Making Your North Sea Investment Decision

North Sea Strategy and Finance 2004

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Making your investment decision

- Defining the opportunity
- Developing an entry strategy
- Getting into the deal flow
- Outlining a plan for deal capture
- Understanding the operating environment
- Newfield's experiences (2002-2004)

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Defining the opportunity

- Sources of information
  - Government
  - Commercial data bases
  - Investment banks / boutiques
- Dispelling the myths

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Defining the opportunity

- World class petroleum basins
  - Significant remaining potential
  - Extensive infrastructure
  - Numerous undeveloped discoveries and prospects
- Political, regulatory and fiscal stability
- Liquid asset market
- Government initiatives to boost activity
- Acreage transfer from majors to independents

Defining the opportunity

- Geologic potential and operating environment in the different provinces
  - Southern Gas Basin – UK / Dutch sectors
  - Central North Sea – UK / Norway / Denmark
  - Northern North Sea – UK / Norway
  - West of Shetlands
  - Norwegian Sea
  - Barents Sea

Developing an entry strategy

- Selecting a niche that:
  - Plays to your company's strengths
  - Satisfies your company's growth targets
  - Falls within your company's risk appetite and capital exposure targets

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Developing an entry strategy

- Decisions
  - Oil or gas
  - Exploration or acquisitions
  - Generation effort or farmins (deal screening)
  - Prospect generation for farmout
  - Operator or non-operator
  - Local office
    - Location – London, Aberdeen, other?
    - Expat or local staff

Developing an entry strategy

- Newfield's Business Plan
  - Southern Gas Basin – UK emphasis
    - Acquire regional 3D seismic data
    - Target undeveloped discoveries initially
    - Pursue exploration prospects
  - Central North Sea
    - Expand to CNS when SGB effort is established
    - Primary focus on exploration activities
  - Acquisitions not a significant component

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Getting into the deal flow

- Where are the opportunities that fit your business plan going to come from?

- Who is your competition?

- What does it take to gain a competitive advantage?

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Getting into the deal flow

- Sources of opportunities
  - License rounds
    - Traditional licenses
    - Promote licenses
  - Acquisitions
    - Corporate and asset sales
    - Production, undeveloped discoveries and exploration acreage
  - Farmins
  - Fallow acreage initiatives

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Getting into the deal flow

- The competition - UKCS
  - – Established players
  - – European utilities
  - – European independents
    - Oil and gas companies
    - The aggregators
  - – North American independents
  - – Promote license entrants

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Getting into the deal flow

- Newfield's experience
  - Acreage and infrastructure dominated by a handful of companies
  - UK Southern Gas Basin activity level is low
    - Limited exploration and appraisal activity each year
    - Re-shuffling of assets occurs on a regular basis
    - Transfer of ownership of infrastructure beginning
    - Fallow initiatives having intended impact

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Outlining a plan for deal capture

- Getting to know the regulators
  - DTI
  - HSE
- Communicating your interests to the existing community
  - Operating companies – the Old Boys Club
  - Investment community
- Understanding the seller / farmor's motivation

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Outlining a plan for deal capture

- Identify specific assets
- Bring something of value to the seller
- Be prepared for changes in the marketplace
- Be flexible – modify your business plan as circumstances dictate

Outlining a plan for deal capture

- Newfield's experience
  - The unsolicited approach can be a "long hard slog"
    - Public data allows you to take an interpretation to a certain point only
    - Need cooperation (and information) from seller's to complete a technical analysis of particular assets
  - Public auctions can be very competitive
    - Preferred route for asset disposal
    - Negotiated deals are not common

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Understanding the operating environment

- Access to infrastructure
- Decommissioning
- Capital and operating costs

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Understanding the operating environment

- Access to infrastructure
  - Most pipelines and platforms have spare capacity
  - Infrastructure owners are receptive to third party business
  - Tariffs have moderated in recent years
  - New Infrastructure Code of Practice is a big step in the right direction
  - However, tying into another operator’s infrastructure can be a lengthy (and sometimes costly) process

Understanding the operating environment

- Decommissioning
  - A very large but poorly quantified liability
  - Little actual experience in UKCS
  - A major concern for government, sellers and partners in property transfers

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Understanding the operating environment

- Capital and operating costs
  - Differentiating between costs associated with harsh operating environment and "culturally" driven costs
    - Construction costs can be lowered
    - Installation costs will be more difficult to decrease
  - Operating cost cutting opportunities exist
    - Current operators have taken the low hanging fruit
    - Legitimate HSE concerns must be factored in
    - Non-operators have little influence on cost structure

Understanding the operating environment

- Newfield's experience
  - Control of infrastructure is more important in the North Sea than North America
  - Security for decommissioning has a significant impact on economics and returns
  - Cost structure can be lowered, within limits

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Adaptability – a key in any successful strategy

- Newfield Business Plan adjustment – 2003
  - Access to infrastructure at reasonable tariffs has always been a key component of our strategy
  - To better control our destiny, we want to control infrastructure
  - Therefore, we will place greater emphasis on acquisitions

UKCS Acquisitions

- Newfield's experience
  - Very competitive market
    - Fewer players for each opportunity
    - One buyer always willing to pay the strategic premium
  - In 2003, we bid on five acquisitions
    - Bids totaled US$480mm
    - Successful on one deal for under US$10mm
  - There are several 'different' factors to consider in UKCS acquisitions from a North American view

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UKCS Acquisitions

- Economic considerations
  - Gas price
    - Contracted vs uncontracted gas (seasonal production)
    - Pipeline agreement restrictions
    - Spot market, forward strip and future supply sources
  - Gas quality and blending issues
  - Currency exchange rate fluctuations
  - Capital allowances
  - Effective date, interest charges and notional taxes

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Adaptability – a key in any successful strategy

- Newfield Business Plan adjustment – 2004
  - We tested the acquisition market during 2003
  - The recent increase in natural gas prices has had a dramatic impact on the acquisition market
  - The hedging market in the UK does not have the liquidity to support bidding the forward curve
  - Fallow initiative is contributing to higher deal flow
  - Therefore, we will focus on the original plan of building the business with the drill bit

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Newfield's Position – November 2004

- License holder in nine permits
  - Operator of seven permits
- Exploration agreement signed recently covering five additional permits
- Active drilling program underway
- Expansion into Central North Sea in 2005

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Conclusions

- The UKCS has significant remaining potential
- A shift of assets to smaller companies is proceeding and will accelerate
- Relationships are key, but the biggest check still wins
- Understand the differences in the cost structure and which components can be impacted
- Patience and persistence – it will take longer than you think to build a business here

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