



29 October 2008

## Chairman's address to NZOG 2008 AGM

### Annual Profit Result

As you already know, NZOG produced an excellent profit result in the financial year ended 30 June 2008, achieving a net profit after taxes of NZ\$97.2m. Essentially, this result came from the first 11 months of oil production from the Tui project, during which time we experienced higher than expected rates of production and a soaring oil price over much of that period.

The strong cash flow generated by Tui allowed NZOG to rapidly repay the bank finance which the company had raised to fund much of the Tui project development. So we are now enjoying "free" cash flows from Tui and the Tui fields are now scheduled to have a production life through to around 2020. The Tui partners are also evaluating the optimal drilling program to test for additional reserves within the Tui permit area, which could boost reserves even further and keep production rates at higher levels.

### Returns to Shareholders

The very positive results from Tui to date and the future outlook for sustained production from that project, together with the start-up of production from Kupe being scheduled for July 2009, led directors to establish a dividend policy on the basis that the company will maintain a sufficient level of profitability into the future. The Board's policy is to pay a reasonable portion of profit as an annual dividend. Most of you will have received the first such dividend in April while future annual dividends are to be announced and paid out around September-October, when the annual result is announced.

The special additional 5cps dividend paid just at the start of this month, recognised the great year we experienced to 30 June 2008.

### Key Operations

Tui and Kupe remain as the two key tangible projects for NZOG. At this stage, as with last financial year, Tui production is likely to be the sole contributor to profits and operating cash flows during the 2008/09 year. Kupe is scheduled to commence production in the third quarter of 2009, which will widen NZOG's revenue sources and should assist in maintaining sound profit levels for the company over a considerable period.

As a point of interest, NZOG has held a position in both Kupe and Tui right from when the exploration permits were granted and through all drilling stages, and on to development.

market release

## **New Business**

Less tangible but vital to the company's future growth and profitability, including maintenance and increases in reserves of oil and gas, are our exploration and asset evaluation activities. David Salisbury as CEO since April of last year has established a team which, under his leadership, is charged with achieving these "next steps" which as I say, are vital to NZOG's future.

## **Making our cash work for us**

Additional to the net cash generated from Tui in the last 15 months, NZOG received in June a cash injection of \$191m from the exercise of options which were priced at \$1.50/share.

The share price on the NZX reached a high of NZ\$1.86 after that, but has since not unexpectedly suffered from the remarkable chaos in world financial markets and more directly, a consequential lowering of the oil price. When we met at last years' general meeting, the oil price was roughly NZ\$110-120 a barrel and currently is back in that territory. I have to say, I was very pleased when oil had actually *risen* to that level last year. Let's remember that the Tui development investment decision was made on the basis of a US\$40 oil price, so we really have been getting a major bonus from the much higher prices of the past several months.

Thus Tui remains very profitable. Similarly, Kupe still stacks up as a project which will deliver good returns to the company.

So I say to you that these two projects remain as very sound and worthwhile activities for NZOG to remain involved in for the long term.

Equally, I believe NZOG's large stake in Pike River Coal Ltd is of real value - Pike is a very well managed company, it is essentially fully-funded, it has an excellent product in its premium quality hard coking coal, a large proportion of which it already contracted for sale and the company is soon to make its first export at a premium price. These are all factors that fully justify NZOG's past support and continued investment in that company.

## **Risk Profile**

NZOG faces commodity price risk but that alone does not make it a risky investment. References are still sometimes made to NZOG being a "speculative" company for investors, but I could point to some much more risky places where investors have really lost their shirts, including high-flying equity groups, finance companies and so on. And even much-lauded major banks have suffered badly from straying into areas not fully understood by their top people. The bottom line is how well an enterprise is managed and ensuring a high level of awareness and inquiry among board members - I put to you that NZOG wins on both those counts - and that is a big "plus" for this company.

NZOG has also been able to reduce its risk exposure financially by paying off all debt, while retaining the NZ\$125m Kupe development facility in reserve. NZOG has some NZ\$35m still to contribute to Kupe before we start achieving returns from production around July next year, and we currently intend to meet those costs from equity.

And we currently hold in the order of NZ\$245m cash which is deposited with major New Zealand based banks in a mix of US\$ and NZ\$.

Thus NZOG has a relatively low risk profile.

### **Optimal use of cash**

This then gets me to the question of the best use of NZOG's cash reserves. How can our spare cash and ability to borrow (on sound terms), best be used to improve returns for you as shareholders?

The Board's approach to this question is to give the brief to David Salisbury as CEO, and his team to seek out new ventures, encompassing exploration, undeveloped reserves and production assets by which the company can grow and prosper further. As to the cost of entering into new projects, the current shortage of finance that has hit many oil and gas companies in the junior-intermediate league [ and facing real challenges in meeting obligations and/or have bankers whose lending criteria has suddenly become much harsher] provides NZOG and similarly well-funded companies with opportunities to acquire assets at more realistic entry prices than has been the case over the past couple of years, when people in this industry have been paying top dollar for production and expected reserves.

Within that brief, the Board has established some basic criteria:-

- that NZOG will not be drawn into asset acquisitions or exploration ventures for the sake of growth or activity alone and premiums for control or other unquantifiable/intangible possible benefits will not be factored into pricing.
- that dividends will be funded from operating cash flows, not from our enlarged cash reserves.
- that in the case of any acquisitions involving NZOG shares as consideration, full or comparable value will be credited to NZOG shares in determining the price being paid or offered.

In other words, the Board, while intent on growth, will not back growth for growth's sake alone. Naturally, there will often be a subjective element to assessing the values, or relative values, but those are the criteria we have set.

### **Directors' Fees**

One resolution to be discussed and decided by you shareholders today is an increase in remuneration to be paid to the non-executive members of the Board (that is, to all directors other than the CEO.) The proposal put to you is I think, fair, but equally I understand there is a lot of emotion surrounding fees for directors and also executive pay in some corporations, [particularly where they have made bad investment decisions]. This resolution has been put forward in good faith but it is up to you, the voting shareholders, to decide the outcome [just as voters will determine who wins the pending general election]. We will of course debate this matter ahead of the voting.

### **Share buybacks not attractive for NZOG**

I feel I should mention one alternative use of a proportion of company funds, which is a possible buy-back of shares, either by pro rata offer to all shareholders or by on-market offer. This is a subject that the Board has addressed more than once in the past year, and the idea has also been proffered by some shareholders as being of benefit to investors in the company. However, buy-backs can work sometimes and in some circumstances - but not right now for NZOG. I say this for three reasons: the volatile share price, the fact that investors who exercised options at \$1.50 just last June sets a minimum price, and the Board's intent to put cash reserves to grow the company. As an alternative to a buy-back the Board introduced a dividend policy as a means of delivering a tangible return to shareholders.

### **The Future**

The Board's clear intent is to achieve continued profitable growth for the company and have this reflected in the share price. With Tui fully on-stream, Kupe set for production in 8-9 months from now and Pike successfully separated as a listed company, and with cash in our treasury, the field is clear to make one or two significant moves to expand and spread NZOG's asset-earning base. David Salisbury will address the ways and means of achieving this outcome in his presentation shortly.

I also ask you not to be too negative about recent falls in the oil price and a share price currently below the \$1.50 June 2008 options price. The core assets of the company are very sound. Your directors are intent that, through our management team, NZOG gets to transact a couple of really good deals for the company within the next 6-12 months - so let's look forward to another positive year!

ENDS

### **FOR FURTHER INFORMATION PLEASE CONTACT:**

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