The Structural Change in the Oil and Gas Industry

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“What’s Next for Australia?”

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What is Driving Oil Prices?

Global Oil Demand is weak
- 2014 demand growth up only ~ 0.6mn b/d
- Weaker than expected in China and OECD
- 2015 economic outlook is weak in EU, Asia
- Major stock-build forecast globally in 1H15

Record Oil Supply growth in 2014
- +1.5mn b/d increase from US “shale” or tight oil
- Record supply from Russia and Iraq
- Libya oil returned to the market in July
- Market is oversupplied

Source: Bloomberg, Morgan Stanley Commodity Research

Source: IEA Oil Market Report, Dec 2014
OPEC is no longer the swing producer:
- Historically OPEC has balanced the oil market, by cutting production in response to demand events
- Saudi Arabia and others have low production costs and spare production capacity to respond to supply crises
- OPEC has been losing market share to higher cost producers such as US shale
- OPEC has clearly signalled it will now compete for market share and will accept lower prices
US crude production is set to overtake Saudi crude output in the next 12 months

Source: EIA, OSH analysis
Oil price outlook revised down

Global oil market undergoing a structural change:
- Most analysts see prices below $80/bl until 2017, and no analyst sees a return to 2014 outlook before 2020
- Market will be highly volatile in this period

Source: Brokers, OSH analysis
A Brent price of $40/bl or below could put material volumes of existing global supply at risk

Volume of production that becomes cash negative as oil prices fall

Source: Wood Mackenzie, Q1 2015
Share price performance reflects relative strength of companies:
- OSH down -2.7% in 2014
- ASX Energy index down -15%, and OSH global peer group down up to 60%
Dividends and buybacks threatened below $80/bl

Brent price required to maintain current debt levels in 2015

Company responses to lower oil prices / revenues:

- Actively revising 2015 budgets and capital spending downwards
- Some companies already in financial distress, looking to raise capital

Source: Wood Mackenzie
Company responses to lower oil prices / revenues:

- Discretionary expenditure, including exploration, slashed
- Development expenditure deferred, and aggressive value engineering for projects in construction
- Service company contracts renegotiated
- OPEX improvement programs, and alignment of corporate cost and structure to activity
Project costs to decline as activity reduces

Upstream capital costs are expected to decline globally by approximately 12% on average between 2014 and 2016 offshore and 7% onshore.

Falling demand will ease labour pressures both onshore and offshore.

Offshore floating drilling rig rates had been dropping as new supply came into the market, and will now be hit with lower demand as well going forwards.

Source: IHS Energy Cost Service
Impact on LNG Prices and Markets

Falling oil prices have already seen LNG spot, medium and long term contracts stall, with buyers expecting LNG prices to fall. Many proposed greenfield LNG projects are not economic at $50/bbl without reductions in capital costs. LNG from PNG may find reduced competition for customers when it begins marketing.

“Grassroots LNG projects will stall. Costs are simply too high…”

Dr. Fesharaki, Feb 2015

Source: FACTS Global Energy
*Capacity per Department of Energy authorization to Free Trade Agreement countries, in addition to capacities under construction

**Project partners’ plan includes expansion up to 50 mmtpa

Source: Goldman Sachs, FGE
Future LNG projects from PNG are highly competitive versus global alternatives

Global LNG plant break-even costs (US$/mmbtu)

Source: Oil Search and Wood Mackenzie, Q1 2015, Project names removed

LNG Projects under construction, selected probable and possible
....but how much will come to market??

Other LNG proposed projects (not shown in the diagram above) have not progressed beyond conceptual – Bonaparte FLNG, Cash/Maple FLNG, Scarborough FLNG, Darwin Expansion.

Lines indicates when FID date first proposed and WM current view

- Operator target FID date - Project cancelled
- FID date continuing to drift

Source: Oil Search and Wood Mackenzie

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PNG LNG is competitive versus LNG projects from Australia

LNG Projects recently commissioned, or under construction, in Australasia

Source: Oil Search and Wood Mackenzie, Q1 2015, Project names removed

- PNG LNG well placed compared to recently commissioned Australian projects
- Debottlenecking at PNG LNG offers opportunity to further improve economics
Many projects possible and speculative projects been muted

Global LNG Capacity and Utilisation versus Demand (mn t/yr)

Source: Wood Mackenzie, Q4 2014
Gas demand by region and supply type

Source: ExxonMobil, The Outlook for Energy, Dec 2014
**Gas resource evaluation ongoing in NW Highlands and Gulf**

Key resource evaluation activities currently underway:

- Structural remapping and reservoir modelling based on information from Hides development wells commenced in 2014. Will help further constrain Hides resource.

- Hides F1 well – material Koi lange exploration target underlying Hides field, currently drilling towards target.

- P’nyang: initial preparations for further drilling to assess resource potential.

- Antelope 4 and 5 appraisal wells: will likely establish whether resource can underpin one or two trains.

- Antelope 6 (to assess resource upside) and Antelope Deep (exploration well) to be drilled in 2015, both wells subject to JV approval.

Resource clarity will determine progression through to Concept Select/pre-FEED/FEED.
Availability of commissioning gas from oil fields in Aug-13, prior to first deliveries from the Hides field in Apr-14, enabling early start-up and rapid production ramp-up at LNG plant

Stick built (vs modular built), enabling issues to be ironed out prior to production. Competitive labour costs

Conventional LNG project, located onshore, with existing infrastructure base from oil operations

Productive wells with high flow rates – only 12 wells required to sustain production for 30 years, resulting in low ongoing capex

Substantial 1P certified reserves base with high heating value, attracting premium pricing and suitable for Asian reticulation network

High liquids, enhancing economics

Located close to growing Asian LNG markets

Stable fiscal regime with strong Government support

Aligned Joint Venture. Exxon highly respected as able to deliver and operate major LNG projects, augmented by OSH’s 86 years of in-country experience

Provides attractive returns and is robust to product price movements
OSH Reassessed Strategic Review

» Review conclusions:
  – OSH in strong position to manage lower oil price environment
  – Proposed LNG growth projects remain attractive based on current assumptions
  – Lower oil prices will impact future cash flows but with careful management, OSH can fully fund its equity share of two new gas development projects
  – Industry capital cost deflation likely

» With production profitable even at current oil prices, opportunity to recalibrate business, improve efficiencies, sharpen fiscal discipline and underscore investment returns

» 2015 work programmes re-prioritised:
  – Reduce capex, with cuts primarily in exploration, other non-gas discretionary spend
  – Reduce 2015 opex
  – Actively engage with contractors to further reduce costs by targeted 15 – 25%
  – Defer activities not required for safety or priority projects
  – Monitor market for distressed sellers or opportunities for expansion with low cash commitments

» Proportional payout ratio of 35 - 50% core NPAT, remains appropriate

» Focus is to maintain top quartile returns to shareholders

2015 Spending Cuts

- PNG Oil and Gas production costs ~20%
- Exploration and evaluation spend ~25%
- Production capital ~20%
- Corporate capital ~40%

Oil Search – Structural Change in Oil and Gas
Oil and Gas industry is undergoing a major structural change, driven by low oil prices.

Industry response has been to cut capital spending and defer projects.

Impact extends to LNG supply and cost environment.

OSH 2014 Strategic Review has been updated. OSH in excellent position to recalibrate cost base and refocus business on potentially high returning growth projects:

- Potential expansion of PNG LNG Project and Elk/Antelope developments - both have robust project economics and remain attractive
- PNG country stability initiatives remain a priority

Capex and opex reductions planned, focused on reducing/deferring exploration, other discretionary items.

Dividend pay out ratio of 35 – 50% of core NPAT unchanged.

Strong balance sheet and ample liquidity to pursue growth.