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Street Sleuth
Woodside Petroleum Encounters Growing Pains

Australian Energy Player Is Learning Tough Lesson In Bid for Global Presence

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PERTH, Australia -- For years, **Woodside Petroleum** Ltd. was a relatively small regional energy company with good natural-gas assets off the coast of western Australia -- and little else.

Then, Woodside went on a world-wide investment spree to diversify. It scooped up assets in the U.S., Libya and Mauritania, and dabbled in places like Kenya and Algeria. Late last month, Woodside offered $883 million for **Energy Partners** Ltd., a New Orleans company active in the Gulf of Mexico.

But like a lot of small and midsize oil companies these days, Woodside is learning a tough lesson: Leapfrogging from regional bigwig to an international oil and gas player isn't easy. Such a move often requires increased involvement in oil-rich but politically unstable countries, or in technically challenging regions requiring big budgets. While the major oil companies have the deep pockets and broad presence around the globe to weather potential problems, smaller operators face greater risk.

For example, Woodside's shares fell 2.8% to 36.61 Australian dollars (US$27.54) in Australia Friday over investor concerns about its Energy Partners bid. Energy Partners late last week rejected the offer, raising concern among investors that Woodside may have to increase its offer.

The company's first big conquest was supposed to be Mauritania, a former French colony south of Morocco. Along with two junior partners, Woodside invested about $700 million to develop the country's first significant oil field, an offshore deposit known as Chinguetti.

But in August last year, a military junta unseated the Mauritanian government in a bloodless coup and refused to recognize Woodside's production contract. The Australians had to pay $100 million to get a new one. A few months later, production kicked off at Chinguetti at close to its capacity of about 75,000 barrels a day -- and then promptly nose-dived to about 35,000 barrels. Technical problems lifting the crude were to blame.

Woodside downgraded its overall 2006 production forecast by 5% and said Chinguetti would need additional investment to reach its estimated potential of around 75,000 barrels a day. Also, a string of new exploration wells Woodside drilled in the area have come up dry, casting further doubt on its efforts outside its comfort zone.

Thanks to its big Australian holdings, "there's no question that Woodside is one of the rising stars" of midsize oil and gas companies, says **Alex Gorbansky**, managing director of **Frontier Strategy Group**, a Cambridge, Mass., advisory firm. But when it comes to promising, high-risk places such as Africa, "they're still a fairly small player," he says, with less political clout and financial heft than their rivals. "How do you acquire the expertise to work in a place like Mauritania when you're really used to operating in a pretty safe area like Australia?" **Mr. Gorbansky** asks.

Many other small and midsize oil companies are awash in cash as high oil prices boost the value of their existing holdings. But it's difficult to effectively invest that cash at a time when asset prices are high and low-risk areas are already picked over. These companies include national oil producers such as Oil & Natural Gas Corp. of India and **Inpex Holdings** in Japan, which are seeking new energy reserves for national-security purposes, with mixed results.

Some analysts speculate that Woodside -- which earned A$1.1 billion (US$827.5 million) last year on production of about 59.7 million barrels of oil equivalent -- could become an acquisition target because of its foothold in Australia's low-risk operating environment. But the Australian government may block an attempt. It rejected a takeover attempt by what is now **Royal Dutch Shell** PLC, which already owns a 34% stake in the company, on national-security grounds in 2001.

Woodside Chief Executive Don Voelte says "any company that has all its eggs in one basket ultimately gets burned." Mr. Voelte, an American who joined Woodside in 2004 after working at Mobil and Atlantic Richfield, believes demand for Australian gas is likely to stay strong. But he says it could "go south really fast" if major Asian economies begin to stumble.

Mr. Voelte says he's "disappointed" in the outcome so far at Chinguetti but believes the investment has been worthwhile.

A Woodside deal for Energy Partners could help even out its risk profile by boosting the company's presence in the Gulf of Mexico. Owning Energy Partners would increase Woodside's daily production by about 30,000 barrels of oil equivalent and give it access to further exploration opportunities in the Gulf region.

But while many analysts applauded the bid, some have questioned whether Woodside is once again taking too much risk by buying at a time when asset prices are high.

Woodside is proceeding with exploration elsewhere, including Libya. It says it intends to spend more than A$500 million on exploration this year, an increase of more than 40% from last year.

Woodside still has a comfortable cushion of backyard gas to fall back on. The company is putting on the fast track development of a multibillion-dollar offshore field called Pluto. Woodside is also among several companies that are expanding the so-called North West Shelf gas project, which Woodside operates, in the same area. But Woodside recently disclosed cost overruns at the North West Shelf as the cost of producing oil and gas world-wide soars because of heavier outlays for raw materials, labor and fuel.

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