

The Cultus Exploration Philosophy

presented by D Beard

Managing Director, Cultus Petroleum NL,
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Abstract

To Cultus, exploration is a core discipline and the centre of growth. It is the tool necessary to sling-shot the company into the "made it" category. It is expensive and often to accountants and engineers, the bane of corporate existence. It is important to have as exploration's main objective the creation of wealth for the shareholders. Wealth is generally created by risk-takers so Cultus provides an environment conducive to risk-taking and constructive conflict. An environment where thought processes evolve in order to enthusiastically seize opportunities, and to advantage the corporation. It is also important that Cultus' Board of Directors is infected with the same enthusiasm for exploration. To prevent destruction of shareholders wealth, it is axiomatic that exploration barrels need to be found cheaper than they can be bought.

As a business, exploration is inexorably tied to people and money. Proactive people with the necessary skills need money provided whenever and wherever to create growth, longevity and wealth. Cultus uses the acquisition of cash flow assets such as its Timor Sea, Cooper Basin and North Sea interests, as a means of providing these funds.

Cultus applies stringent prerequisites in its search for exploration acreage, restricting its business to Australia, New Zealand and the United Kingdom. It then builds large meaningful data bases and attempts to crystallise advantage by utilising them. Cultus believes that a statistical sufficiency of wells needs to be drilled in order to court success. A mixture of prospect size and variety of risk is essential, although scale is no necessary recipe for success. Cultus' Cornea, Tenacious, Haselgrove and Redman discoveries all derive from different sections of the size and risk spectrum. A simple measure of their success is the resultant growth in underlying asset value.

Cultus sees the twilight of the "Age of Petroleum" as a time of unlimited opportunities for small to medium size companies which have the will, the flexibility and the speed to seize them.

Introduction

Cultus Petroleum's exploration philosophy expounds nothing really new, just a reinvention of the wheel with perhaps a few innovations and adjustments as we endure yet another global oil glut and head toward the end of the Age of Petroleum. There is no dogmatic preaching here just a summation of ideas for your perusal.

The Centre of Growth

In Cultus' world, exploration is the core business. It is the centre of growth leading to financial success. It is the discipline that will provide the quantum leap necessary to sling-shot the company into the "made it" category. By comparison, acquisition of assets and going concerns provides at best, reasonable returns for the shareholders, but without the quantum leap. However, acquisition of cash flow assets has played a most important role in establishing Cultus' exploration position and priorities. It has supplied the source of funding.

Cultus did not begin as an oil and gas E (exploration) and P (production) company. From the late 1960s its interests were many and varied, including mineral exploration in Australia, Papua and New Guinea, and the Philippines, real estate in Western Australia, and of course oil and gas interests. For a small company, this diversification had led to severe capital depreciation. In the early-to-mid 1990s Cultus focused on oil and gas, ceased the inefficient use of human and financial resources which had gone hand-in-hand with diversification, and became an energy E and P company.

In order to grow any organisation the taking of risks has to be encouraged. To ensure the future and prosperity of an organisation and its shareholders, the management of that risk has to be undertaken successfully. Early on Cultus discovered the need to generate an atmosphere of risk taking and constructive conflict. It is believed that this rather contentious environment evokes thought processes that lead to the occasional great idea together with a plethora of difficult but necessary decisions. Of course all of this has to be mixed with a liberal helping of good old commercial common sense. Who would explore for barrels of oil if it was cheaper to buy them? Explorationists are by nature optimists. Again, who would look to progress anything if pessimism were the dominant character trait. Optimism encourages risk taking and this is the most important factor in growth and the creation of wealth. Employ optimists.

Exploration as we all know is a very expensive business in a capital intensive industry. It consumes funds, usually at a faster pace and in larger amounts than we budget for. Recent increases in costs of seismic acquisition and daily drilling rates together with even more recent plunging oil prices are sufficient vindication that "Murphy's Law" is alive and well.

To many accountants, financial types and engineers, exploration is the bane of corporate existence, and often with a degree of justification. One has only to look at the massive destruction of oil and gas shareholder wealth on a world-wide basis in the 1980s. As an approximation, reserves added during that decade represented half the value of the monies expended trying to find them. Also as a generalisation, small non-integrated upstream companies performed worst of all. We are singling out here the type of company which is near-and-dear to most of us. Still, if one has a penchant for exploration and risk taking, then the 1980s certainly serves up many glaring examples of how not to run and build an E and P company.

This is a Business

An underlying objective for Cultus has been that exploration reserves must be added at finding costs equal to or better than the cost to purchase comparable reserves. In addition, one of senior management's charters is to provide adequate funding, whenever and wherever Cultus needs it, and to do so at the lowest cost obtainable. Exploration's number one objective is the creation of wealth for the shareholders, and this is generally achieved by value added growth. The investors are looking for results not excuses. Often explorationists describe dry holes as technical successes; they often see a duster as an affront to their ability, security, and consequent career path. Tell it like it is; learn from the "mistake" and move on. One has to extract maximum value from every dollar spent, and that often translates into "don't drill to China".

In short, Cultus believes the business of exploration should be run with the "bottom line" in mind. Explorationists have to pay goodly amounts of time and attention to the understanding and the bringing to fruition of the economic and commercial aspects of their chosen discipline. As explorationists we have to continually ask ourselves whether or not the particular project in which we are involved is in the quest for shareholder wealth, or for some personal gratification or just to follow some antiquated but well accepted industry practice. The answer should be unequivocal. If the essential answer is not to build wealth, then forget the project.

Explorationists should continually renovate their business. Today's treasures can easily, and often do, become tomorrow's trash. Now that we all play on a global stage it is important to adjust and adapt quickly. Timing is everything. It is a dynamic business and as the Age of Petroleum draws to a close it is likely to become more so.

People

Teamwork is another essential facet required for success. If I would have described Cultus as an exploration company I would have been describing a failure or at the very best a company which had yet to taste success. After any discovery, additional skills are needed in order to convert the

perceived value into real value. Thus, a continual exchange of cross-discipline ideas is another necessary function of the explorationist. Oil and gas is found and developed in the minds of intelligent and creative men and women. These people generally have an enthusiasm for new ideas and situations, and any resultant growth arises out of both challenge and bewilderment. To suppress talented people from speaking their minds, is to deny your corporation the most important resource in exploration ideas.

Cultus has opted for an experienced workforce with enviable track records. These people are innovative, imaginative and dedicated. When developing these human resources management has tried to include individuals with an entrepreneurial bent, i.e. people able to turn a dollar when opportunity is either identified or blatantly absent.

Apart from an enthusiastic team of explorationists, a supportive Board of Directors is a pre-requisite. It is important that Cultus' Board of Directors is infected with the same enthusiasm for exploration as staff and management. To achieve this end, it is essential that the Board of Directors is kept well informed, and is constantly updated on current and future projects. The Board must be able to move quickly and be able to sympathise with the risk verses reward ratio that is generally applicable to exploration. What is even more important is the make-up of the Board of Directors. A proactive and successful E and P company must have at board level a significant representation of men or women who understand the risks and technology associated with the business, preferably by virtue of their own experience. I cannot over emphasise this point. Given that the decision making processes usually start and finish at the board level, it is at this level where management must concentrate its efforts in order to engender and maintain the support and enthusiasm required, in this time and money consuming business of ours. We can all refer to Boards of Directors of E and P companies with the prescribed make-up and understanding which are the epitome of success, conversely there are numerous examples of E and P companies where lack of success can be readily traced to incorrect board make-up and lack of understanding of the business.

Money

I mentioned that part of senior management's charter is to provide exploration funding at minimum cost. Cultus has chosen to provide these funds mainly via acquisitions of oil and gas cash flows. This is an ongoing process, which will diminish in importance as Cultus' own discoveries are brought on-stream and begin to supply the necessary funds. Cultus believes that the days have gone when companies automatically turn to the shareholders for exploration funds when the coffers are empty. Acquisition of cash flow assets usually provide additional bonuses for the purchaser, particularly if they are a pre-requisite ingredient. These bonuses are generally hidden within the asset, are not valued and hence not paid for. Their value is extracted at a later date and sometimes can actually overshadow the original cash flow item. Examples of these bonus elements include:

- Blue sky exploration potential
- Opportunity to lower operating costs
- Potential for additional reserves
- Purchaser can add value because of its infrastructure etc
- Tax relief
- Often assets can become non-core. This is a euphemism for those assets one believes that someone else covets and values more. When this occurs it behoves the company to continue the renovation process and monetise those assets where possible.

Although I don't intend to dwell on Cultus' acquisitions, I make mention that it has made five acquisitions since June 1992, all of which have assisted in propelling the company through its various stages of growth. All have provided some form of cash flow.

Cultus is as enthusiastic about its acquisition programmes as it is with its exploration business. It sees the current relationship between exploration and acquisition as symbiotic. The Company is proactive not reactive with regards to both these disciplines. In fact it sees proactivity as a necessary prerequisite for success in its business.

Where and Why

Cultus applies stringent requirements in its search for exploration acreage. This search is currently restricted to Australia, New Zealand and the United Kingdom. Some of the more important requirements which lead to various global locations include:

- Fiscal terms which lead to better "Contractor take"
- Easy repatriation of funds
- Low political risk
- High prospectivity
- Larger reserve targets
- Clear understanding of contractual relationship with host government
- Balance between oil and gas

Asset	Date Purchased	Type of Cash flow
Barcoo Petroleum Ltd (All Shares)	30.06.92	Cash reserves Small cash flow-Cooper and Surat basins
Basin Oil NL (All Shares)	10.07.92	Gas, oil and tolling revenues - Cooper Basin
Esso Timor Sea Ltd (All Shares)	01.11.93	Oil revenues - Jabiru, Challis and Cassini fields
GFE Resources Ltd (All Shares)	15.09.95	Gas revenues - Port Campbell, Katnook, Palm Valley and Boggy Creek Gas fields
Mobil North Sea Ltd's interest in Hutton and Q-West fields	20.08.96	Oil revenues - 6.7% Hutton Field 5.8% Q-West Field

Cultus' current exploration locales may change in the future, but only with reference to the above factors. Cultus believes there are certain countries where it has no business exploring; e.g. most Asian, African, Latin American and South American countries, and Russia. Apart from failing the above requirement test, many of these countries possess exploration logistics which go well beyond Cultus' means. Many have government controlled oil companies which usually help to reduce contractor take and possess other financial negatives. Although there will be some lucky and some smart winners in these countries, in the wash-up most of the explorers are likely to be disappointed. In exploration there is more than sufficient geological risk to cope with, why compound the difficulty by adding risks which are nigh on impossible to manage.

As we are all now playing on the global stage, companies have to be prepared to gear up for both beneficial and untoward changes, as both the stage and its backdrops move.

Cultus explores where it is most likely to be profitable. It has successfully been a "fringe" player having explored in and made deals on acreage initially unwanted by the major and larger companies. Cultus then builds large meaningful data bases within these areas and attempts to crystallise advantage by utilising them e.g. PEP 38413 in the offshore Taranaki Basin which had been recycled a number of times prior to Cultus' latest farmout to Shell and Todd. Cultus grows by accretion in specified areas, rather than by employing a scatter-gun approach. Advantage is generally fleeting but Cultus is constantly on the lookout for any position that will give it one. Cultus continues to develop new beachheads in regions of interest, matures the data, and as opportunity avails itself, grows the acreage position.

Technology

One element available for explorers to reduce risk is technology, particularly new technology. New views and opinions will always find new oil in old acreage. By all means learn from past errors but don't go forward looking in the rear-vision mirror, its likely to be a slow and tortuous trip. One has to apply innovative technical solutions to existing activities, but don't get locked into any pursuit for the pursuit's sake. Whatever is taken on by the technologist has to be with the aim to add or precipitate value. Cultus believes that a small well financed company with the necessary technical skills and available specialist expertise can compete successfully for new reserves.

Wells and Prospects

In any acreage a statistical sufficiency of wells needs to be drilled in order to court exploration success. On average, Cultus has participated in 22 exploration wells per year over the last five years.

Year	Cultus Well Participation	Approximate Exploration Cost (A\$ million)	Potential Reserves Discovered (MMBOE)
1993	15	4.6	7
1994	13	2.9	2
1995	13	6.8	1
1996	24	9.5	3
1997	46	19.2	62

This is not proposed as an exact formulation for success, far from it, but it does give an inkling into the size of the programme needed in this particular case.

Within any of Cultus' annual drilling programmes there is a predetermined mixture of high-risk, high-reward and low-risk, low-reward prospects. A particular mix may change from year-to-year, and certainly does as growth continues and the company feels the need to become exposed to larger reserve targets. However, one has to remain conscious of the fact that scale is no necessary recipe for success. Cultus is indeed fortunate to be able to present examples of recent discoveries which have emanated from the above drilling programme, and which derive from different sections of the size and risk spectrum.

Discovery Name	Location	Risk Prior to Drilling	Potential Size
Redman	Onshore Otway SA	Low	10+BCF
Haselgrove	Onshore Otway SA	Low	30+BCF
Tenacious	Offshore Timor Sea	Moderate	5-40 MMBO
Cornea	Offshore Browse	High	200_MMBO

As well as being capital intensive, exploration is time consuming and requires decades of commitment by corporations, if they wish to truly participate. Feet of clay is not what is needed at any of the corporate levels.

As I've already mentioned, continual renovation of acreage and exploration interests is a must. If goals are not met after meaningful attempts are made, be prepared to abandon them and the permits, licences etc that attend them. Become traders and be prepared to sell exploration interests and assets if others perceive higher values than you are prepared to condone. The result of this prioritising will be an upgrading and positive revaluing of the company's acreage portfolio and exploration interests.

Environment and Heritage

This decade has seen an upsurgeance in awareness by industry as a whole, in environmental and heritage standards. Generally the oil and gas industry has an excellent record in these areas, but there is no room for complacency as the rules are changing rapidly. These areas are now intrinsic parts of the oil and gas industry's business. Cultus recognises its responsibilities in this regard and believes that prevention pays. Environmental and heritage protection is simply good business. Any arising problems should be responded to effectively and openly.

Nevertheless, in a greening world, explorationists should vigorously and vocally defend their activity as a legitimate and wealth creating part of a modern society.

Statistical Priority

One thing that I feel I must comment upon is the variety of statistical methods used to analyse exploration risk. More specifically geological risk and the prioritising of prospectivity. Personally, I've never seen a better way to crush thought provoking ideas, in my entire career. Why should such a pessimistic, negative, and totally subjective formulation be used to grade or pre-judge ideas and prospects. How can we as optimistic scientists condone the use of such a method when we all know, or should know as explorationists, that we are wrong more times than we are right. These methods of appraisal are only subjective views utilising state of the art information, at that time, which we invariably find to be incorrect. This is no way to treat active and talented minds, let alone for use in planning the destiny of the companies and the individuals involved. Reward original thought and provocative ideas, don't stifle them.

Success

Whether or not Cultus or any company is successful depends on growth in the asset value. This is directly related to increasing the underlying reserve and production base, which is a better indication of value added growth than the year-to-year profit and loss account. Generally the stock market takes some time to come to this landing but it eventually does and companies' share prices reflect a combination of both real and perceived value. It's a capital gain for the shareholders. Other CEO's have observed that success is found in the journey not the destination and I agree. In a truly successful company the journey never ends. I'm grateful to have had the opportunity of commencing my journeys as an explorationist, without the like of which no journey in this business would ever commence.

To my Cultus travelling companions, thank you for your vigorous initiatives, and the fact that you've displayed the courage of your convictions. You have not become too cautious or unimaginative, and have never felt intimidated by the large corporations. You have learnt from other people but

you have been your own benchmarks.

We may be in the twilight of the Age of Petroleum, but as we get closer to that very last barrel of oil with the inevitable associated rationalisations, there will be unlimited opportunities for small-to-medium sized companies which have the will, the flexibility and the agility to seize them. The current situation of global over-supply of oil is not unique, and in the long haul, as in the past, will tend to be self corrective. Our priorities will be to attempt to smooth out the feast versus famine curve.

We have an exciting future in front of us and there will be many success stories. Rest assured those stories will belong to those explorationists who have taken upon themselves the mantle of puppeteer rather than that of puppet.

Author

Donald Beard is Managing Director of Cultus Petroleum NL. After graduating from the University of Queensland with a First Class Honours degree in Geology and Mineralogy in 1969, Mr Beard spent the first five years of his career in Australia working as a geologist. In 1976, he moved to Balikpapan, Indonesia, with Union Oil Company of California. In 1978 he joined IAPCO where he was promoted to Vice President Exploration in May 1981. In 1984, after a takeover, he was promoted to Vice President Exploration Asia/Pacific for the Diamond Shamrock International Petroleum Corporation. In 1986 Mr Beard returned to Australia and was appointed Chief Executive and Director for Peko Oil Ltd. SANTOS took over Peko in 1988 and Mr Beard retired from Peko in 1990. In September 1990 he was employed by Cultus Petroleum NL as Chief Executive and was appointed Managing Director in November 1990.