direction.

#### Conclusion

There are opportunities before us in New Zealand for both the larger established players and the juniors. Opportunities that, if pursued within the correct strategic framework, will enable explorers to receive a return on their investment dollar, the gas industry to flourish, the petrochemical industry

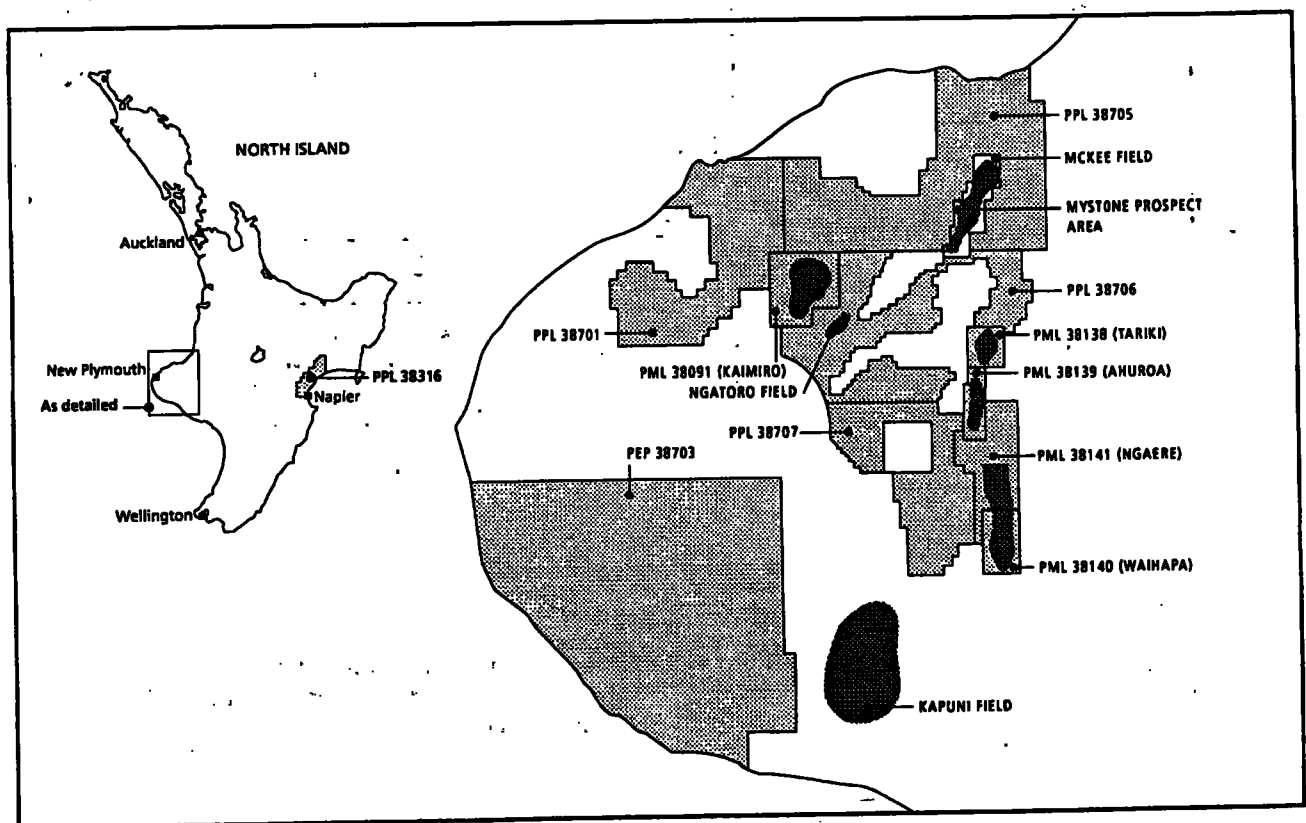


Fig. 2. Licence interests.

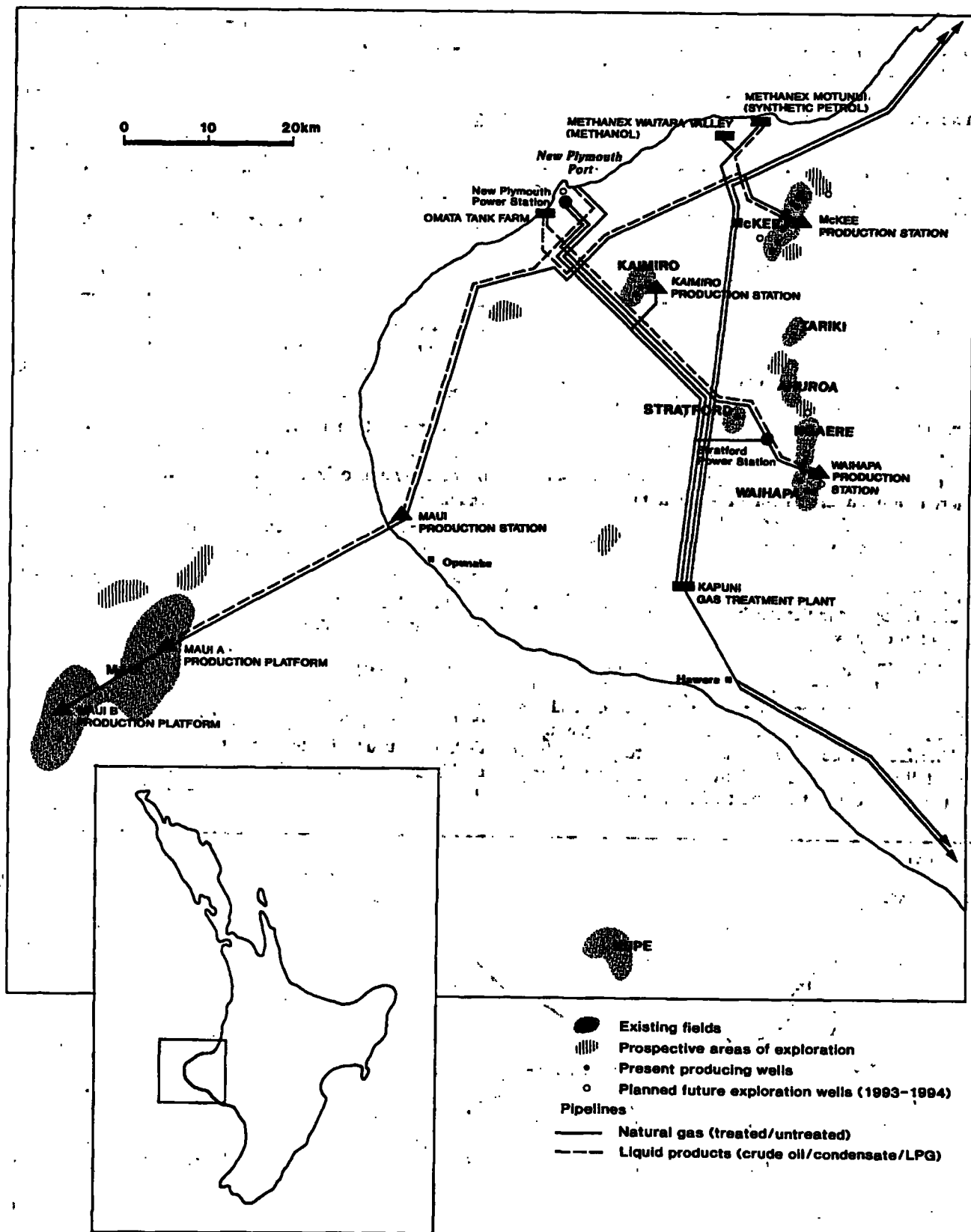


Fig. 3. Taranaki Basin activity in New Zealand (Source: FCP Annual Review 1993).

to continue to operate, and more importantly, the petroleum industry to continue to be a significant contributor to New Zealand's well being.

To answer Chris's original comment on motivation: "It is already happening as we speak here today" I am confident the Southern story can be repeated.

**Author**

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