Raising the Profile of Small Exploration Companies

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INTRODUCTION

This paper discusses how the profile of the smaller oil and gas companies listed on the ASX has changed over time, and what tools management can use to raise their company's profile.

BACKGROUND

In the early 1980s, the Oil & Gas Index represented between 5% and 10% of the total ASX market value. Today, the renamed Energy Index has shrunk to about 2.5%, primarily due to the addition of new, large stocks such as Telstra, Commonwealth Bank, NRMA and others. Although the market capitalisation of the oil & gas companies has quadrupled in absolute terms, the relative size of the sector has at least halved.

However, the number of oil and gas companies has remained relatively stable, with about 50-70 companies consistently listed within this index over the last two decades. There are 62 such companies listed today.

Over the last 20 years there have been two new IPOs per year on average, with the mid-1980s and the mid-1990s the most active periods. As far as IPO funds raised, the mid-1990s was the strongest period, with over $500 million taken up by companies such as Novus, Bass Strait Oil Trust, Tap Oil and AWE between 1995-97. This compares to less than $100 million raised in total over the last four years.

This has clearly translated into less expenditure on exploration, particularly onshore. During the early 1980s, the industry spent $300-$400 million per annum onshore, which was on a par with the offshore spend. In recent years however, onshore expenditure has struggled to surpass the $100 million mark, despite some new spending in Coal Seam Gas. The offshore statistics are better, but this is largely the domain of large companies, rather than small oil and gas explorers.

With reduced exploration activity, there is obviously less chance of finding new reserves, but to make matters worse, the discoveries made have generally been smaller, and the success rates have also come down.

Some of the reasons for the decline in the 'profile' of oil and gas companies can be better understood through these statistics, but there are also some more subtle trends at work. These include issues such as:

- Company success stories are rare;
- Over-promotion and under-delivery has been the norm, rather than the other way around;
- Fund managers' expertise is down, while their aversion to risk has increased;
- Stockbroking research coverage has declined due to the falling number of oil analysts employed. In addition, the larger brokers tend to ignore the small exploration companies, while State-based broker research is somewhat patchy and lacks distribution;
- Media attention / expertise is limited as well;
- Investors with a speculative appetite have been attracted to other sectors such as Technology and Bio-technology;
- There has been a rising influence of environmental groups, which have taken a negative stance towards the industry;
- Domestic self-sufficiency has been largely adequate, so the problem is not perceived as a pressing issue;
- Political support is arguably down, with new imposts, reduced service from Government bodies and stubborn resistance to improving the fiscal regime; and
- Legal and regulatory issues such as native title, land access, as well as access to infrastructure effectively act as impediments, costs and a growing source of frustration to the industry.

So what can a small exploration company do to improve its profile?

There is no simple answer to this question, but a few suggestions are worth considering. Some things are beyond your control, such as oil prices, the exchange rate and the general stock market environment. In this context, it is worth noting that the Energy Index has a much higher correlation to the stock market, rather than the oil price. If both are in the ascendancy, and your company makes a discovery that is commercially significant, the company profile will definitely improve. But if we're in a bear market when you make a good discovery and the oil price is US$30, it will be a much greater challenge to get recognition.

Small companies do an enormous amount of good work, and have a terrific capacity to generate new ideas and concepts, as well as new technologies, or new applications for 'old' technologies.

In our view, small companies need a few key ingredients in order to achieve a positive profile in a broader sense:

1. Management which is able to develop, articulate and execute the company's strategy. This has to be done with skill, passion and credibility;
2. Asset package which makes sense, yet differentiates your company from others;

3. Cash—not too little and not too much. Funding for at least one year, and preferably two years is good. Avoid becoming a cash box;
4. Cash flow is desirable, but not essential. An Australian cash flow asset is preferred to an overseas property, but the lack of depth in the domestic market does pose a problem; and
5. Promote responsibly: downplay the upside, ensure the risks are understood, and communicate results in a timely and honest manner.

For small exploration companies, it has obviously become more difficult to get a hearing with the investment community, and perhaps the media and politicians as well.

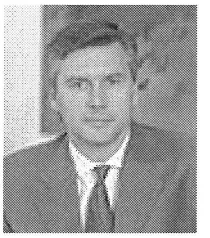
As an industry, organisations like PESA and APPEA do a good job of representing you in a variety of areas. However, there is a tendency to stick together, preaching to the converted, and not adjusting the message for a broader audience. The APPEA conference and the PESA meetings are very useful for yourselves, but of limited value to the investment community.

In contrast, the Diggers & Dealers conference in Kalgoorlie has pitched itself successfully to both the industry and other interests. The 'Good Oil Conference' in Fremantle is a great initiative to emulate Diggers & Dealers, but is yet to achieve the same level of success.

PESA/APPEA should look at alternative ways to educate and inform the market about the industry. To be most effective, it has to be 'user-friendly'. Maybe regular lunches or morning/evening seminars throughout the year and on the east coast would attract more broking analysts, fund managers and journalists who are time-poor, and find it difficult to justify 2-3 days away from the office in WA.

As a representative of an independent research house, with a genuine interest in the small end of the market, we would be happy to participate and assist with such seminars. From our discussions with the ASX, it is also very keen to improve the level of market information at the smaller end of the market. With such support, and an important message to tell, let's try to find new and better ways of communication, to enhance the profile of what small oil and gas companies are doing.

THE AUTHOR



Johan Hedstrom has a Bachelor of Applied Science (majoring in Geology) from Canberra University. After working as a geologist with the Swedish State Mining Authority in Stockholm, he began his career as a resources analyst with AMP Investments in 1984. In 1987 Johan moved into stockbroking as an Oil & Gas Analyst at County NatWest Securities (now known as Smith Barney Australia). Johan has been with Aegis Equities Research since the company's formation in 1999, and also holds the management position as Head of Retail Research.

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