

Positioning For Exploration Success in the Upstream Petroleum Business

As a result of the drop in oil prices during the mid-1980's worldwide exploration activity decreased significantly. Further commodity price drops in the late 1990's compounded this situation as companies in the oil and gas sector saw their valuations reduced and had to respond to shareholder demands for stock price increase through a combination of superior financial returns and long-term resource base growth. Portfolio management (with the divestiture of assets which did not meet internal growth and value hurdles), optimization of operations to reduce costs and minimization of expenditure have all been undertaken to maximize value by increasing cash flow, net income and earnings, as well as enhancing metrics. Maximizing reserves to provide options for future production growth was accomplished in two ways: first, inorganically through mergers and acquisitions and/or asset purchases; secondly, organically through exploitation.

Exploration conducted during this time primarily involved low risk, step-out drilling. Thus, as a strategy to organically replace and grow reserves and production, exploration has been secondary except for those companies which did not have the option to grow inorganically due to balance sheet size or leverage. As a consequence reserve replacement from exploration during the last decade has declined considerably and now only accounts for a relatively small proportion of produced oil.

Today the industry is in a new era, one of higher commodity prices. Prices have risen due to longer term, below-ground concerns and, additionally, for oil, prevailing above-ground supply threats. This has led to recent shareholder value appreciation. Companies have to continue to focus on returns, maximizing production and minimizing costs and expenditures for short-term value. An inorganic strategy, however, to deliver future value and growth is threatened by today's higher prices (which have inflated acquisition costs) as well as by uplifted operating expense, thereby

reducing return and increasing risk and exposure to future lower cycle prices. It will also be affected by an ever-maturing resource base, a limited opportunity set and high competition.

For these reasons, as well as current market sentiment of not rewarding growth without value, M&A transactions have reduced significantly. Some companies may still either take advantage of

current prices and sell or wager on future prices and acquire. Some asset trades are likely to continue as portfolios are rationalized rather than liquidated. However, exploitation and low risk exploration is now the principal operating strategy. Notwithstanding, many companies are currently using excess cash flow to pursue stockholder value increase through financial strategies of paying down debt and buying back stock.

While companies and their shareholders have benefited recently from the commodity price increase and though overall higher prices may be the future norm, they will no doubt continue their cyclicality. Thus, companies cannot depend solely on future price increases to deliver continued value growth. It will be the companies which are able to progressively increase reserves and production at a competitive unit cost and with high value metrics that will survive and prosper. This performance will be delivered by one or both of two operating strategies. These include further industry consolidation coupled with exploitation and new exploration.

To date, however, companies have not re-directed their efforts to focus on value creation and growth through exploration. For many upstream companies exploration still remains a secondary strategy as evidenced by the still-suppressed activity and expenditure indicators. The forthcoming exploration challenge is further compounded by the ever increasing difficulty of our function, as we pursue new petroleum systems, fairways and/or plays.

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Unfortunately, exploration is a risk business and, as history has shown, it offers a greater chance of failure than success and more losers than winners. The consistent creation of value through successful exploration with the drill-bit is the aspiration of all but the feat of only a few. As explorers we are obligated to regain the confidence of management and shareholders, re-position exploration as the primary business development strategy and create our own future.

The presentation reviews where high volume and value oil may be expected to be found in the future and considers the factors which combine to characterize and differentiate failed exploration, the "accidental" or "occasional" oil finder and the "true" or "serial" one. The speaker addresses the organization and its culture, its people and their behaviors, the technical and business decision-making process, and team and individual roles, together with personal competencies. ■

Biographical Sketch

From 2002-03, **MR. MAXTED** was Senior Vice President of Global Exploration and New Ventures for Amerada Hess Corporation. Under his guidance, the company participated in several finds in the deep water Gulf of Mexico, and made new field wildcat dis-

coveries offshore West Africa. Previously, Mr. Maxted was Senior Vice President, Exploration for Triton Energy Limited and led the team that made the Ceiba Field discovery offshore Equatorial Guinea in 1999 and several follow-up finds. Joining Triton in 1994, Mr. Maxted was seconded as Exploration Manager to Carigali-Triton Operating Company (CTOC) in Kuala Lumpur, Malaysia. CTOC, jointly owned by Hess and Petronas Carigali, is the operator of Block A-18 in the Malaysia-Thailand Joint Development Area. During his tenure, the company found several multi-TCF gas/condensate fields.



Mr. Maxted began his career in 1979 and worked in the UK sector of the North Sea before being assigned in various roles to Egypt, Canada, Colombia and Norway with BP. As Exploration Manager in Colombia during the early 1990's he was involved in the discovery and confirmation of the giant Cusiana-Cupiagua oil fields. Educated in England, Mr. Maxted holds a master's degree in organic geochemistry from the University of Newcastle-upon-Tyne and a bachelor's degree in geology from the University of Sheffield.

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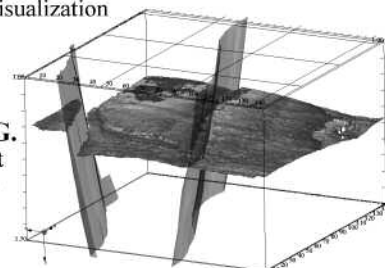
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