

Views of a small company on the way forward for exploration in New Zealand

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Next time I talk, I hope and intend that I will be giving you the views of a medium sized company on the way forward..... The way our share price has been soaring in North America over the last few days, maybe Austral Pacific will have raised the funds to pursue good projects and build itself to such status by then.

Let me say up front that I believe that small companies are the lifeblood of NZ exploration. They are the ones which by and large develop the new ideas, and draw investment capital into new projects – because they have the greatest incentive to develop new ideas and typically the most focused expertise in their areas of interest.

So it is important that these companies are ‘fostered’ and encouraged by government, not discouraged.

We are most unlikely to see the major companies, the Shell’s and ExxonMobil’s etc, involved in New Zealand much any more. The siren calls of deepwater GOM, offshore West Africa, with their enormous potential size, are really the only sort of projects they can justify.

It is great to see new second and third tier companies, such as Pogo and Transworld, entering New Zealand, to add to the already present players in these categories. Small companies have played and continue to play very significant roles in attracting companies of this type to invest here.

Before outlining specific measures that I would like to see initiated in New Zealand, I would like to talk about political and bureaucratic attitudes towards oil and gas exploration, because I think these are important in forming, as well as reflecting, public attitudes.

Frequently, one hears officials and politicians mentioning ‘renewables’ as a sort of Holy Grail, and comparing these favourably (in an emotive sense) with gas (and oil) as energy options. But much of this is new age religion, without much foundation in reality. Over the course of time, dams silt up, turbine blades pit and break, windmills fall over or breakdown (as any casual glimpse at the weird landscape of windmills on display as one drives from San Francisco over the Altamont Pass, shows); and geothermal fields falter. The RESOURCE (ie the wind or the rain or the hot rock) might be effectively always around; but to exploit it requires continuous and ongoing re-investment. By the same token, as various papers at this conference have shown, the potential gas resource in New Zealand is of such probable magnitude that we may consider it also to be ‘always around’, ie of

potentially similar longlived status as the more politically correct resources. The same, I might say, could also be said of coal. What is required, just as for those other resources, is continuous ongoing reinvestment in the petroleum resource, to establish usable and available reserves of energy. This process is called exploration.

So my first specification is that there should be a realignment of public thinking into recognizing that gas is at least as environmentally acceptable a choice for energy supply as is 60 km of towering canal walls down one of NZs most beautiful valleys, or serried ranks of infrasound generators cluttering skylines; and that exploring for gas is merely reinvestment in what should be recognized as the best acceptable and most economically effective energy supply choice.

Lets get rid of this NZ hangup and hangover from the ‘think big’ era of the 70’s & 80’s that oil and gas are, somehow, ‘bad’; and start thinking about them as being necessary and typically ‘good’ when compared to the alternatives.

For too long, energy planning has been a political no-no; the last Energy Plan, was, I think, in 1987; until last year’s release of the Energy Outlook; which itself is a logically flawed exercise in unthinking worship at the altar of ‘renewables’. We are living with the consequences of such ideologically based inertia.

I have recently returned from a two week visit to North America; during which I spent some time in Calgary. This is a city with more oil and gas exploration companies per square foot than any place on earth. There are more than 10,000 wells a year drilled in the West Canada Basin (actual 2003 : 19,400); and huge ongoing production of oil and gas. Major companies have very little presence – like NZ today they have largely ‘moved on’.

Yet despite (and probably because) of the absence of the majors, the dynamism of the Calgary scene is maintained. It remains a driver to development and acceptance of new technologies, of cost effective exploration; and a focus and magnet for private investment from major investment funds down to individual investors.

In New Zealand, we average half a dozen wells per year, maybe 10 in a good year with the wind behind us; and despite the identification of numerous exploration plays and prospects in NZ’s extensive sedimentary basins; the industry remains starved of capital; and limps along at a rate which is totally inadequate to ensure NZ’s energy future. Let’s be

real; while windmills will, no doubt, rise; they will not address the energy problems of this nation. If this woeful situation of under investment in oil and gas exploration does not improve, NZ will inevitably turn to a coal fired energy future, or maybe even (dare I say) a nuclear powered one. Either of those forms of energy supply, even including Kyoto inspired handicapping such as carbon taxes, are enormously more cost effective than LNG import or mega scale wind power; which I therefore do not consider viable options for this reason.

Now I am not suggesting that anything like the scale of the Canadian scene is achievable in New Zealand exploration; but if the Canadians can do what they do; surely we could and should be able to do something a bit better than 1/1000th of that in our extensive and underexplored bounty of prospective basins. Let people not say, in a hundred years time, 'well they were given their opportunity and they turned their backs on it'.

So what specific changes to public policy do I think should be considered? Firstly, I would like to see governments accept that the Crown, as owner of the resource, is a participant in this process; not just a major beneficiary in the form of an enormous royalty stream, in addition to the direct benefits to employment and energy supply and economic wellbeing. Rather than just dumping the entire royalty largesse into the consolidated account, I would like to see a significant reinvestment from these funds into the baseline studies end of the exploration sector. The Aussies recognize this, so why can't we? As any rental property owner knows, if one wants to maintain the flow of rental income, it is necessary to reinvest in fixing the leaks in the roof, painting the property and putting up new curtains from time to time. So we should see ongoing budget allocation in the following areas at least:

- a) Employment of expertise. Rather than playing with meaningless requirements for reserves disclosure, a certain recipe for confusion and misunderstanding, the government should maintain its own pool of expertise and form its own opinions as to what are appropriate field management practices, and work cooperatively with the explorers in seeing such practices initiated;
- b) Availability of data. While a reasonable job is done by MED in maintaining and making available the data base for interested explorers, more funds need to be put into this area, to upgrade the quality of the data base.
- c) There should be ongoing government investment in baseline studies. These should include funding of several stratigraphic wells per year, key seismic acquisition for basin architecture evaluation, funding of core collection in exploration wells (as has been done in the past in Australia) etc.

Secondly, I would like to see review of the royalty regime. It is often repeated, as a sort of mantra, that NZ has a very attractive fiscal regime for exploration. That is only partly true, and only in certain instances. New Zealand suffers from a high cost structure, due to the small scale of its industry

and the high costs of mobilization of rigs , seismic vessels etc. While the overall 'take' in the event of a shallow oil discovery is relatively low, that is achieved only after relatively high exploration investment. In the case of offshore or deep gas exploration, where the costs are enormous and the lead times to monetizing the asset can be very long, the royalty in itself can be a significant deterrent to investment. I would like to see the AVR cancelled. This would allow the explorer to recover his risk capital before the APR royalty pitches in. I note that if the AVR is cancelled, the APR payment position is reached sooner, so canceling the AVR has the net effect of deferring royalty payment until profitability is achieved, but not particularly of reducing the overall royalty 'take'.

People talk about the toughness of the Indonesian regime, yet it has it all over the New Zealand regime in that it does allow full deductibility upfront before the profit oil split kicks in. In fact, I believe we should go one step further, and see the introduction of 100% or greater upfront tax credits for deep gas drilling, and for new technology implementation.

I would like to see encouragement for the introduction of equipment and technology into New Zealand; and fully support, for example, the initiatives of NZOG, PEANZ and others to remove the 6 month limit on New Zealand taxation holiday for foreign contractors working here. It is tough enough to mobilize an offshore drilling unit to NZ, but to watch it have to leave again within 6 months is an absurdity.

Most of all, I would like to see the government recognize that exploration is a vital activity, and provide mechanisms to encourage private investment in exploration, as is widely the case in North America and elsewhere. We, AustralPacific Energy, were the first exploration float on the NZ stock market in two decades; and even then a relatively modest one. That speaks for itself. There needs to be a lot more risk capital raised into energy and resource development . I see the need to establish tax deductible drilling funds and flowthrough investment mechanisms which can allow investors to receive the tax deductibility benefits of investment in companies legitimately involved in this nationally vital, yet on an individual project basis, high risk activity. There needs to be more of us small companies out there, working on becoming medium and big companies, and government should be supportive of this.

I could continue on such matters for quite some time, but will stop there, and thank you for your attention.