New Zealand Oil & Gas Ltd

ActivitiesReport

for the quarter ended 31 December 2010

Dear Investor

New Zealand Oil & Gas Ltd, as our name clearly suggests, is primarily an oil and gas exploration and production company. But in the last quarter the terrible events at the Pike River coal mine on the South Island's West Coast were front of mind – for NZOG, for Pike River Coal Ltd, for the West Coast community and most of all, for the families of the 29 men who lost their lives.

We all watched the events triggered by the explosion on 19th November unfold with mounting concern, sadness, sympathy and despair.

There is still a lot of uncertainty as this tragedy plays out and NZOG will continue to have a key interest and role to perform. On the back page of this report, we explain in some detail what NZOG's role has been to date, and what might lie ahead.

We also have a responsibility to our shareholders to get on with our core business of oil and gas, and we've been doing so throughout the last three months.

A comprehensive inspection of the Kupe Production Station was successfully carried out in November. The Kupe gas and oil field continues to perform strongly.

Like Kupe, the Tui area oil fields benefitted from oil prices that hit two year highs during the quarter. Despite the three week shutdown at Kupe and a shorter shutdown at Tui to undertake some process improvements, the two fields combined provided NZOG with NZ$16.7m in revenue for the quarter.

In our exploration portfolio, NZOG has built a dominant position in the relatively lightly explored northern offshore Taranaki Basin, with large holdings in three adjoining permits. In the southern Taranaki offshore basin, the Kaupokonui prospect is 'drill-ready' and NZOG is looking at drilling options. To increase those options, we have applied for a 6 month extension to the date for making a "drill or drop" decision and continue with our farm-out activities.

Due to the Pike River situation, NZOG will incur a significant accounting loss for the six months to the end of December. However, our balance sheet remains strong, we have good cashflows from Kupe and Tui, and we remain very focussed on growing our oil and gas business and increasing shareholder value.

David Salisbury CEO
21 January 2010

Key Points

- **Tragedy at Pike River**
- **Kupe inspection successfully completed**
- **Tui facilities upgraded**

Production

Kupe

Kupe Gas and Oil Field (PML 38146)
NZOG interest 15%

A comprehensive inspection of the production station, required within the first 12 months of operation, was successfully completed in November.

In the three months to the end of December, Kupe produced 3.3 PJ of sales gas (NZOG's allocation 0.56 PJ), 14,800 tonnes of LPG (NZOG's share 2,200 tonnes) and 350,000 barrels of light oil (NZOG's share 53,000 barrels).

The sales gas from Kupe is sold to Genesis Energy and NZOG's share of the LPG is sold to Vector subsidiary On Gas, both under long-term contracts. The light oil is exported to Australian refineries through Port Taranaki. NZOG's revenue from Kupe in the quarter was NZ$8.9m.

NZOG Production

Product	October-December 2010
Kupe:	
Kupe sales gas	0.56 petajoules
Kupe LPG	2,200 tonnes
Kupe light oil	53,000 barrels
Tui:	
Tui oil	90,000 barrels

Tui

Tui Area Oil Fields (PMP 38158)
NZOG interest 12.5%

The Pateke well returned to production in October following the successful completion of a workover. In November, Tui production was halted for a week to allow for maintenance and planned process modifications to be made to the floating production storage and offtake (FPSO) vessel, the Umuroa. This was just the second shutdown required since the Tui fields began production in July 2007.

Total Tui production for the quarter was just over 715,000 barrels of oil, at an average rate of 7,770 barrels per day. NZOG's share of the oil production was almost 90,000 barrels.

NZOG's revenue from Tui in the quarter was NZ$7.8m. With international oil demand firming, recent shipments have received the highest prices seen for two years. There were two tanker shipments totalling just under 573,000 barrels, with approximately 440,000 barrels in stock (NZOG's share 55,000 barrels) at the end of the quarter.
A further shipment of 405,000 barrels was offloaded on 5 January.

Financial update

NZOG's operating revenue for the December quarter was NZ$16.7m. This was comprised of revenue from the sale of Tui oil (NZ$7.8m) and revenue from the sale of Kupe sales gas, LPG and light oil (NZ$8.9m).

During the quarter NZOG advanced NZ$25m to Pike River Coal Ltd. This included a payment of NZ$12m made following the explosion at the mine on 19 November.

$500,000 was donated to the Pike River Miner's Relief Trust Fund.

In November, US$10m was converted to New Zealand dollars as part of re-balancing NZOG's currency holdings toward a 50/50 mix of USD and NZD holdings.

During the quarter, 753,000 shares were acquired and subsequently cancelled under the share buyback scheme, at a cost of NZ$857,000.

At 31 December 2010, NZOG's cash balance was the equivalent of NZ$111.8m. NZ$63m has been drawn from a NZ$75m debt facility with Westpac, giving NZOG a net cash position of NZ$48.8m.

More financial information is contained in the December 2010 Quarterly Cash Flows Report, which has been released to the NZX and ASX.

Exploration

TARANAKI BASIN

PEP 51311 (Kaupokonui)
NZOG interest 90%
The Kaupokonui oil prospect is ready to drill when a suitable drilling rig on acceptable terms is available in New Zealand waters. NZOG is looking at potential options for late 2011.

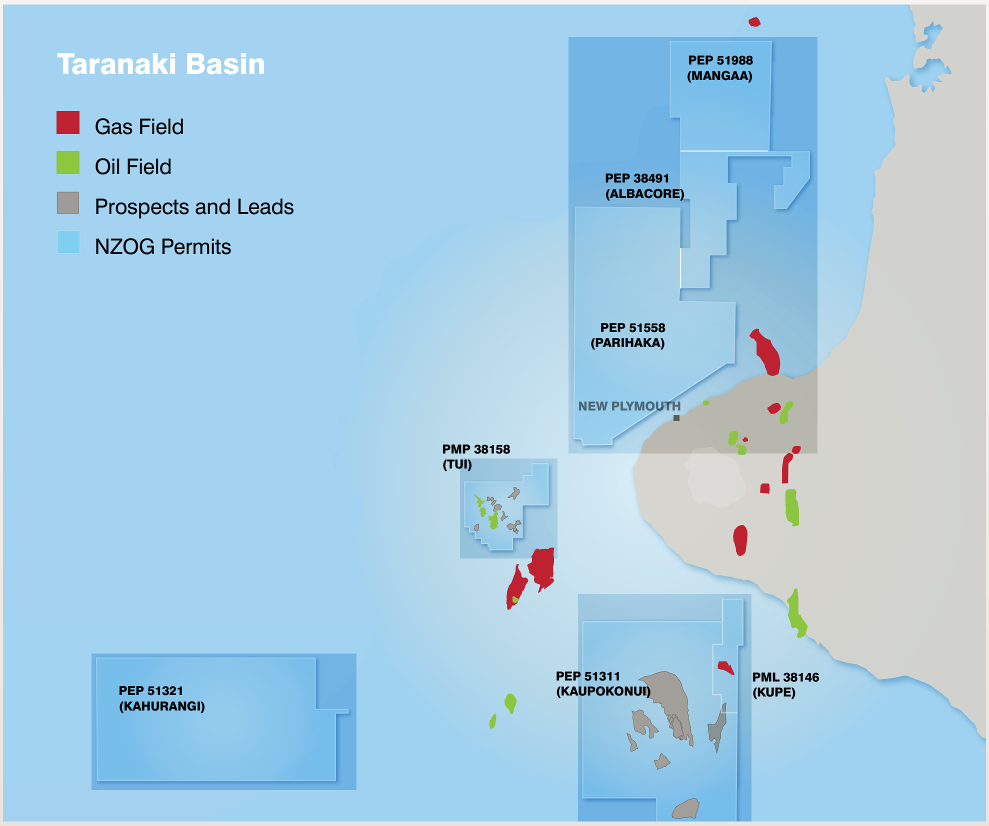
Kaupokonui comprises several vertically-stacked potential reservoir sands with recoverable resources (un-risked) in excess of 200 million barrels of oil. Several other prospects have been identified within the permit.

NZOG has entered into a farm-out agreement with Peak Oil & Gas (an Australian company which is in the process of merging with Raisama Ltd, an ASX-listed resource exploration and development company) whereby Peak will earn a 10% interest in PEP 51311 by contributing 20% of the cost of the Kaupokonui-1 well. NZOG intends to further farm down its exposure to the cost of drilling.

PMP 38158 (Tui)
NZOG interest 12.5%
This permit contains the producing Tui area oil fields and a number of prospects and leads. The 3D seismic data covering most of the permit area is being reprocessed including pre-stack depth migration. This is expected to improve the resolution of the reservoir interval and enable a thorough evaluation of the undrilled oil prospects which include Oi and Tieke North. The results of systematic reservoir modelling during early 2011 are also expected to establish the scope for further development drilling within the producing Tui, Amokura and Pateke fields.

PML 38146 (Kupe)
NZOG interest 15%
This permit contains the producing Kupe Central Field area and also a number of interesting prospects and leads. The joint venture is conducting further geological and geophysical assessments, with the possibility of drilling one or more prospects in conjunction with scheduled 2nd stage development drilling in 2012/13.

PEP 51558 (Parihaka)
NZOG interest 20%
NZOG has a 20% stake in this permit and is in discussions to raise this level further. This permit is the largest of three adjacent permits through which NZOG has built a dominant position in the relatively lightly explored northern offshore Taranaki Basin, to the west and north of the Pohokura gas/condensate field. A large 3D seismic survey acquired by a previous venture in 2007 will be reprocessed to improve definition of deep targets within the Kapuni and Pakawau groups. Deep Kapuni group sandstones are proven effective gas-condensate reservoirs in the northern part of onshore Taranaki.



PEP 38491 (Albacore)
NZOG interest 100%
NZOG will hold 100% of this second-term exploration permit following the withdrawal of Westech, the previous operator. The prospectivity associated with several undrilled structures is being examined in conjunction with exploration work in the adjacent permits.

PEP 51988 (Mangaa)
NZOG interest 100%
NZOG was granted this block in January 2010 and is continuing to work on its prospectivity with the extensive existing seismic data set.

PEP 51321 (Kahurangi)
NZOG interest 18.9%
Interpretation of the seismic data set incorporating the 200km 2D survey conducted during 2010 will be completed by March, and a decision will be made whether or not relinquish the permit or proceed to drill.

PEP 38483 (Bahamas)
NZOG interest 18.9%
The operator, AWE, was unable to attract a new partner to join the joint venture before drilling the high risk biogenic gas play. As a result, the joint venture elected to surrender the permit and it was handed back to Crown Minerals in December.

CANTERBURY BASIN

PEP 38259 (Barque)
NZOG interest 40%
The large Barque gas-condensate prospect has been mapped and continuing evaluation is focused on key technical risk factors and the determination of the optimal drilling location. The permit is subject to a change of conditions application to allow the joint venture sufficient time to identify a suitable rig and ensure that the prospect is commercially viable, given the cost of drilling and developing a frontier basin prospect.

PEP 52717 Application
NZOG interest 40%
NZOG expects to be granted this permit adjacent to the north of the Barque permit and will be reprocessing existing seismic data in order to map out a newly-recognised potential reservoir system across both blocks. The joint venture is the same as the one which holds the Barque permit, with NZOG as operator.

Pike River – an NZOG perspective

NZOG doesn't know what caused the catastrophic events at the Pike River mine on 19 November 2010. We watched, with the rest of New Zealand and others around the world, as the tragedy unfolded and it became clear that 29 men had lost their lives. In time, the various enquiries should provide some answers. Until then, speculation about the cause does little but add to the distress of those who have lost their loved ones.

NZOG has had a long association with the Pike River mine. The mining licence was held by an NZOG subsidiary through the consent process and up until the very early stages of development. Following a public float in 2007, the mine had been developed and operated by a separate listed company, Pike River Coal Ltd (PRCL). NZOG retained a minority (ca. 30%) shareholding, and more recently, became a lender.

As a shareholder, we are in the same position as the thousands of other PRCL shareholders, big and small. PRCL has been suspended from trading and the value of our shareholding is very uncertain. Our shareholding may still have some value (and we are working to address that), but shareholders are at the end of the line when it comes to getting something back on their investment.

As a debt holder, NZOG has had a more involved role. In May 2010 we advanced US$29m of first ranking secured convertible bonds, as the mine struggled to meet its production and financial targets. In September 2010, with PRCL facing cash flow difficulties, we provided a further NZ$25m short-term working capital facility.

Before the explosion, $13m of this had been drawn down by PRCL to meet its wages bill and other ongoing costs.

After the explosion, the NZOG Board agreed to provide PRCL with a further $12m under the working capital facility.

At the time, everyone was still hoping that the men underground were alive and awaiting rescue. Without our $12m, PRCL was broke – and facing insolvency at the very time it needed to focus on the rescue effort. The balance remaining of this $12m is now funding the receiver's ongoing work.

The NZOG Board believed – and continues to believe – that providing the $12m was the right thing to do commercially and ethically, based on the information that we had at the time. We have received a great deal of shareholder correspondence on this issue, which runs 9 to 1 in favour of NZOG's actions.

Subsequently the situation deteriorated rapidly with further explosions, fire, loss of life and a great deal of uncertainty about the mine's future.

The Board of PRCL then came to us and asked that we arrange for the company to be placed in receivership. A company cannot put itself into receivership – this can only be arranged by a secured creditor.

PRCL had concluded that even with the $12m provided by NZOG, it could not avoid insolvency. Our Board agreed that receivership was the only viable course of action and in consultation with another secured creditor, the BNZ, arranged for the appointment of three Pricewaterhouse-Coopers partners as receivers.

Receivers are required by law to look primarily at how best to recover funds for secured creditors, which can be by ongoing operation of the business or sale of its assets.

Since their appointment on 13 December, the receivers have had the complex task of cooperating with the Police and other agencies, reviewing options for the mine's future, determining employee and contractor entitlements and preserving the remaining value of PRCL. That work is all ongoing.

NZOG is owed around $64m in loans and our PRCL shareholding cost $82m. It will be some time – possibly more than a year – before we know how much of that almost $150m investment can be recovered.

NZOG's share price had been declining throughout 2010 and a number of analyst reports had attributed this to market concerns about the poor performance of PRCL and the flow-on impact on NZOG. Following the mine explosion, NZOG's share price fell another 30%.

In NZOG's view, our share price declined by more than the total value of our investment in PRCL. On top of that, the share price has not reflected the strong rise in international oil prices or the increase in reserves at the Kupe field.

19 November 2010 will be a day that will never be forgotten, but we must move on. In 2011, NZOG will be doing everything it can to grow its oil and gas business, recover value from its PRCL interests and re-build shareholder value.

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