

23 March 2009

Competitive Outlook in the Deepwater Gulf of Mexico Central Sale 208 Recap and Evaluation of Results

In our pre-sale analysis, we argued that Central Sale 208 will be an important test of how company expectations and strategy are responding to the current economic situation.

Based on our analysis and our knowledge of the players involved in the DW GoM, we made a number of specific projections concerning the level and nature of the competition to be expected in Sale 208.

Our discussion of the competitive drivers of Sale 208 focused on (1) the number of companies bidding for deepwater blocks, (2) the percentage of bidders that increased their bid budgets compared to last years' Central Gulf of Mexico Sale and (3) the shape and level of the bid distribution curve in Sale 208 compared to prior sales.

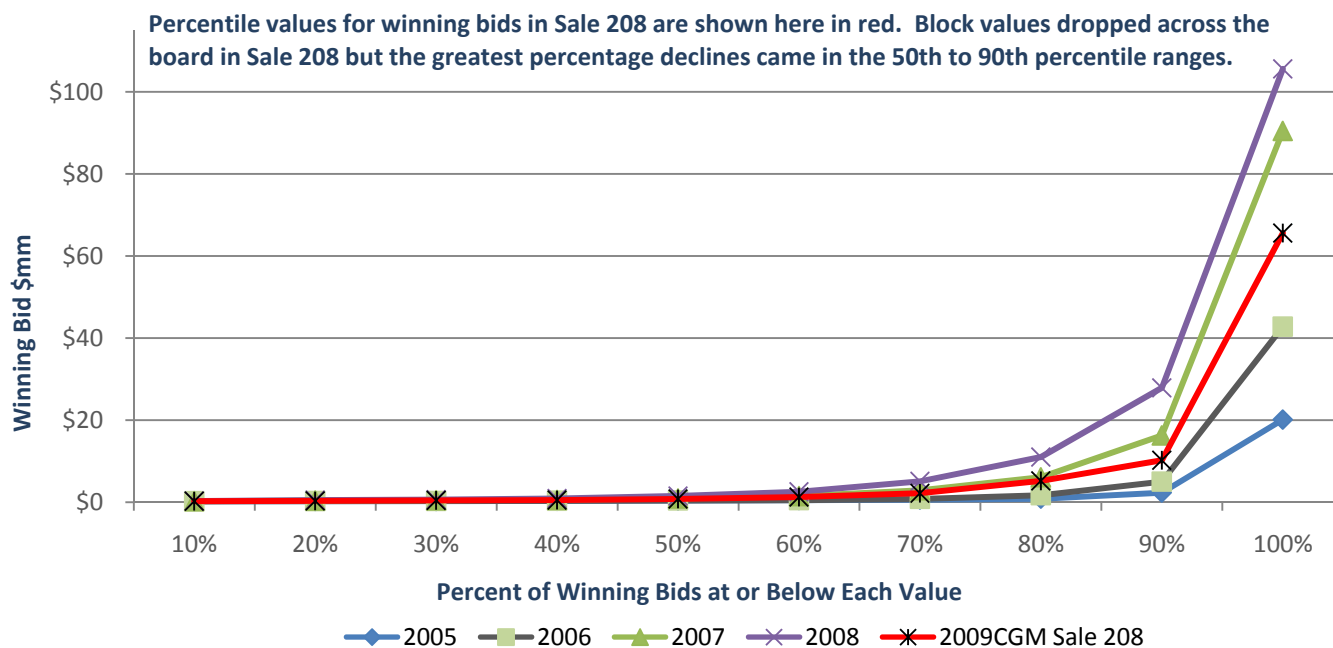
Our Pre-Sale Forecast and Outcome

As we expected, the number of companies placing bids on blocks in water depths of 400 meters or more fell from 44 to 37. The downward pressure on lease bids was considerably greater than this number would suggest since five of the 37 companies placing bids risked less than US\$1 million in capital and, therefore, were of negligible impact on competition. Prior to Sale 208 we projected that the majority of companies participating in deepwater bids will significantly reduce their bid budgets in Sale 208. The magnitude of the decline is extraordinary with the industry bid budget dropping from US\$5,437 million in Central Sale 206 held last year to only US\$884 million in Sale 208. Only nine of the 37 companies bidding for deepwater blocks in Sale 208 increased their bid budgets compared to the CGM sale budgets last year. However, this group of nine includes the five companies that bid less than US\$1 million in the sale. Moreover, of the 44 companies that were bidders in Sale 206 in the CGM last year, only two increased their bid budgets for Sale 208. This statistic is similar to the same store sales data used in retailing to avoid distortions associated with entry and exit.

The bid distribution curve shows the winning bid percentiles for successive Central GoM sales. The bid curve results are shown below in Figure 1 and the associated table. The bid curve shifted upward significantly in each of the past three years. The inflation in winning bids was greatest, in relative terms, in the 50th to 90th bid percentiles. This is reflected in the thickening left hand side tails of the distribution.

We projected that the 2008 bid curve will shift downward in Sale 208. Our view was that the greatest percentage shifts will come in the 50th to 90th percentiles of the bid distribution. In other words, it should not be surprising if the winning bids on the most highly valued blocks (in the top 10 percent, for example) remain relatively high. What this implies is that (1) companies will cut the aggregate size of their bid

Figure 1: Percentile Distribution of Winning Bids in the Central Gulf of Mexico Sales, 2005-08 and Sale 208



Bid Percentiles \$mm	10%	20%	30%	40%	50%	60%	70%	80%	90%	100%
2005	\$0.230	\$0.260	\$0.280	\$0.330	\$0.410	\$0.510	\$0.630	\$0.860	\$2.330	\$20.150
2006	\$0.230	\$0.270	\$0.290	\$0.350	\$0.420	\$0.520	\$0.800	\$1.710	\$5.010	\$42.790
2007	\$0.260	\$0.410	\$0.500	\$0.600	\$0.940	\$1.520	\$2.900	\$6.090	\$16.300	\$90.490
2008	\$0.280	\$0.510	\$0.630	\$0.920	\$1.510	\$2.560	\$5.070	\$11.020	\$27.870	\$105.600
2009, Sale 208	\$0.250	\$0.330	\$0.460	\$0.550	\$0.810	\$1.290	\$2.190	\$5.210	\$10.250	\$65.610

% Change in Percentile Values										
2006	0.0%	3.8%	3.6%	6.1%	2.4%	2.0%	27.0%	98.8%	115.0%	112.4%
2007	13.0%	51.9%	72.4%	71.4%	123.8%	192.3%	262.5%	256.1%	225.3%	111.5%
2008	7.7%	24.4%	26.0%	53.3%	60.6%	68.4%	74.8%	81.0%	71.0%	16.7%
2009, Sale 208	-10.7%	-35.3%	-27.0%	-40.2%	-46.4%	-49.6%	-56.8%	-52.7%	-63.2%	-37.9%

budgets and (2) shift the allocation of the remaining budget to a heavier weighting on targeted prospect bids

The percent of DW bidders increasing their budgets on a year to year basis was 79% and 93% in 2006 and 2007, respectively. However, by 2008 this support under acreage values fell to 56% of the competing companies. When this sort of drop occurs it suggests that a growing number of companies are not

prepared to pay the prices being commanded. We expected that another drop in this indicator would occur in Sale 208 and it did—dropping to 24%.

Our Recommended Bidding Strategy for Sale 208

The pre-sale bid strategy we recommended was simple:

- Bid low and bid often
- Sale 208 offers a low risk opportunity to pick up substantial acreage at a low cost

The scenario we described for Sale 208 presented an outstanding opportunity to pursue what we call a swath block bidding strategy. The goal is to build substantial acreage positions now when the cost is likely to be lower. This involves focusing on the lower end of the bid distribution and bidding lower than the 2008 bid distribution would suggest for those blocks.

There is some evidence that a small number of companies bid in Sale 208 in the manner we recommended. However, there is little doubt that the current price uncertainties resulted, in most cases, in radical budget cuts.

It is beyond the scope of this newsletter to fully discuss our analysis of bidding strategies or patterns in the bidding behavior of specific companies operating in the deepwater Gulf of Mexico.

However, we welcome inquiries and will be happy to further discuss our analysis via online web meetings or teleconference calls.

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