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Conference Call Transcript

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PRESENTATION

Operator

Thank you for standing by, and welcome to the Santos full year results conference call. At this time, all participants are in a listen-only mode. There will be a brief overview of today's announcement, followed by a question and answer session (OPERATOR INSTRUCTIONS). I must advise you, this conference is being recorded today, Thursday, February 21, 2008.

I would now like to hand the conference over to your facilitator today, Andrew Seaton. Please go ahead, sir.

Andrew Seaton - Santos Ltd. - Executive of IR

Yes, good morning all, and thank you for joining the call. With me here in Adelaide is John Ellice-Flint, our Chief Executive and Peter Wasow, our CFO. As the conference administrator said there, we'll have just some brief opening remarks by John and then we'll throw the floor open to Q&A. The assumption here is that people have the presentation that we gave and have already viewed the webcast by now, so, over to you, John.

John Ellice-Flint - Santos Ltd. - CEO

Thanks, Andrew. I'd just like to spend a couple of minutes to give the highlights from today's announcement. Production was in line with the guidance that we gave this time last year, and continues the trend of us being able to deliver on what we say; three years in a row that we've been able to meet what our production guidance was. EBITDAX is in line with consensus.

Net profit is down but, however, it's been affected by the industry cost inflation, leading to higher depreciation, higher taxes and a strong dollar -- Australian dollar. The -- it's the fourth consecutive year of reserve growth, average over 200% reserve replacement ratio. And, very importantly, these reserves have been put back on -- put onto our books at low reserve replacement costs.

In terms of the outlook, in the short term, we see a return to production growth in 2009 as our new projects come online. And in the medium to longer term, we see exciting opportunities for gas in Eastern Australia, as the volumes that we see in Eastern Australia has outgrown the market. And, of course, Santos is by far the largest share. We've got enough gas to supply Eastern Australian gas for over 100 years at the current and expected demand rates.

[Glads] in LNG will be key to us receiving global parity gas prices with the strong demand we've seen up from that project from Asian and North American buyers. These developments should see a transformation in the value of our total reserves.

With that, I will hand over to you all for questions and answers. Thank you.

QUESTION AND ANSWER

Operator

We will now begin the question and answer session. (OPERATOR INSTRUCTIONS). Your first question comes from Mark Greenwood from JP Morgan. Please ask your question.

Mark Greenwood - JP Morgan - Analyst

Good day, John. I've just got a question on the slide 18 that points out the targeted 300% reserves growth. I was wondering if you could step through that in terms of the timing and the contributions. I assume included in that is PNG, LNG and [Glads] LNG. Does that include any expected reserve growth from the Cooper Basin in anticipation of higher prices, and are there any other elements that we're missing?

John Ellice-Flint - Santos Ltd. - CEO

Yes, we can go through that in detail. And Pete will go through that.

Peter Wasow - Santos Ltd. - CFO

Mark, what we did to construct that chart was take our opening reserve, 2P reserve position, of 879m barrels and then look at our existing contingent resource on a -- what we call a 2C or, most likely, basis and book the resource according to the FID schedule which is included in the catalyst slide. So, for example, we've got FIDs for PNG, LNG in 2010. And so we've booked --

John Ellice-Flint - Santos Ltd. - CEO

Late 2009.

Peter Wasow - Santos Ltd. - CFO

Late 2009, sorry. So we've got that booked. Actually, in this slide it's booked as 2010. And then for coal seam gas, what we've done is to not book it at one moment like that. We've actually taken our reserves build profile from the 2C book that we have and get that in through time. And we've also got a late booking in there for Darwin LNG, although that's much more difficult to be precise in terms of when the FID decision will be. So we've put that in in the 2012 timeframe.

Mark Greenwood - JP Morgan - Analyst

Okay.

Peter Wasow - Santos Ltd. - CFO

I wouldn't take that as our forecast of when FID would be. It's just -- it will be in this timeframe --

Mark Greenwood - JP Morgan - Analyst

Sure.

Peter Wasow - Santos Ltd. - CFO

-- in that year.

John Ellice-Flint - Santos Ltd. - CEO

To answer another part of Mark's question, the answer is no, we haven't taken any for any price improvements for any added reserves in the Cooper Basin. That's an additive to --

Peter Wasow - Santos Ltd. - CFO

That's right, and there's no discoveries required. It's just straight booking of contingent resource that's on our books today.

Mark Greenwood - JP Morgan - Analyst

Okay. And one follow-up question, if I may. On slide 32, you highlight a number of the growth projects you're pursuing. And I'm just curious -- you sort of grouped them there in terms of CapEx. I'm just curious about whether that is meant to be CapEx on a Santos share basis or on a gross basis. And I'm particularly interested in the expected future investment in Chim Sao, in Vietnam and also Cooper Oil. You've indicated AUD500m to AUD1b. Is that Santos share or on a gross basis?

Peter Wasow - Santos Ltd. - CFO

Those are Santos share numbers. And the exact amount at Chim Sao is subject to the development studies that are underway at the moment.

Mark Greenwood - JP Morgan - Analyst

Okay, great.

John Ellice-Flint - Santos Ltd. - CEO

There should be an update on that in the next couple of weeks. I think Premier are coming out with their half-year results.

Mark Greenwood - JP Morgan - Analyst

Okay. And there might be an estimate of the CapEx, is that right?

John Ellice-Flint - Santos Ltd. - CEO

Yes. They're having TCM meetings -- TCM and ACM meetings this week, Mark.

Mark Greenwood - JP Morgan - Analyst

Great. Okay, thank you.

Peter Wasow - Santos Ltd. - CFO

As operator, we will go with those numbers. We've obviously got people on the team, but that's -- you'll get an update then.

Mark Greenwood - JP Morgan - Analyst

Great, thanks.

Operator

Your next question comes from Anthony Bishop of Goldman Sachs. Please ask your question.

Anthony Bishop - Goldman Sachs - Analyst

Good morning, men. Just in relation to slide 18 again, you've identified the projects. Is it possible to give me an idea of what you're contemplating in terms of prices to be received to make those contingent resources reserves for each of those projects? What are you assuming in terms of your likely --- I know you have given some idea with your net gas pricing slide. You've got as good a guide as anything we can use.

John Ellice-Flint - Santos Ltd. - CEO

Well, for the LNG projects, we calculate the economics of LNG projects using an estimate of WTI and an estimate of the beta. We've shown the assumptions that we've made to calculate these charts at the bottom of that page. And I just make the point that both the WTI estimate and the beta estimate are quite conservative on today's -- in today's market.

Does that answer your question, Anthony or --

Anthony Bishop - Goldman Sachs - Analyst

I'm just turning to slide 18 to have a quick look.

John Ellice-Flint - Santos Ltd. - CEO

It's there in the notes on the bottom left-hand corner. (Multiple speakers).

Anthony Bishop - Goldman Sachs - Analyst

I take it in beta you're referring to is the gradient of the LNG pricing curve. Is that what you're saying?

Peter Wasow - Santos Ltd. - CFO

That's right. Yes, we have. Yes.

Anthony Bishop - Goldman Sachs - Analyst

Okay. All right. (Multiple speakers). Thank you.

Peter Wasow - Santos Ltd. - CFO

For LNG projects, that's the price that's being used in the revenue chart on the right.

Anthony Bishop - Goldman Sachs - Analyst

Yes. And for any other CSM developments, you mentioned that you've booked the reserves as you build your -- as you build the profile that's not attached to an FID per se.

John Ellice-Flint - Santos Ltd. - CEO

Well, next -- I think that's an important point. But for the next two years we don't -- we can -- we are developing our coal seam gas position and we are very much of the mind that we will export it. But we have the opportunity to sell that gas into existing domestic markets. So we're not relying on project sanction to book those reserves as we delineate them.

Obviously, if we are able to have a project sanction, then the value of those reserves will be greatly augmented.

Anthony Bishop - Goldman Sachs - Analyst

Okay. So you haven't necessarily assumed a domestic gas price to book those reserves. It's really based on LNG at this stage though?

John Ellice-Flint - Santos Ltd. - CEO

Well, we've -- the bookings that are necessary in that chart, before FID on Gladstone, would be using our existing contracted prices, so it's not -- we're not using greatly inflated gas prices to justify bookings of coal seam gas in '08, '09 and '10 under our conventional contracts.

Peter Wasow - Santos Ltd. - CFO

Yes, into our existing contracts. Once we've reached FID, we'll have a gas sales agreement. We'll have the whole suite of things that we need to have sufficient certainty about what the future processes of those sales will be.

Anthony Bishop - Goldman Sachs - Analyst

Okay. You mentioned the three projects, PNG, CSM and Darwin LNG in terms of pushing up that -- I think it was production growth by around 70%. Are there any other projects in there -- and I assume this is your total Company production estimate going out into the future.

Peter Wasow - Santos Ltd. - CFO

That's right. I'd make a couple of points, though. The 70 -- production grows by 70% because we've assumed an FID in the year of 2012 for Darwin LNG2 from Caldita and Barossa that, therefore, doesn't really reflect significantly in the sales volume because it will be a later sale.

And then the second thing I would make is that this doesn't require exploration success. It does require development success and delineation success, but it's not heavily dependent on new discoveries.

Anthony Bishop - Goldman Sachs - Analyst

Yes, I understand. So are there any other major projects you'd want to draw our attention to that make up that production profile?

Peter Wasow - Santos Ltd. - CFO

Well, the ones that are obviously closer in are Henry, which will be impacting us as early as next year. We also have a significant ramp-up in coal seam gas production, which 2007, 2008 will be the trough year in our Eastern Australian gas sale.

So as we continue to develop Fairview it will initially be sold in domestic gas markets and then [on the] export markets. So that's a part of the production growth story. And then in '10, we have the other projects coming on -- in '10 and '11 we have the other projects at Kipper and Chim Sao coming on

John Ellice-Flint - Santos Ltd. - CEO

Plus Reindeer.

Peter Wasow - Santos Ltd. - CFO

Yes, Reindeer. And plus the satellites around our discoveries in Vietnam.

Anthony Bishop - Goldman Sachs - Analyst

And what's the underlying production in assumption for growth out of the Cooper oil optimization program, because that could potentially be significant?

Peter Wasow - Santos Ltd. - CFO

Well, what we've put in the slides is a production estimate of 12,000 barrels to 14,000 barrels today on average, net for Santos over the whole year.

Anthony Bishop - Goldman Sachs - Analyst

That's for '08, but beyond that?

Peter Wasow - Santos Ltd. - CFO

We're looking at a small increment in this chart over and above that number. And in fact --

John Ellice-Flint - Santos Ltd. - CEO

And a lot of that depends, Anthony, on -- what we want to do is get pattern drilling. So this year we are doing a lot more exploitation with -- basically we -- for us, we're actually putting a lot of money into CSG and LNG. And so we're moving capital from there and we've got -- you will see the wells that we're drilling in Cooper Basin are more on the western margin. And so that's the program.

And then when we have discoveries -- if we find new pools, we're going to get back to what we initially had in mind, which is to go out there and get one rig and pattern drill that up and bring that field on and tie it back. So it truly is scaleable.

Anthony Bishop - Goldman Sachs - Analyst

Okay. All right. Just another question. In relation to something Andrew picked up earlier, Mutineer-Exeter we saw an impairment charge of AUD48m on the Santos Limited account, but in the consolidated account it's not there. Can you just -- I'm sure there's a simple explanation, but can you just explain to me how that occurs on the Santos Limited account but not on the consolidated account?

Peter Wasow - Santos Ltd. - CFO

Yes. That was as a result of -- we transferred the Mutineer asset between subsidiary companies over the last couple of years for a variety of different reasons. And what that meant was that when you transferred the asset a couple of years ago, it was transferred at the then current market price -- at the then prevailing NPV of the asset.

But I just have to point out that, while there is an impairment at the subsidiary company level, it's completely eliminated at the consolidated level. So it's only the fact that the subsidiary company that we transferred it out -- that we transferred it into is one of the subsidiary companies that we actually report separately from the consolidated or, in fact, the holding company that we report separately from the consolidated result. So I would just ignore it. It's an accounting adjustment not affecting the consolidated result.

Anthony Bishop - Goldman Sachs - Analyst

So it doesn't foreshadow any potential impairment of that asset going forward?

Peter Wasow - Santos Ltd. - CFO

No, not at all.

Anthony Bishop - Goldman Sachs - Analyst

Okay.

Peter Wasow - Santos Ltd. - CFO

That would not -- that's a long way from being impaired, that asset.

Anthony Bishop - Goldman Sachs - Analyst

Okay, thank you. Just a final question. In relation to -- look, I like the opportunity that Gladstone LNG brings the Company. What I would personally like to see is that you bring in a strong partner that can help you on both the operational side of the LNG facility and also marketing. I think that would be a good fit.

Can you just talk around what sort of equity levels you would be prepared to take, whether you would relinquish operatorship of the downstream facilities in -- if you were to get the right partner? And, yes, just getting back to any discussion that you can highlight in terms of potential partnering opportunities.

John Ellice-Flint - Santos Ltd. - CEO

There's a lot of if's in that question, Anthony.

Anthony Bishop - Goldman Sachs - Analyst

That's the nature of the project, I think, John.

John Ellice-Flint - Santos Ltd. - CEO

I don't think so at all. It's a fantastic project. It's very exciting. We've got the land. We've got the port. We've got, obviously, a lot of labor [and] adjacent to it, so it's got a lot of things going for it. And it's got, basically, a feedstock with zero too, so there is some of the highlights of why I like that. In terms of partnering, it's very rare that a Company of our size gets something where you've got 100% of and so we're going and looking at partners.

I suppose the history of Santos is that we've -- people mentioned this when we went offshore with Mutineer-Exeter. We were able to put Mutineer-Exeter as an FPSO. We're basically known as an onshore Company. We were able to put that in the top [gecile] of projects worldwide. So I've got a lot of confidence in our project management skills.

But that being said, we're also looking at options for partners. As long as it makes shareholder value, we will look at that. And we'll take a number of parameters that you mentioned into account when we make those decisions. But it will have to be truly value-adding for the shareholder.

Peter Wasow - Santos Ltd. - CFO

I'd just add to that that there are no shortage of people seeking to partner with us. No. I think that the demand has been immense, from national oil companies to super-majors.

Anthony Bishop - Goldman Sachs - Analyst

And in terms of your initial marketing discussions, is there any reluctance to take on CSM as a feedstock gas for an LNG plant? Has that been of some concern to the buyers and is that likely to translate into pricing discussions?

Peter Wasow - Santos Ltd. - CFO

No, we haven't seen that at all.

Anthony Bishop - Goldman Sachs - Analyst

Okay. Best of luck, but I think it's going to be interesting to see how you go. I think it's certainly a great opportunity for the Company. Thanks, John.

John Ellice-Flint - Santos Ltd. - CEO

Fine.

Operator

Your next question comes from Stewart Baker of Morgan Stanley. Please ask your question.

Stewart Baker - Morgan Stanley - Analyst

Excuse me. Morning, gentlemen. Just another question on Gladstone. Yes, I concur with everyone else, it looks like a great opportunity and just wanted to know a little bit more about what the CapEx might look like for that.

I don't know whether anything is being put out there or not. We do see anecdotes elsewhere from the industry and those CapEx pressures have yet to abate. I'm just wondering if there's a loose figure running around of what it all might cost to pull together, whether that's 5b, 10b, 15b or whatever. Can you give us any guidance on that?

John Ellice-Flint - Santos Ltd. - CEO

No, Stewie. The only -- we've come out and said that the 7b were in pre-engineering right now with major the contractors and, subject to more work, basically. And once we get that initial engineering, we'll come out with a figure. We've actually -- we've got milestones in milestone slide. What slide is that number? 32? No, it's not 32 is it? Oh, the Gladstone LNG.

Unidentified Company Representative

: Yes, Gladstone LNG one. That's slide 29.

John Ellice-Flint - Santos Ltd. - CEO

On slide 29. Did you see that one, Stuey?

Stewart Baker - Morgan Stanley - Analyst

Good day, John. There's a lot of stuff to look at (multiple speakers).

John Ellice-Flint - Santos Ltd. - CEO

Okay. I've got -- I'll help you through it. So it says the pre-feed contracts to be awarded by Q1 2008.

Stewart Baker - Morgan Stanley - Analyst

Right, yes.

John Ellice-Flint - Santos Ltd. - CEO

And that's where you've got the major contractors all doing that engineering work. That's well advanced.

Stewart Baker - Morgan Stanley - Analyst

Right. Second question leading on to that then is, as you move through that process in terms of then lining up what you need to do to get it working, which is gas contracts, bankability, etcetera, and probably proving your reserves, I'm just trying to understand the sequencing of how you manage that. Presumably, you have to drill a whole bunch of wells first, [take] water, prove the deliverability. I just wonder if you can walk us through that sequence as to what you have to do before you can write a bankable gas contract.

And secondly, what you do with the ramp-up gas. Presumably, at some point when you turn the project on, you've got to have 500m or 600m scuffs of gas ready to go. Just wondering how you manage all that.

John Ellice-Flint - Santos Ltd. - CEO

There's a couple of things there, is that -- and we mentioned it -- I can't remember if it was a year ago or six months ago. And there was a feeling in the industry that you couldn't shut in CSG wells and bring them back on.

It varies from field to field. Some of our fields you can shut in and we've been looking at that. Because that was one of the big concerns for us is how much we could take for our CSG and be able to put it into our contracts. And as you know, we've been flying CSG molecules from east to west and shanding them and selling them throughout Eastern Australia for, I suppose, a year now.

So that's one issue. But that, for us, is the beauty of it because it adds NPV, it's unique to Santos because we actually have got long-term contracts that we can put that ramp up gas into. In other parts of our portfolio we can shut the wells in and bring them back on. So that's quite exciting news for us that we've actually got that option to do that.

Stewart Baker - Morgan Stanley - Analyst

Thanks. And just moving on to a second thing, I haven't been able to figure it from the slide yet. It might have been asked before. It was just that the CapEx from Vietnam, I was going to ask further about the flow rates and the timing as well. But I presume that -- I guess your observation was we should look for Premier for that. Is that correct?

John Ellice-Flint - Santos Ltd. - CEO

We will come out at the same time as Premier, yes. That work is currently ongoing and we'll give you an update as soon as the work's finished.

Stewart Baker - Morgan Stanley - Analyst

Okay. Final question then, I think, and it's been --

John Ellice-Flint - Santos Ltd. - CEO

I suppose there's other stuff there that you'd be interested in; the results of the seismic that we shot last year etc. So there will be a total update.

Stewart Baker - Morgan Stanley - Analyst

Good. Just flip one through on the fax; I'll have a squint at it.

John Ellice-Flint - Santos Ltd. - CEO

Yes.

Stewart Baker - Morgan Stanley - Analyst

Final thing. Just looking at the production again, on chart 18, people have asked it. I guess the more direct question is it's hard to see the production growth in the near years, '08, '09. Yes, Kipper, Reindeer Vietnam is out there and the next chunk you could turn them on in '10, '11.

Between now and then, frankly, my model tells me production is going down because of just natural decline from everywhere. And it looks like less contribution from the Cooper program than we'd expected. And I'm just wondering what I'm missing and whether it's in terms of gas production. I've got gas production rolling off just a bit until those projects come in.

John Ellice-Flint - Santos Ltd. - CEO

Sounds like where you might be out, Stewart, is on your estimate of coal seam gas production, which are significant as we ramp -- as we have been spending money, as we continue to spend money this year on further development activity.

Stewart Baker - Morgan Stanley - Analyst

Right.

John Ellice-Flint - Santos Ltd. - CEO

That's probably most definitely it. You know that we're the first Company to have produced over 100 at the moment.

Stewart Baker - Morgan Stanley - Analyst

Right. I'll have a look at that. I did -- I thought I had factored in what was shown as prior guidance, but it may well be that's out of date.

John Ellice-Flint - Santos Ltd. - CEO

And we've probably spent more money in the last half of this year in CSG plus --

Peter Wasow - Santos Ltd. - CFO

By next year we'll be ramping up to 115 kilojoules a day out of Fairview, so that's the next milestone.

Stewart Baker - Morgan Stanley - Analyst

So that's '09 is it, or '08?

John Ellice-Flint - Santos Ltd. - CEO

'09.

Stewart Baker - Morgan Stanley - Analyst

Right.

John Ellice-Flint - Santos Ltd. - CEO

So -- and that's Fairview alone.

Peter Wasow - Santos Ltd. - CFO

I think there's also, Stewie, there's -- the Maleo field is still choked back in Indonesia. So we can see that going back to its design production rates rather than being restricted. Also growth in Cooper Oil, as Peter said earlier.

Stewart Baker - Morgan Stanley - Analyst

Okay. Thanks, gentlemen.

Just one final question, which is probably a little bit more strategic. I guess, like most people, we see the export opportunity; it looks a good one. I'm curious as to your Press Release then, which indicates that as part of your future strategy going forward you might seek to fund a part of it through portfolio rationalization.

And I'm just wondering to what extent that portfolio rationalization might look. Because the problem a lot of investors have is the export opportunity looks good, but to access it you get a lot of other stuff, you know, bits and pieces of oil offshore WA. And, frankly, people see better leverage or whatever else in other stories, rightly or wrongly.

I'm just wondering how seriously the Company's thought about really making, or becoming more of a pure play LNG producer?

John Ellice-Flint - Santos Ltd. - CEO

As the portfolio unfolds I'm thinking you're going to see that story. You saw it with us getting -- selling the assets in the United States. You've seen us spring back and pull back to South East Asia. And as we're moving funds from one area to another, [it's] the highest value part of the portfolio that makes sense. I think you're going to continue to see that.

And the note in the Press Release was in reference to partnering, as the previous discussion took place, Stewie, with Gladstone LNG, for example.

There's no question we've got to concentrate on our capital, concentrate our capital on where the upside is the greatest and, therefore, expose our shareholders to the most amount of upside. And there are certainly assets in our portfolio which are not material to the strategy that we outlined today.

Stewart Baker - Morgan Stanley - Analyst

Right. Okay. Thanks, gentlemen. That's it from me.

Operator

Your next question comes from John Hirjee of Deutsche Bank. Please ask your question.

John Hirjee - Deutsche Bank - Analyst

Morning, gentlemen. I also have a question along the line of LNG. I'm trying to get a hierarchy of how your LNG projects stack up. I'm looking at slide 32, the catalysts, and I note that Darwin LNG is absent from that. So can we assume from that that, therefore, Darwin is bottom of the tree in terms of your LNG hierarchy of projects?

John Ellice-Flint - Santos Ltd. - CEO

I think it's quite interesting John that -- as you are aware, technical work is going on all the time.

John Hirjee - Deutsche Bank - Analyst

Yes.

John Ellice-Flint - Santos Ltd. - CEO

And as discussions go with the operator and where the operator is at, so we'll be working one minute with ExxonMobil in PNG, the next minute with ConocoPhillips. They're doing work all the time, a lot of it in The States and keeping us up to speed. But there is a lot of work going on in the Timor Bonaparte. That's all I can release at this stage, until we come out with a definitive bid.

So some of the things I can talk about is that we shot for Australia's largest [3D] over the whole area. That has been interpreted. And that was to look at the volumetric distribution. And also at the same time, as there's been a step change in the oil price and therefore, consequently, the change in LNG price, that brings things into view, such as Petrel/Tern where we've got a large percentage of, and we've got somewhere between 1.5 and 2 tcf and developments in floating LNG. All those things are continually being re-evaluated as we look at the assets.

John Hirjee - Deutsche Bank - Analyst

All right. Yes. I understand that.

Then a follow-on question, then, directed at Peter. In terms of funding all of this LNG development, CapEx heavy, and at the moment you're 100% for Gladstone and I understand you're looking at partners, what are some of the funding options you're considering, Peter, in terms of this, because I imagine it's going to be multiples of what you're projecting for 2008?

Peter Wasow - Santos Ltd. - CFO

Yes, just to finish off on that last question, we've put on that catalyst slide the things that we're planning to deliver in '08 and '09 that we have high confidence around. And we want to make it clear that we believe that there is high confidence around PNG and GLNG FEED and FID decisions and, therefore, we were able to communicate those to the market. We don't have that same clarity about when those dates will be for our Darwin LNG.

John Hirjee - Deutsche Bank - Analyst

All right.

Peter Wasow - Santos Ltd. - CFO

At this stage.

John Hirjee - Deutsche Bank - Analyst

Yes.

Peter Wasow - Santos Ltd. - CFO

But going on to your actual question, our objective in funding the de-risking phase of the project is to do so from cash flow, or from assets which aren't material to the strategy. So just saying that another way, what we want to do is not be in a position where we need to seek equity prior to the point where we've significantly de-risked the project.

Once we reach a final investment decision, and we're faced with the challenge of funding two probably, at least two, LNG projects simultaneously, we'll then have to address that. But in the meantime, we're not seeking to raise any funds from external sources to take us through until the end of 2010.

John Hirjee - Deutsche Bank - Analyst

All right. So, on that note then, in terms of gearing levels what should we take away as the comfort level that you're prepared to go up to, to fund all of these projects?

Peter Wasow - Santos Ltd. - CFO

Well, our capital management strategy has always been to maintain fairly conservative gearing numbers so that we can take advantage of opportunities and this is one of those opportunities. So when you're faced with an opportunity like this, that means you're probably -- it's one of those times when you go closer to your limits than you would otherwise like to.

John Hirjee - Deutsche Bank - Analyst

Yes.

Peter Wasow - Santos Ltd. - CFO

We've talked about a 45% gearing ceiling in the past. And in terms of cash flow to debt kind of a 40% level is where the rating agencies would see our rating capped out. So we're -- we also have, as a strategic objective, to maintain our credit rating.

John Hirjee - Deutsche Bank - Analyst

Right. Okay. Thank you, Peter. That's it from me.

Andrew Seaton - Santos Ltd. - Executive of IR

Thanks, John.

Operator

Your next question comes from Andrew Blakeley from Macquarie. Please ask your question.

Andrew Blakeley - Macquarie Securities - Analyst

Good morning, gents.

Andrew Seaton - Santos Ltd. - Executive of IR

Morning.

Andrew Blakeley - Macquarie Securities - Analyst

Just following up on a similar theme with regard to the LNG project. Can you give us just some sort of guidance? Obviously, you've done preliminary work using your capital cost and outlook for price, as to what you generate internally with regard to an IRR, because obviously Woodside has given guidance as to what their IRR for Pluto is looking like it could be. Do you have a similar guidance?

John Ellice-Flint - Santos Ltd. - CEO

We are not in a position to give an IRR estimate for the project. But if you think about it, you have to ask yourself what are the things that will make the project more or less successful than the average project? And there are some things that mitigate against a higher rate of return, some things that mitigate for a higher rate of return.

So it's very difficult in the world of LNG where the amplitude of the cost and revenue curves, or the volatility is so great that it's -- any moment you snap the [torque] line the result you get then is not really going to be very indicative of what the full life cycle rate of return on the project will be.

And the other thing I'd mention is that if you focus only on the rate of return of the LNG project, you actually miss half the story. We're in a situation where if we are able to make the LNG project work, we not only get the opportunity to sell the coal seam gas at higher prices and at higher rates and at bigger volumes, we also get the benefit of having the re-rating in the value of our Australian gas business.

So, for us, the rate of return would actually be sensational if you measure it in terms of impact on the overall business instead of just focusing on impact of the LNG project alone.

Peter Wasow - Santos Ltd. - CFO

The other point to make there, Andy, as well is that independent studies by people like Wood Mac have compared GLNG with Pluto and have found that the GLNG compares favorably on an IRR basis.

Andrew Blakeley - Macquarie Securities - Analyst

But I think you'd have to admit that their capital cost structure is a little bit more locked down than the guidance that you've been giving so far.

Peter Wasow - Santos Ltd. - CFO

Oh, no question. They've placed --

John Ellice-Flint - Santos Ltd. - CEO

[Further into their] engineering.

Andrew Blakeley - Macquarie Securities - Analyst

And just on that actually, in terms of the forward-looking schedule, you've given guidance of a 12 month feed, which is obviously considerably more rapid than any of the other projects. Is that something that you're comfortable with?

John Ellice-Flint - Santos Ltd. - CEO

Yes, because we've been doing a fair bit of work. It's how much of work you do, engineering work you do before you actually get into it really.

Andrew Blakeley - Macquarie Securities - Analyst

Okay. And I guess the last question on Gladstone is there's obviously a lot of competing projects, all looking for a home in Gladstone. Do you think that all four of those projects can get started up in the timelines which have been provided, which is all sort of 2012 to 2014?

John Ellice-Flint - Santos Ltd. - CEO

Some of them are different, Andy. Obviously, the 1m metric tonne proposal is different to the 3m -- the [two] that are talking about 3m metric tonnes and above. I think that the market will eventually sort that out. We know that we've got our land position. We're comfortable with that. We've got significant involvement with the Queensland Government. And the others have got a vision and it's up to them to deliver on that. But the onus is on us to deliver on what we're doing.

Andrew Blakeley - Macquarie Securities - Analyst

So at this point --

John Ellice-Flint - Santos Ltd. - CEO

But we've always said that we'd be prepared to look at -- if it ends up into a Santos LNG park and there's third party gas, then that's a good thing as well.

Andrew Blakeley - Macquarie Securities - Analyst

So at the moment when you look at it, you would consider yourselves to be ahead of the competition?

John Ellice-Flint - Santos Ltd. - CEO

No. We know that we've got goals out there and we're going to deliver on our goals and make sure that we stay focused on what we've got to do.

Maybe I can answer that a different way. We feel like we are in a pretty good position in the event that there is some form of consolidation to influence the outcome.

Andrew Blakeley - Macquarie Securities - Analyst

Okay. I'm just thinking about it, in terms of the overall supply capacity, there's going to be a lot of activity to firm up supply capacity for what looks to be close to 10m tonnes per annum total.

John Ellice-Flint - Santos Ltd. - CEO

Yes that --

Andrew Blakeley - Macquarie Securities - Analyst

And so if some of those projects don't get up, then there's obviously sufficient spare capacity looking either for a third party access or for a domestic market.

John Ellice-Flint - Santos Ltd. - CEO

Yes. That's right, and some of that rationale is -- of why we've taken interest in a specialized CSG drilling company. Because we looked at where the bottlenecks could potentially occur in this supply chain. So we've looked at all those areas. And you've seen us take a big jump on maturing our resources to reserve conveyor belt.

Andrew Blakeley - Macquarie Securities - Analyst

Okay.

John Ellice-Flint - Santos Ltd. - CEO

To ensure that we've got the supply ready by the time the plant is there.

Andrew Blakeley - Macquarie Securities - Analyst

Okay. On a slightly related, but not completely (inaudible), when you look at the charts that you've given in terms of your expectation for production ramp up, I was a little bit confused.

I wasn't sure whether maybe I missed the point a little bit, but in that forecast production ramp up I think you talked about -- I think Andrew threw out a number of Fairview kilojoules per day in the 2009 target. But then in another part of the conversation you were talking about the fact that you would be shutting in production during the ramp up phase.

And so I was wondering whether or not that production assumes a shut in, whether it's a Fairview of your other parts of your portfolio, or whether that includes all of those fields producing at capacity.

John Ellice-Flint - Santos Ltd. - CEO

Yes. I'll just try and clarify that bit. You have -- we have now technically got the option to shut in. Before there was a concern generally in the industry that you couldn't shut CSG wells in because the water would come back. So that's what I was trying to explain there. In some fields we have actually got the opportunity to do that. So that gives us another option that we didn't talk about a year ago.

Andrew Blakeley - Macquarie Securities - Analyst

But the production profile assumes that all the ramp up gas goes into the domestic market?

Peter Wasow - Santos Ltd. - CFO

Yes. But, Andy, as you -- let's say the focus for Fairview will be on initially --

John Ellice-Flint - Santos Ltd. - CEO

Getting to 115 --

Peter Wasow - Santos Ltd. - CFO

Getting to 115 kilojoules a day because that is what we need for our existing contracts and for the domestic market. Beyond that, our focus will be on converting 3P and contingent resourcing to 2P ahead of the FID decision on Gladstone LNG. The development of the ramp up gas then follow FID, so there will be some through that appraisal phase. But then the real hard yards on the development will come following FID before start up of the project.

And at that time, as John said, there is turn down in some of the wells and there is the ability to shut some of the wells in. At the same time, we'll be backing out gas from the rest of our portfolio, so substituting ramp up gas into existing sales contracts that are serviced by coal seam gas.

John Ellice-Flint - Santos Ltd. - CEO

I suppose we don't know, we're not clever enough to know, but by then I would imagine that the carbon -- there will be a price on carbon, there will be a price on water and there will be huge demand for gas by generation as well. So I see a step change also in the domestic demand.

Andrew Blakeley - Macquarie Securities - Analyst

So, sorry if I'm laboring the same point again, but once you get to the 115, which is the 2009 target, on that production profile between 2009 and 2014, does it include an assumption that some ramp up gas will be shut in?

Peter Wasow - Santos Ltd. - CFO

Yes.

John Ellice-Flint - Santos Ltd. - CEO

Yes.

Andrew Blakeley - Macquarie Securities - Analyst

Okay. So it's not that all the ramp up gas is in that production forecast?

John Ellice-Flint - Santos Ltd. - CEO

No. You're right. But then that gives us the option, as I just mentioned, right in this particular model that's shut in, but also we expect demand to be picking up for gas-fired power generation which is not in the model.

Andrew Blakeley - Macquarie Securities - Analyst

Okay. I just -- hopefully, I'm not laboring the mic too long, but just on the Cooper Oil program which has obviously had some negative setbacks, what is the major driver between the doubling in the F&D cost? Where is that really coming through?

John Ellice-Flint - Santos Ltd. - CEO

I suppose rate. There is obviously some good news in there as well that we're seeing, the water flood working in a number of those fields, that is an update, so that would be the first. But we expected more high-rate wells. So that if you drilled 10 wells we would be able to get one or two of those, 3,000 barrels to 5,000 barrels a day or even higher that -- in our assumption. So that's one area.

Permeability is the other area in different parts of the basin. So all of it's back to rate, so it's basically --

Andrew Blakeley - Macquarie Securities - Analyst

So it's actually field productivity rather than rig costs and labor costs?

John Ellice-Flint - Santos Ltd. - CEO

No, there's also -- rig and labor cost component as well; they're higher than we originally said.

Peter Wasow - Santos Ltd. - CFO

Andy, part of it is what we explained when we put out our quarterly last October, when we first flagged it. We initially embarked on the Cooper Oil project as a real pattern drilling operation, and we saw that in the Tintaburra block, where we went in there with a couple of rigs and just pattern drilled out that area. The initial results from that were above our expectations at the time, there's no question. But then, subsequent appraisal results showed that the pool sizes --

John Ellice-Flint - Santos Ltd. - CEO

In different fields --

Peter Wasow - Santos Ltd. - CFO

-- in different areas and in stepping out more from Tintaburra showed that the pool sizes were actually smaller. So where we -- say, for example, the first AFE that we signed up for Cooper Oil was for 51 wells. So we just went out there and the rig moves were short and we just drilled a pattern. What we're now finding is smaller pool sizes, so we might be AFE-ing two or three wells in one area. So you can drill those, but then you have to move the rig to another area to drill another puddle. So the drilling costs have gone up as a result because you've got --

John Ellice-Flint - Santos Ltd. - CEO

Longer --

Peter Wasow - Santos Ltd. - CFO

-- longer rig moves, more expensive set up and preparation in services and so forth. Also success rates we've -- are down slightly on the amount of reserve that we've booked per well.

Andrew Blakeley - Macquarie Securities - Analyst

Okay.

And the last question. I apologize for holding the mic up, almost taking as long as [Bish]. The DD&A rate is obviously much, much higher. And you said that that's a result of an estimate of higher future costs. Can you give a little bit of elaboration as to where the higher costs are coming from? Is it just higher maintenance in the Cooper basin? Is it higher costs on top, or where?

John Ellice-Flint - Santos Ltd. - CEO

Well, I'd make a couple of points there. We calculate DD&A by reference to our 2P reserves. About 35% or 40% of the 2P reserves are undeveloped so we have to make an estimate of what the future development cost will be for that undeveloped portion. And the part that impacted the result the most was the down hole costs. So it's not maintaining the plant, it's not maintaining the infrastructure, it's mostly to do with the down hole costs.

The other point I'd make is that we also booked more reserves. So the downside, or the factors that are driving the higher industry costs, especially down hole, are also being reflected in higher prices. So, while the DD&A has gone up, the value of the barrel has also gone up, but that's not reflected in the accounts. We only reflect the increase in the DD&A. So does that answer your question?

Andrew Blakeley - Macquarie Securities - Analyst

Yes. Hopefully, we will take account of the higher costs, or the higher prices.

John Ellice-Flint - Santos Ltd. - CEO

Yes, well, hopefully -- yes, that's right, yes. [You can include that] in your models.

Andrew Blakeley - Macquarie Securities - Analyst

All right guys, thanks very much.

John Ellice-Flint - Santos Ltd. - CEO

Thanks.

Operator

Your next question comes from Di Brookman from Citi. Please ask your question.

Di Brookman - Citi Investment Research - Analyst

Hello. Just following on from that question regarding the DD&A, the actual pipeline there from Southwest Queensland to Eastern Queensland, you've accelerated depreciation through the P&L there about AUD48m. Is that a one-off, or is that an item that we can expect over the next few years?

John Ellice-Flint - Santos Ltd. - CEO

I'll take that, Di. The Moonie to Brisbane pipeline had a leak, as you know, and that's caused in total AUD26m after tax hit to our profit and loss. Part of that was the accelerated depreciation. I just want to correct, the number was actually AUD14m. And it is a one-off.

Di Brookman - Citi Investment Research - Analyst

Okay.

John Ellice-Flint - Santos Ltd. - CEO

And it's basically [we've knocked] the remaining asset value of that pipeline. So that's part of -- and that's part of the reason why the guidance for DD&A through '08 goes down because we won't have that one-off. And also we'll benefit from having higher leased facilities, or a higher proportion of leased facilities.

Di Brookman - Citi Investment Research - Analyst

Okay. Thank you.

In regards to Vietnam, on page 32, you talk -- and I know that this has been discussed before, but the actual CapEx figure there is AUD500m to AUD1b. That's quite a substantial range, given the reserve is circa of, I think, it's about 80m barrels at the gross level. Is that just for Blackbird Dua development at the moment, or would there be something larger that you might consider that might be included in that larger CapEx number?

John Ellice-Flint - Santos Ltd. - CEO

Yes, for other times as well, Di. As I said, in the next we will be able to give an update on that, I would say, in the next four to six weeks.

Peter Wasow - Santos Ltd. - CFO

But Di, that's a gross number, and if you think about Blackbird and Dua where the most likely development is, is tie backs to an FPSO, AUD500m is a reasonable lower-side estimate for that. And, as John said, we need to wait for the operators to come out with numbers, but I'm surprised that you don't see it in that band.

Di Brookman - Citi Investment Research - Analyst

I thought those numbers were net numbers.

Peter Wasow - Santos Ltd. - CFO

What did she say?

John Ellice-Flint - Santos Ltd. - CEO

Di said she thought the numbers were net numbers.

Di Brookman - Citi Investment Research - Analyst

I thought somebody else asked the question earlier on. Sorry, if I misinterpreted that.

John Ellice-Flint - Santos Ltd. - CEO

No, you're right. They're supposed to be gross numbers.

Andrew Seaton - Santos Ltd. - Executive of IR

Let me get --

John Ellice-Flint - Santos Ltd. - CEO

[Is Diane] saying they were net? They're supposed to be gross numbers, so obviously GLNG --

Di Brookman - Citi Investment Research - Analyst

Okay, thanks. That makes a lot more sense and remove that question.

John Ellice-Flint - Santos Ltd. - CEO

Yes. Okay.

Di Brookman - Citi Investment Research - Analyst

Ichthys North, I'm sorry, but I haven't actually looked fully through this presentation yet, but is there anything there? Is that well actually happening in the next six months?

John Ellice-Flint - Santos Ltd. - CEO

Yes it is. It was delayed because of the cyclones in Western Australia. So it's in --

Andrew Seaton - Santos Ltd. - Executive of IR

We've got it for later, for Q3 '08.

Di Brookman - Citi Investment Research - Analyst

Q3. So it has moved down a bit.

John Ellice-Flint - Santos Ltd. - CEO

Yes. Because of the delay in other people's drilling to get the rig.

Di Brookman - Citi Investment Research - Analyst

Okay. Thanks very much.

Andrew Seaton - Santos Ltd. - Executive of IR

Thanks.

Operator

Your next question comes from Mark Greenwood from JP Morgan. Please ask your question.

Mark Greenwood - JP Morgan - Analyst

Hello. Just a question on the gas market. Now that GEC is reserving its gas for LNG projects and you guys are in a -- I thought you would have been in a similar position to not sign up too many long-term domestic contracts. However, earlier in the conversation you stated that 2007/2008 would be a trough in your east coast gas sales, so, implying you'd be growing the east coast gas volumes going forward.

Are you going to be back out in the market signing long-term domestic contracts, or will -- because I would have thought you would be racing to build reserves ahead of an FID decision on Gladstone LNG.

John Ellice-Flint - Santos Ltd. - CEO

No. The 2007/2008 trough is being caused by the decline in the Cooper coming a little earlier than the increase in coal seam gas, and did follow the contract -- and the contract profile initially followed the Cooper decline. So we are pretty much fully contracted for the remainder of this decade and we are able to sell into those contracts.

Now in terms of the -- there's another slide in there which shows the amount of gas that is -- the amount of gas that is contracted in terms of what's subject to price review and what isn't. And the subtext of that is that our contracting strategy now is to contract as short as possible, not only because of the points you raise, Mark, but we have a view that gas prices are going up. Price reviews are not as efficient as new contracts in making that price impact felt on the P&L. So our strategy is to not sign long-term contracts as far as possible at all, and keep the duration as short as possible.

Mark Greenwood - JP Morgan - Analyst

Okay. And just --

Peter Wasow - Santos Ltd. - CFO

And, of course, that depends on the value of the deal.

Mark Greenwood - JP Morgan - Analyst

Yes. And so just one very quick confirmation. They are gross numbers are they on those CapEx numbers? And if so, have you ordered them in terms of scale, so is the Chim Sao or the Vietnam development going to require more CapEx than the Cooper Oil program?

John Ellice-Flint - Santos Ltd. - CEO

No, there's not that degree of -- you shouldn't read that into those.

Mark Greenwood - JP Morgan - Analyst

Okay. But they are gross numbers? I just got a bit confused there.

John Ellice-Flint - Santos Ltd. - CEO

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Yes.

Peter Wasow - Santos Ltd. - CFO

Yes, they are.

Mark Greenwood - JP Morgan - Analyst

Thank you.

Operator

Your next question comes from Anthony Bishop of Goldman Sachs. Please ask your question.

John Ellice-Flint - Santos Ltd. - CEO

Anthony? No, I think he's gone.

Anthony Bishop - Goldman Sachs - Analyst

Sorry, guys. I had you on mute.

John Ellice-Flint - Santos Ltd. - CEO

How was the question? Did we answer it well?

Anthony Bishop - Goldman Sachs - Analyst

Your best ever, John. Just in terms of -- I was going to clarify that gross versus net on slide 32, but that's been done to death, so that's fine. Thank you.

John Ellice-Flint - Santos Ltd. - CEO

Thanks a lot, Anthony.

Operator

Your next question comes from Di Brookman of Citi.

Di Brookman - Citi Investment Research - Analyst

Just following on, one more question regarding the domestic gas, you mentioned that you're fully contracted out for the rest of this decade. Do you have some price re-openers on the eastern seaboard that are coming up for discussion?

John Ellice-Flint - Santos Ltd. - CEO

Just on the price re-openers, the point we're trying to make there is that by -- we're saying that by 2010 a very small portion of our existing contracted gas is not subject to price review. But all new contracts that we're signing now are either short term and, therefore, will be re-priced as they're resold, or subject to price review. Does that answer the question on --?

Di Brookman - Citi Investment Research - Analyst

Partially. I was just wondering whether there are any price reviews coming up over the next year.

John Ellice-Flint - Santos Ltd. - CEO

Yes. There are price reviews coming up in 2008. There are two --

Di Brookman - Citi Investment Research - Analyst

Are they material?

John Ellice-Flint - Santos Ltd. - CEO

Yes. There are two important long-term contracts that are coming up for review.

Di Brookman - Citi Investment Research - Analyst

Are you able to tell us which ones?

John Ellice-Flint - Santos Ltd. - CEO

I'm not sure, but I suspect I won't be able to, but --

Di Brookman - Citi Investment Research - Analyst

Okay.

John Ellice-Flint - Santos Ltd. - CEO

But you imagine who our major contract --

Di Brookman - Citi Investment Research - Analyst

Yes. So what volume would that cover?

John Ellice-Flint - Santos Ltd. - CEO

-- would be for the long term.

Di Brookman - Citi Investment Research - Analyst

What total volume would that cover annually?

John Ellice-Flint - Santos Ltd. - CEO

Off the top of my head I don't know, but the point I've made, though, is that as we moved forward through time the proportion that's not reviewable keeps going down. So how much these two particular contracts cover, I just can't answer.

Di Brookman - Citi Investment Research - Analyst

But they are material.

John Ellice-Flint - Santos Ltd. - CEO

Well, they're -- we only have a small number of customers on a long-term contract basis.

Di Brookman - Citi Investment Research - Analyst

Okay.

Peter Wasow - Santos Ltd. - CFO

Getting back to your other question, we've other 2p that we can --

John Ellice-Flint - Santos Ltd. - CEO

Later in the decade.

Peter Wasow - Santos Ltd. - CFO

Yes. But that's not what Di -- the question was between 2008 and 2010 was it?

Di Brookman - Citi Investment Research - Analyst

Yes, predominantly.

Peter Wasow - Santos Ltd. - CFO

Is that it?

Di Brookman - Citi Investment Research - Analyst

So, obviously, if you still had those price reopeners this year, though, and it was appealed against, it would still take a couple of years to implement would it not?

John Ellice-Flint - Santos Ltd. - CEO

Price reviews aren't really a -- they are a way in which we can increase our average prices. But the better way to increase average prices is through setting shorter contracts, because you don't need to go through any kind of negotiation phase. And the price is then a forward-looking price, while the price review tends to be a backward-looking price, or relating to contracts that are in the market at that time.

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Peter Wasow - Santos Ltd. - CFO

Delay.

John Ellice-Flint - Santos Ltd. - CEO

Yes, it's a lagging process. So that's why we've been increasing -- decreasing the duration of our contracts.

Di Brookman - Citi Investment Research - Analyst

So, what kind of duration are you predominantly looking for? We've seen you doing a couple of three-year ones.

John Ellice-Flint - Santos Ltd. - CEO

Well it depends very much on what the customer needs as well. Quite often industrial customers are seeking longer term surety of supply. In the event there are long-term supply needs, then we are sure to get price reviews into those contracts. But our predominant strategy is to shorten the duration.

Di Brookman - Citi Investment Research - Analyst

Okay. Thank you.

Operator

(OPERATOR INSTRUCTIONS).

Andrew Seaton - Santos Ltd. - Executive of IR

Thank you very much, everyone.

Operator

There are no further questions at this time.

Andrew Seaton - Santos Ltd. - Executive of IR

Okay. Thanks for joining the call. We'll end it there.

Operator

That does conclude our conference for today. Thank you for participating. You may all disconnect.

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