WOODSIDE'S FINANCING OF THE NORTH WEST SHELF PROJECT

An Address by
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Thank you for this opportunity to speak to so many members of the securities industry in this city.

Some of you may remember that I was scheduled to speak here some months ago, but a strike by air hostesses forced a postponement.

That delay may have been fortuitous because Woodside Petroleum is now much further down the road and I can tell more about the direction in which we are going.

On September 30 last year, Woodside and its partners announced their intention to proceed with the development of the North West Shelf natural gas fields, setting in train the first part of the biggest natural resource project yet undertaken in Australia.

Woodside is a 50 percent Participant in that project, and the Operator responsible to all Participants for its implementation.

You know as well as I do that though Woodside ranks as perhaps the sixth company in Australia in terms of sharemarket capitalisation, it has no significant income and was until eight or nine years ago just another of the many enterprising but undistinguished small companies which make the Australian exploration scene such an active one.

How we emerged from the plethora of small entrepreneurial petroleum exploration companies to achieve our present eminence as the major Participant and the Operator for this mammoth project, will be, I believe, of considerable interest to this meeting.

Today's Woodside Petroleum Ltd evolved from the companies Woodside (Lakes Entrance) Oil Company NL and Mid-Eastern Oil NL which were formed in the early 1950s during the speculative share boom which followed the non-commercial discovery of oil at Rough Range in Western Australia.

Their initial activities were directed towards exploration for hydrocarbons in the Gippsland Basin of Victoria, but in 1963 both companies were granted rights to explore for petroleum offshore on the North West Shelf of Australia.

This move offshore represented a tremendously ambitious undertaking by two very small companies. The permits encompassed some 370,000 square km, an enormous area totally covered by sea except for a few small islands and reefs.

At the time the great depth of water over most of the permits (some 500 metres of water covered at least a third of the area), their remoteness and a decline in enthusiasm for oil exploration throughout the world made it a very audacious exploration venture.

The companies, sensibly, sought other participants with financial and technical strength to share the cost and risks involved in exploration in this huge virgin area.

As a result, an exploration joint venture was formed with the Burmah, Shell, BP and Chevron groups. This original group has undergone some changes over the years and it now comprises the Woodside Group 50 percent, BP and Calasiatic each 16-2/3 percent, and Shell and BHP each 8-1/3 percent. Shell and BHP each own 21.3 percent of the shares in Woodside with the majority 57.3 percent being publicly held.

Today Woodside has three separate activities which are of interest to the sharemarket – a 50.6 percent shareholding in Vamgas Ltd, an ongoing exploration programme in its own right and the North West Shelf natural gas project.

Vamgas, which has significant current and future production interests in the Cooper Basin and exploration interests throughout Australia, including an interesting play in the Devonian reefs of the onshore Canning Basin, is a story in itself and I do not propose to discuss it today.

Woodside's own exploration activities began with the formation of the Company in 1954 and are for the present concentrated on the North West Shelf.

To date the Joint Venture has completed 68 wildcat wells on the North West Shelf and the results of this exploration have been most rewarding. In the Dampier Sub-basin, major gas fields have been discovered in the North Rankin, Goodwyn and Angel structures. A number of small oil accumulations and related or separate gas/condensate occurrences, with no immediate commercial potential have also been discovered in the same area.

North Rankin is the largest gas field in Australia and is classed as a giant by world standards. Our plans to develop North Rankin, and later plans to develop the Goodwyn gas field, will be the main topic of this talk.

In the Browse Basin, the Joint Venture has made significant gas discoveries at Scott Reef and in Brecknock

No. 1. These merit further investigation and could warrant possible development in the future.

In addition, the Caswell No. 1 well, which was drilled in 1978, encountered an oil show which is regarded as important in establishing that oil has been generated in that Basin.

Our exploration drilling programme for 1982 includes two Browse Basin wells, one of which will be a follow-up of the Brecknock/Scott Reef gas discoveries.

In the Bonaparte Gulf Basin, the Joint Venture has discovered gas in the Troubador and Sunrise structures.

Drilling in the Beagle Sub-basin and the offshore Canning Basin has failed to discover hydrocarbons and our holdings in these areas have been relinquished.

It is evidence of our continuing enthusiasm for the potential of the North West Shelf that the Joint Venture has recently applied for and has been granted renewal of most of the exploration permits to the maximum extent of its entitlement which is 50 percent or slightly more in some cases. In this way, we have retained enough identified prospects to justify a continuous drilling programme on the North West Shelf over the next five years.

At the same time we are looking to new exploration horizons. Late last year, in association with another group, we applied unsuccessfully for rights to explore a new permit in the Gulf of Carpentaria. Early this year we applied in partnership with others for some offshore acreage in the Bass Strait.

Though we are continuing our role as one of Australia's most active oil explorers, the foundation of the value placed on Woodside by the stock market is, I believe, the North West Shelf natural gas project.

I think it would be useful if I first outlined the project to you before going on to talk about the unique steps we have taken to finance our participation in this massive undertaking.

The North West Shelf project is planned to supply gas to the State Energy Commission of Western Australia at a rate of 385 MMCFD for 20 years beginning in September, 1984.

During the two years following 1984, construction of an onshore liquefaction plant will be completed in order to export to Japan six million tonnes per annum of liquefied natural gas (LNG) beginning in 1986.

Over and above this, the project will produce 1.4 million tonnes of condensate per year and 640,000 tonnes of liquefied petroleum gas (LPG). Although these products are really by-products, they are extremely valuable and our 50 percent share of the total production from the integrated project will amount to approximately 320,000 tonnes a year of LPG and 700,000 tonnes a year of condensate. Both products have a ready market.

The major components of the project will be:

- An offshore production platform to be established on the North Rankin gas field, 130 km offshore from the port of Dampier which is now under construction and will be in production in 1984.
- A second platform about 5 km from the first.
- A third production platform to be established on the Goodwyn gas field, approximately 30 km southwest of North Rankin.
- A pipeline approximately one metre in diameter to carry both gas and liquids from the production platforms to the coast at Withnell Bay on the Burrup Peninsula, 10 km north of Dampier. The pipeline will be laid next year.
- A gas treatment complex at Withnell Bay which will produce sales gas, LNG, condensate and LPG. Site clearance for this plant is under way and the contract for the plant itself will be let late next year.
- Storage and shipping facilities for LNG, LPG and condensate.
- Accommodation and amenities for employees in both the construction and production phases and other infrastructure items required to support a complex industrial operation in a remote area. Work on this infrastructure is well advanced and will be substantially completed next year.

A fleet of seven specialised ships to transport the LNG to customers' terminals in Japan is also required.

The contract for the sale of gas to the State Energy Commission of Western Australia was signed on September 30, 1980.

Although we cannot talk of specific figures for reasons of commercial confidentiality it can be said that the price, which includes escalation arrangements, reflects the value of energy more realistically than any previous major gas supply contract in Australia.

The Joint Venturers have already exchanged draft Letters of Intent for the sale of LNG to Japan and we are advised by the negotiating teams that the completion of an agreed Letter of Intent is very near.

The capital cost of the project, including the seven LNG carriers has been estimated at about $5,000 million in

January, 1980 terms. After allowing for inflation over the planned construction period from 1980 to 1992, the final cost is expected to be about $8,000 million in money of the day terms.

However, Woodside's own capital raising requirements have been significantly reduced by an agreement in principle under which we will sell our 50 percent share of LNG production to Hematite Petroleum and Shell Development in equal proportions on an f.o.b. basis, thus avoiding the need to invest in shipping.

Exclusive of LNG shipping costs and interest charges, the total cost of the project was estimated in January, 1980 dollars at approximately $4,000 million for which Woodside is responsible for half.

This cost is expected to be $6,500 million to $7,000 million when allowance is made for inflation over the long construction period. Woodside's task of providing 50 percent of this sum will be assisted over the latter part of the period by the availability of substantial revenues for the project.

It will perhaps be of interest if the phasing of some of the expenditure is outlined a little further before I attempt to explain how we are going about the task of financing our share.

The three production platforms, each of which is likely to cost between $500 million and $600 million in January, 1980 dollars, will be constructed in the period which commenced last year and which will run on until the early 1990s.

During 1982, the major pipeline is to be laid to shore and throughout the period from 1983 to 1986 the onshore plant will be being constructed and commissioned. Each of the offshore platforms will take some four years to complete and it is some measure of the scale of this undertaking that full plateau production will only be reached about 8-9 years after the award of the first construction contracts.

From the point of view of the estimation of the finance required, there are certain important landmarks. These commenced with the award of the first contracts in 1980 and then the further award of major contracts throughout the period of construction.

The maximum cash requirement will come around 1983/84 when full construction of the onshore plant, the jacket and modules of the second platform and drilling from the first platform will be taking place. However, during 1984 another major landmark, a positive one in this case, is achieved when gas sales commence in September.

These domestic gas sales rise to plateau level around the end of 1985. Some six months later the first loading of LNG for export is scheduled. Thereafter LNG exports will build up over a period of two years until full plateau level is reached in 1988.

Major capital investment in the project will still not have finished by that stage and it is only in 1989 that we expect a third platform to have been installed and drilling to have commenced from it.

All of this adds up to a massive financial package phased over a considerable period and one in which the phasing, and the interest related to that phasing, has a considerable impact on the total finance required.

It was from the technical plan that Woodside started around the end of 1978 to contemplate the various possibilities for financing its 50 percent share of the venture.

Quite clearly in looking at this massive sum of money it was going to be necessary in some way to break it down into manageable units and with these in mind from the financing point of view, the project could be seen to have various patterns.

As mentioned, shipping could be clearly identified as a unit of the total project which could, and has been, excised.

Another split within the branches of finance would be seen to lie between the domestic gas contract and the LNG sales.

During 1978 Woodside decided to appoint an independent financial adviser, Morgan Grenfell & Co, to assist in the evaluation of the financial markets and to give its advice on how best to raise the capital.

Various modes of raising the finance were considered but by mid-1979 it was believed that it should be possible to obtain the money from commercial banks in the Euro dollar market. It seemed to many people at that time to be a very optimistic proposition but certain factors were very much in Woodside's favour.

In the first place, the North West Shelf project was an energy related project and during 1979 energy prices were rising fast and there was every expectation that they would stay ahead of inflation.

Secondly, many of the major banks, and for finance on this scale only the largest banks in the world could be considered as lead banks, had already committed large sums of money throughout the world on sovereign loans which had not all turned out as successfully as they might have wished.

Many of those loans had relatively small margins and the banks were coming to the view that although a commercial loan such as one which Woodside might require had a higher risk than one for a Government or Governmentbacked utility, the expected higher rates of return made them attractive.

Furthermore, it was around early 1979 that the Iranian revolution took place and energy projects, particularly those away from the Middle East and non-OPEC countries, assumed a new attraction.

It is perhaps interesting at this moment to get a feel of the type of project loan which had been negotiated by relatively small companies over the previous few years. Some typical loans by minority participants in major North Sea developments up to 1978 were as follows:

In 1974/75 negotiations were completed for a US$100 million limited recourse loan in which participating banks accepted various commercial risks directly related to a North Sea project, but in return for assuming these risks the banks received royalty entitlement in addition to the appropriate margin on the underlying loan.

The same small minority partner in another development structured a similar US$100 million limited recourse loan shortly afterwards but it was cross collateralised on the previous field of development.

In another financing in 1976, a US dollar loan of rather more than US$120 million was negotiated for the minority partner in another major North Sea development. In this case the financing was fully supported by a guarantee from one of the major partners.

In return for the guarantee the major partner received a substantial royalty interest as well as an entitlement to all of the borrower's share of the crude oil produced.

From these three examples, and there are many more related particularly to North Sea field developments, certain features of typical loans available to small companies in the middle to late 70s are apparent.

In the first place most of them were for relatively small sums compared with the Woodside loan – US$100 million to US$300 million.

In the second place there was always a recourse to the assets of the company or guarantees from a parent or partner.

The common feature to the provision of such guarantees is an equity rate of return, frequently designated in royalty terms.

Thus the first major difference which has arisen since the Iranian crisis is a willingness by the banks to accept a far greater risk than had previously been the case.

This feature is not unique to Woodside as there are many loans being negotiated today for energy projects on a non-recourse basis.

During 1979 Woodside and its advisers came to the view that it should be possible to raise finance for Woodside in two stages without recourse and without expensive guarantees either from its major shareholders or from other Participants.

At that time Woodside's estimate of its requirement for the domestic gas phase was something less than $1 billion including interest charges and possible overruns.

With this in mind, a short list of major international banks was selected and they were approached in order to ascertain whether they would be interested in joining a lead group under such conditions.

Eight of those banks formed a lead management group which on October 1, 1980, reached final agreement to underwrite a project financing facility totalling US$1,400 million.

The prime security for this facility, which was subsequently syndicated to 62 banks throughout the world, is the contract which was signed with the State Energy Commission of Western Australia on September 30 last year for the sale of gas to Western Australia.

Another major agreement, also completed a few days before October 1, was the Project Agreement which binds the Participants together and governs their relationships with each other.

Over and above this, there are a series of service agreements by which Woodside obtains technical and commercial services from its major shareholders, BHP and Shell, over a wide range of activities.

The strength of Woodside is very much determined by these agreements because although it is a company which has existed for 27 years and had a small core of its own experienced staff, the expansion into and the scale of the investment and technical sophistication necessary for the development of the North West Shelf could only be obtained from major organisations which have had relevant experience through the world or in Australia.

The enthusiasm of 62 of the world's leading banks participating in the syndication of our Phase I financing, is a sign of their confidence in the North West Shelf project and in Woodside's strength and ability to implement the project satisfactorily.

To date their confidence appears to have been well placed. Our Chairman, Geoff Donaldson, was able to tell our recent annual meeting of shareholders that the project was generally on time and within budget.

Some months ago in an article in, I believe, The Financial Times, Woodside was described as having achieved the financial coup of the year by its impertinence in approaching the world's leading banks for one of the biggest non-recourse financings, if not the biggest, that the world has ever seen.

Today that finance is complete and the money is being spent but Woodside still faces an even bigger challenge.

The completion of the Memorandum of Intent between c.i.f. sellers and the Japanese utilities for the sale of the entire output of LNG from the North West Shelf project will mark a start on the next phase of the project.

That Memorandum of Intent, coupled with the Letter of Intent of the sale of Woodside's LNG to Shell and BHP will open detailed negotiations for financing the next phase of the project.

These Letters and Memoranda of Intent will have to be converted into full sales contracts, which will be the foundation for Woodside to raise between \$3 billion and \$3½ billion for the next phase of the project.

It should be apparent to you that there will be the same complex inter-relationship between the marketing and financing of this second part of the project as there was for the domestic gas phase which is now being implemented so successfully.

The signing of the export M.O.I. will be a very important step, but there are others still to be taken and we do not expect to reach "go" position for the export phase of the project until later this year.

We might have considered that \$1.4 billion was a challenge. \$3 billion is going to be an Everest.

But with the confidence and experience that both we and the banks have obtained working together over the past few years we have every expectation that it can be achieved in time to allow the second phase of this remarkable project to go ahead on time, generating a very significant cash flow in the second half of this decade.

At that stage, and we are very confident that we will reach it, the shareholders who began putting their faith in Woodside so many years ago, and who have continued to support us through many trials, may get their ultimate reward.

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Fellows shall be elected by the Council and every candidate for election to Fellowship shall be an Associate of the Institute, shall be not less than twenty-five (25) years of age and shall meet the requirements set out below.

(i) He shall have been engaged for a period of twenty (20) years in the office of one or more organisations engaged in or associated with the Securities Industry as his chief occupation and shall have been a member of the Institute for a period of three (3) years and shall have for at least three (3) years in the past ten (10) years been a senior executive of one or more organisations engaged in or associated with the Securities Industry provided that in calculating the said period of three (3) years as a member of the Institute he shall be entitled to include any period served as a member of the Australian Society of Security Analysts;

or

(ii) He shall have been a member of the Institute for a period of twenty (20) years and shall have for at least three (3) years in the past ten (10) years been a senior executive of one or more organisations engaged in or associated with the Securities Industry provided that in calculating the said period of twenty (20) years as a member of the Institute he shall be entitled to include any period served as a member of the Australian Society of Security Analysts;

or

(iii) He shall have been appointed President of Federal or Divisional Councils;

or

(iv) He shall have in the opinion of the Council served with distinction the aims and objectives of the Institute for a period of at least three (3) years;

and

(v) He shall satisfy the Council that he is a fit and proper person to become a Fellow of the Institute, both in respect of his own character and in respect of the position which he holds, and he shall furnish the Council with such particulars as it may require with regard to the nature of his duties in the organisation to which he is or has been attached.

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