

ON POINT

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GORDON ENERGY
SOLUTIONS

Candid, Forward-Looking Analysis of the Oil & Gas Industry

IN THE NEWS

Changes at PdVSA

Although little has changed in a practical sense, PdVSA's statutes were recently formally revised. One provision makes PdVSA explicitly responsible for agricultural and industrial development. Another formalizes the political nature of the company by allowing PdVSA board members to serve on the boards of political organizations as well.

Australian Gas Discoveries

Mimia-1 has been reported as a discovery WA-344-P, 20 kilometers northeast of the Ichthys project. Total holds 40% in this discovery with Inpex. Inpex and Total interests in Ichthys are 76% and 24%, respectively. Hess has also reported a second discovery on WA-390-P. Briseis-1 found 151 net feet of gas pay, following up on the earlier Glencoe-1 discovery.

South Stream Pipeline Cost Inflation

The cost of the Gazprom/ENI project to ship 2.9 Bcf/d of Russian gas to Bulgaria, Austria and Italy has been estimated by the Russian Energy Ministry at US\$20 billion. This is double ENI's original estimate.

Shale Gas Alliance Formed

Grande Energy, Mitsubishi and Schlumberger have entered into an agreement to acquire and develop unconventional gas positions over a ten-year period.

Grande holds acreage in the Barnett, Marcellus, and Fayetteville shale plays as well as the Williston Basin. Grande will locate prospects, Mitsubishi will finance land acquisition and development, and Schlumberger will undertake drilling and completion.

Peruvian Gas Demand Outstripping Supply

Initial capacity of the pipeline supplying Camisea gas to Lima has been exhausted after four years. Compression can increase volumes from 290 to 380 Mmcf/d but negotiations are underway to increase volumes to 1 Bcf/d by 2010.

A Brazilian Pemex?

In the May issue of On Point, we warned that Brazil's oil and gas policy is likely to take a hard left turn.

Given the apparent potential of Brazil's pre-salt play and the government's belief that its exploitation can be a key economic development tool, we specifically argued that "... the IOC role in the pre-salt play may be significantly limited".

We also warned that, if this is true, "... Petrobras will be expected to carry the bulk of the burden going forward and that Brazilian capital resources, directly or indirectly, will bear the bulk of the risks." It will be difficult, at best, for Petrobras to carry the new pre-salt burden and continue building its international program.

News reports seem to confirm our expectations but with an unfortunate twist.

President Luiz Inacio Lula da Silva said recently that the pre-salt belongs to all Brazilians not just a few oil companies. It is hard to argue with this as a matter of principle. However, it is now rumored that the government is considering the creation of a new state-run company to develop the pre-salt.

This potential step backward in Brazilian oil and gas policy is likely to combine the worst of all possible combinations.

- If the new company is not merely an administrative agent of the government, it will have to be staffed from the ground up which means
 - Petrobras will probably be stripped of substantial numbers of its key personnel and its capacity to function internationally will be undermined

- Costs will be higher than they should be
- During the lengthy setup period uncertainty concerning Brazilian policy will be high

- If the new company's role is purely administrative then that will conflict with existing regulatory agencies such as ANP as well as Petrobras' functions and the resulting multiplication of bureaucracy could seriously hamper efficiency

- As a one-dimensional entity (essentially a throw back to a pure NOC that bars IOC entry), the strategic mandates of this new state-run company as well as internal evaluations of its performance will be defined by two criteria: volumetric growth and employment.

- This prospect should make you think of Pemex with its history of inefficiency.
- It should also remind you of the Mexican constitutional prohibition to non-Mexican ownership and the resulting perennial political stalemate to reform.
- Finally, this structure will provide an outlet for the extraordinary pressures to develop the pre-salt at irrationally rapid rates

These issues are all speculative at this time although we continue to believe that the risk of severe policy mistakes in Brazil in the coming months is very high.

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CONTACTS



Gordon Energy Solutions is an energy consulting firm specializing in competitor analysis, strategic decisions, political risk analysis, and global issues concerning the international, integrated oil & gas industry. We anticipate future opportunities and challenges confronting our clients and assist in exploiting those opportunities.

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For additional information concerning our most recent work or to find out more about our company, please visit <http://www.gordonenergysolutions.com>.

Ecuador's Love Affair with Bad Policy

Resolution of a sort has been achieved in the escalating disputes between Ecuador and a number of producing companies with respect to their participation contracts.

Repsol, Andes Petroleum (CNPC and Sinopec), and Petrobras have agreed to convert their existing contracts into service contracts. In addition, the companies will withdraw arbitration claims before the World Bank or switch these claims to a regional UN court in Santiago, Chile.

In exchange, the duration of the contracts will be extended and the companies will avoid the 99% windfall profit tax. Under the service contract arrangement the IOCs will receive a production fee and be reimbursed for costs. All crude output will belong to the government.

Perenco (with ConocoPhillips) has apparently chosen not to accept these terms. Also, City Oriente has relinquished its license for Block 27, will drop its arbitration claim and will be paid US\$69 million.

The ongoing degeneration of Ecuador's oil and gas policy (at least insofar as the licensing fiscal systems are concerned) can be traced to as early 2006 with the imposition of a 50% windfall profits tax tied to oil prices. The windfall tax, in isolation and without some cost adjustment mechanism, is bad but not crippling policy. The October 2007 increase in this tax rate to 99% was crippling in its impact. This and demands for conversion to service contracts precipitated numerous arbitration claims. The recent conversions are part of a continuing obsession within Ecuador for the service contract – a fiscal system that, in the long run, the country cannot afford in a cyclically volatile price and cost environment.

Sale 207 in the US Gulf of Mexico

The western Gulf of Mexico (GoM) lease sale was held on 20 August 2008.

Sale 207 results reflect the effects of the MMS allocation of substantial parts of Keathley Canyon and Garden Banks to the Central region. High bids totaled \$487 million compared to the \$3.7 billion received in Central Sale 206. A total of 53 companies bid in Sale 207 compared to 85 in the last central sale.

In effect, this sale was about:

- the deep and ultra-deep water plays and

- company efforts to replenish their acreage portfolios by capturing part of the very large volumes of acreage that have recently expired

Ultra-deep water (UDW) is defined for our purposes as water depths of 800 meters or more. Winning bids for blocks meeting this criteria contributed 87% of the total \$487 million in high bids in this sale.

These bids were made by only 17 of the 53 companies that participated in the sale. Figure 1 shows, by company, capital committed to winning UDW bids in the sale. From this it is clear that, of the 17 UDW bidders, Chevron, ExxonMobil, and StatoilHydro accounted for 80% of winning bid capital.

Between the two most recent Western sales, there has been a substantial shift in company bidding efforts. Figure 2 shows bid budgets for UDW blocks in Sales 204 and 207. The figure also shows changes in budgets by company in Sale 207 compared to Sale 207.

Chevron and ExxonMobil were the leading drivers of the overall level of competition as measured by both the number of bids placed and the capital exposed in the UDW budget.

Table 1: Status of Service Contract Conversions in Ecuador

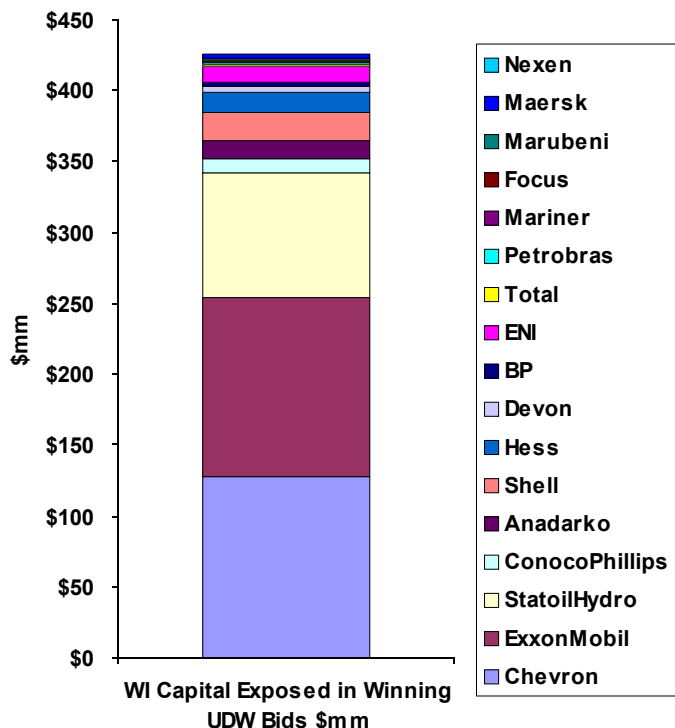
Companies	Blocks	2007 Output Mb/d Gross/Net	Original Expiration	Revised Expiration	Notes
Repsol	16	Na/18	2008	2018	Transfer arbitration
Andes Petroleum (CNPC, Sinopec)	14, 17	60.00			Service contract conversion in one year
Petrobras	18*	32/10			Withdraw arbitration claims
City Oriente	27	3.00			Relinquished
Perenco, ConocoPhillips	7, 21	30/23(e)	Block 7: 2010; Block 21: 2021	2010	Will expire

* Includes Block 18 and Palo Azul field. Teikoko agreed in 2005 to acquire a 40% working interest in Blocks 18 and 31 but the sale is pending approval of amendments to the original participation agreement.

OUR PERSPECTIVE



Figure 1: Capital Exposed in Winning UDW Bids, Sale 207



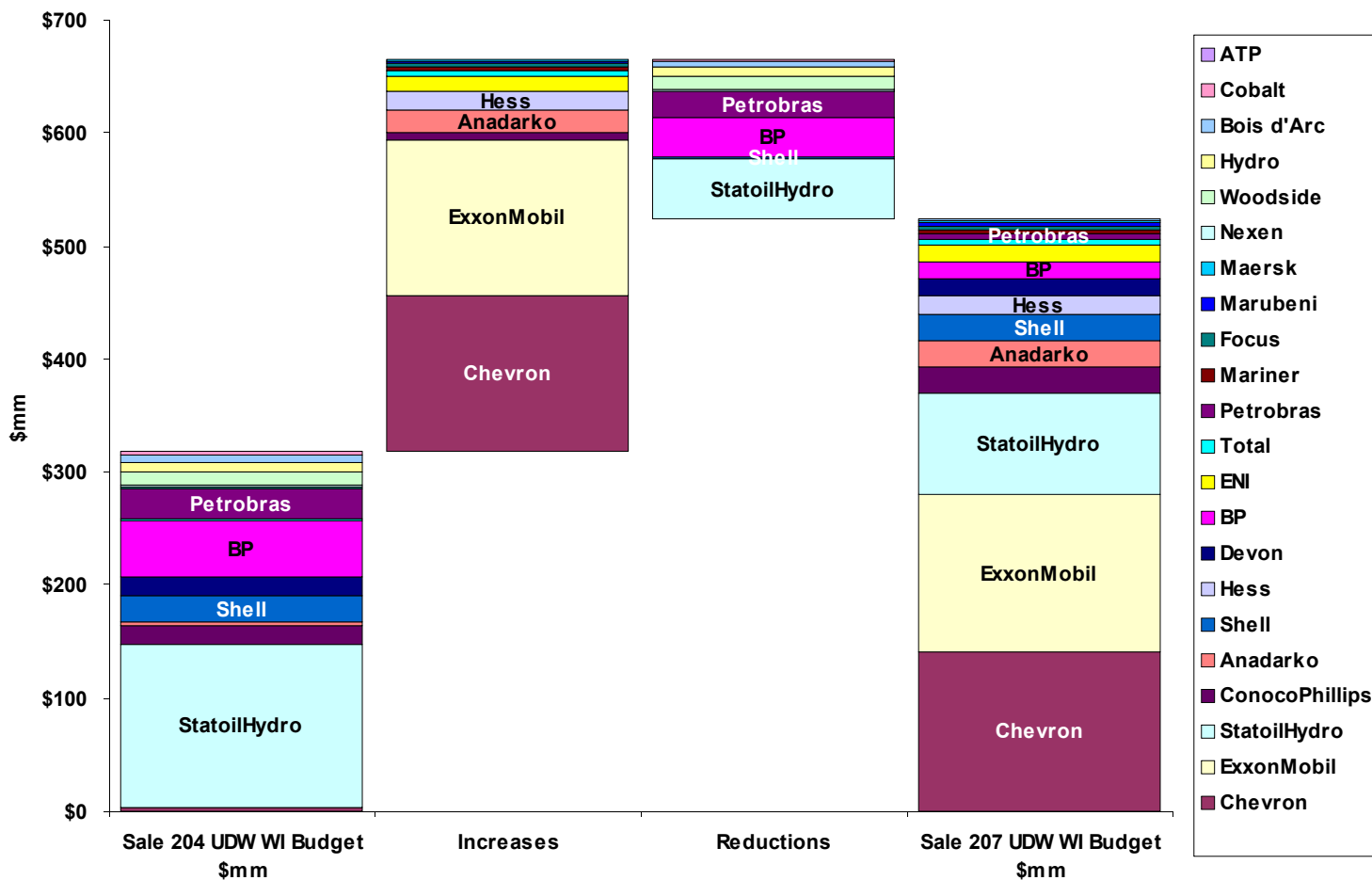
As shown in Figure 2, Chevron increased its budget from only \$4 million in the last sale. However, the major surprise of the sale is ExxonMobil's return to the competition after a long period of absence or near absence. StatoilHydro, while considerably below the top two companies, was also substantially more aggressive in terms of budgets than the rest of the bidders. Most other major players in the region cut their budgets including StatoilHydro, BP, Petrobras and Woodside.

Three UDW hot spots emerged in Sale 207. These hot spots are areas consisting of blocks that capture an unusually high share of total winning bids or of combinations of blocks that meet this standard. These hot spots include:

- Two contiguous blocks in Alaminos Canyon (380 and 424), \$83 million total winning bids
- Two separated blocks on the margin of the Perdido Regional Development project (Alaminos Canyon 775 and 771), \$20 and \$12 million, respectively
- Contiguous blocks 973 and 972 in the Garden Banks area, \$52 and \$35 million, respectively

On a combined basis, these three hot spots captured 47% of the winning UDW bids in Sale 207.

Figure 2: Sales 204 and 207, Shifts in Capital Budgeted for WGM UDW Bids in 2007 and 2008



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Ithaca Deal with Shell & ExxonMobil

Shell and ExxonMobil sold their combined 66.67% interest in the UK Stella discovery to Ithaca Energy. Ithaca agreed to pay US\$15 million at the time of the deal with another US\$15 million payable when the field development is approved. Ithaca also agreed to pay a 5% over-riding royalty on future production from the field.

Stella is on UK Block 30/6. Estimated reserves at 31 May 2008 were 4.6 Mmboe proved, 9.79 mmboe proved

and probable and 23.66 mmboe proved, probable and possible. The field includes both gas and condensate (GES estimated liquids share of reserves is 47%). Table 1 shows the acquisition metrics for this deal, excluding the estimated 13.9 mmboe of possible reserves.

Total Completes Synenco Deal

Total has acquired Synenco for US\$525.4 million. Synenco's primary asset is a 60% interest in the proposed Northern Lights oil sands project. The remaining 40% interest is held by Sinopec.

The Synenco deal adds to Total's oil sands positions in the Surmont and Joslyn projects. The Northern Lights project analysis does not include the costs of upgrader facilities since the previous proposed upgrader has been put on hold due cost inflation. The estimated cost of the mining project has increased from C\$1.7 billion (2005 values) to the present estimate of C4.4 billion (2006 values).

Table 2 shows the key metrics of this deal. These results have not been adjusted for the discounted value of

Table 2: Ithaca Stella Field Acquisition Metrics

\$mm	Acquisition Price	Contingent Payment	YTD 2008 Capex	Future Development Cost	All In Costs
Net Reserves mmboe	\$15.0	\$15.0	\$0.0		\$30.0
Proved 4.6					
Proved & Probable 9.8					
Ithaca Energy Share 67%					
Proved mmboe 2.9					
Proved & Probable mmboe 6.2					
\$/boe Proved	\$5.15	\$5.15	\$0.00	\$0.00	\$10.30
\$/boe Proved & Probable	\$2.42	\$2.42	\$0.00	\$0.00	\$4.84

Note: Proved and Probable reserves are based on the 29 May 2008 estimates by Sproule Associates as reported by Ithaca Energy. These reserves have been reduced by the 5% over-riding royalty retained by the sellers.

Table 3: Total's Synenco Acquisition Metrics

\$mm	Acquisition Price	Contingent Payment	YTD 2008 Capex	Future Development Cost	All In Costs
Net Reserves mmboe	\$525.4	\$0.0	\$0.0	\$2,537.4	\$3,062.8
Proved 1,673.0					
Proved & Probable 0.0					
Total Share 60%					
Proved mmboe 900.4					
Proved & Probable mmboe 0.0					
\$/boe Proved	\$0.58	\$0.00	\$0.00	\$2.82	\$3.40
\$/boe Proved & Probable	na	na	na	na	na

Note: Estimated Bitumen resources of 1.673 billion barrels. Future development cost based on most recently revised estimated of C\$4.4 billion in 2006 dollars. Royalty rate estimated.

MERGERS, ACQUISITIONS, & DIVESTITURES



bitumen reserves receive compared to the upgraded crude that would be sold if an upgrader is included.

Forest Oil Increases Buffalo Wallow Position

In a cash and stock deal worth US\$892 million, Forest Oil acquired assets in the Greater Buffalo Wallow area of the Texas Panhandle and assets in East Texas from Cordillera Texas, L.P. Forest is paying US\$708 million in cash plus 3.5 million shares.

Forest estimates proved reserves of 350 Bcfe (36% developed) and net unrisks

potential of 1,200 Bcfe. Current output is 34 Mmcfe/d. Gross land acquired in the deal is 118,000 acres (85,000 acres net).

Table 3 shows the acquisition metrics of the deal. After allocating a portion of the purchase price to existing producing assets, the estimated cost per net acre is US\$7,987.

Timor Sea Farm-In

Stuart Petroleum has farmed into a 50% working interest and operatorship of AC/P33 in the Timor Sea. The block

includes the Oliver oil field which was discovered in 1988 by BHP. Oliver is located in 1,000 feet of water

Stuart will earn its interest by providing sole funding for an appraisal well and engineering studies up to FID. The estimated cost of this portion of the agreement is US\$52 million. Stuart will also fund 100% of the first US\$22 million in development costs.

Appraisal drilling and engineering studies leading up to FID are expected to be complete in late 2010.

Table 3: Forest Oil Buffalo Wallow Acquisition Metrics

\$mm	Acquisition Price	Contingent Payment	YTD 2008 Capex	Future Development Cost	All In Costs
Net Reserves mmmboe	\$892.0	\$0.0	\$0.0	\$1,678.1	\$2,570.1
Proved 58.3					
Proved & Probable 200.0					
Total Share 100%					
Proved mmmboe 58.3					
Proved & Probable mmmboe 200.0					
\$/boe Proved	\$11.64	\$0.00	\$0.00	\$28.77	\$40.41
\$/boe Proved & Probable	\$4.46	\$0.00	\$0.00	\$8.39	\$12.85

Note: Reserve estimates are as reported by Forest Oil. Future development costs are estimated by GES based on average per well EUR and well costs in the Buffalo Wallow play. An estimated US\$213 million is allocated by GES to existing producing assets in the per boe calculations.

Table 4: Stuart Farm-In Acquisition Metrics

\$mm	Acquisition Price	Contingent Payment	YTD 2008 Capex	Future Development Cost	All In Costs
Net Reserves mmmboe	\$52.0	\$22.0	\$0.0		\$74.0
Proved 9.9					
Proved & Probable 33.0					
Stuart Petroleum Share 50%					
Proved mmmboe 3.1					
Proved & Probable mmmboe 10.4					
\$/boe Proved	\$16.67	\$7.05	\$0.00	\$0.00	\$23.73
\$/boe Proved & Probable	\$5.00	\$2.12	\$0.00	\$0.00	\$7.12

Note: Reserve estimates are as reported by Stuart. Future development costs are not included. Royalty and Crude Oil Excise Tax estimated.

MERGERS ACQUISITIONS & DIVESTITURES



US Asset Sale Value Indicators Trailing 12-Month Period, June 2007-June 2008

Non-Operated Working Interests 6:1

	Average (Mean) \$/BOE/D	Average (Weighted) \$/BOE/D	Average Multiple (Average Income)	Average Multiple (Last Income)
Appalachians	\$45,873	\$28,278	38.50	35.19
Ark-La-Tex	\$42,975	\$34,667	47.56	50.36
Gulf Coast	\$35,729	\$23,611	35.62	45.01
Michigan Basin	\$37,138	\$26,415	40.11	55.73
Mid Continent	\$47,948	\$41,969	51.24	55.85
Permian Basin	\$74,420	\$75,092	56.99	51.72
Rockies	\$48,652	\$56,898	44.52	42.26
South Texas	\$36,738	\$31,067	35.53	39.14
West Coast	\$42,260	\$27,675	44.73	44.48
Column Average	\$45,748	\$38,408	43.87	46.64

EnergyNet data on US deal metrics over the 12-month period from June 2007 through June 2008 are shown here.

EnergyNet provides a way to high-grade a portfolio of assets, maximizing value for each individual property or field, without expending significant time and effort. EnergyNet maximizes value by efficiently offering the elemental properties (single well, lease, or field) to the largest audience of qualified and accredited oil and gas investors. There are simply more Buyers in the marketplace capable of competing to win a \$1MM property than a \$100MM package of properties, and EnergyNet has established relationships with over 12,500 Buyers. Geographically diverse packages benefit by being broken down into their elemental parts. By marketing and selling properties in the most logical, elemental pieces, Sellers maximize value for each part of the package and do not exclude Buyers from the process.

Operated Working Interests 6:1

	Average (Mean) \$/BOE/D	Average (Weighted) \$/BOE/D	Average Multiple (Average Income)	Average Multiple (Last Income)
Appalachians	\$85,524	\$56,867	45.70	54.69
Ark-La-Tex	\$32,972	\$28,431	29.47	32.74
Gulf Coast	\$31,344	\$23,493	26.30	48.76
Michigan Basin	\$44,967	\$44,967	31.40	41.35
Mid Continent	\$56,945	\$28,516	53.39	51.61
Permian Basin	\$45,293	\$51,050	54.59	45.04
Rockies	\$39,791	\$46,338	38.03	44.97
South Texas	\$23,632	\$21,145	36.68	54.64
Column Average	\$45,058	\$37,601	39.44	46.73

EnergyNet can prepare, market, and close a set of property transactions much faster than any other divestment-focused company in the industry. The Continuous Model allows EnergyNet to handle as much for a company as requested, including gathering data, preparing properties, filing the conveyance documents, escrow and post-closing services.

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E-mail: energy@energynet.com Or visit their website: www.energynet.com

July Cost Inflation Results

Drilling costs in 2008 continue to be down relative to the same time last year. Year to date, drilling costs continue to be lower than in the same period in 2007 (down by 2.8%). However, month to month changes in 2008 continue to be positive, and have generally ranged between slightly less than 1% and nearly 3%.

Inflationary pressures continue to be considerably stronger in the oil field machinery sector. On a year to date basis, oil field machinery costs are up 7.3%. Rotary drilling machinery costs are up 5% thus far in 2008. Support services are only modestly up so far this year. Inflationary pressures in the oil field machinery sector are particularly strong in the production machinery sector (up almost 15% in July compared to July of last year).

UPSTREAM

Annualized Cost Inflation Rates: 2006, 2007 and 2008 YTD

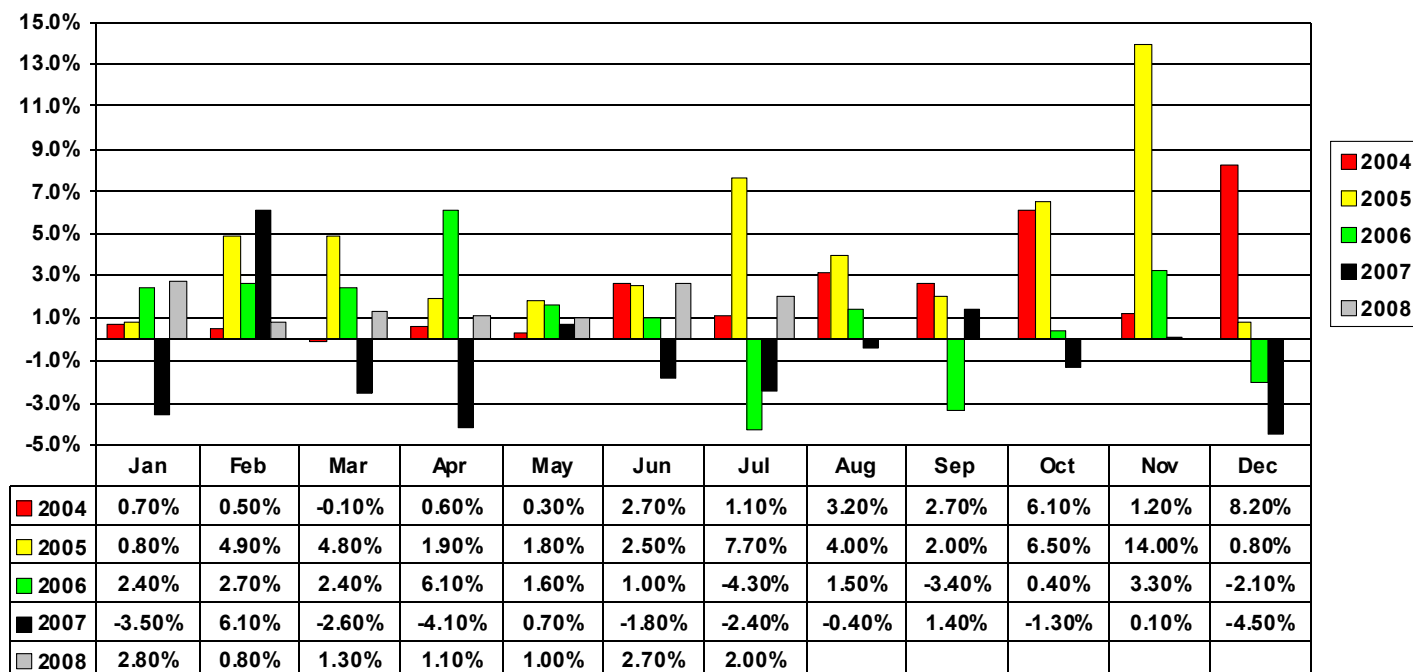
Cost Component	2006/2005	2007/2006	2008 YTD/2007
Drilling Cost	37.8%	-4.6%	-2.8%
O&G Support Activities	13.1%	3.6%	0.3%
Oil Field Machinery	8.7%	7.0%	7.3%
Rotary Drilling Machinery	11.5%	8.9%	5.0%

Note: 2008 YTD inflation estimates subject to revision

Reflecting the combined impact of rising drilling costs and strong inflation in oil field machinery costs, our composite index of onshore US drilling and completion costs is

up for July by almost 6% compared to the index last year.

US Producer Price Index: Monthly Percentage Change in the Cost of Drilling Oil & Gas Wells



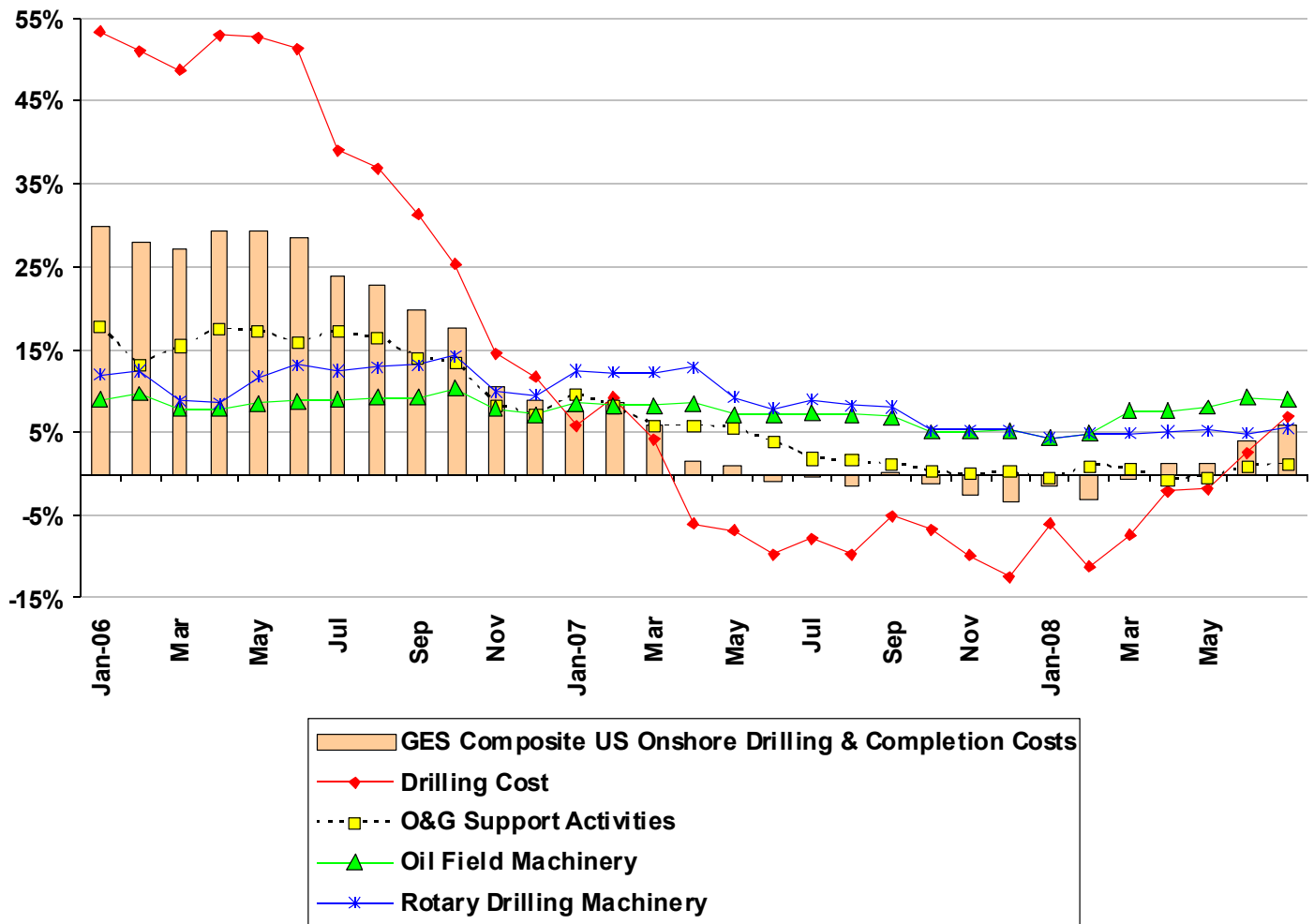
Year over Year Percentage Change

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Annual
2006	53.3%	51.1%	48.7%	53.0%	52.7%	51.3%	39.2%	36.7%	31.3%	25.2%	14.5%	11.6%	37.8%
2007	5.7%	9.1%	4.2%	-6.1%	-7.0%	-9.8%	-7.9%	-9.8%	-5.0%	-6.7%	-9.9%	-12.4%	-4.6%
2008	-6.1%	-11.3%	-7.5%	-2.2%	-1.9%	2.5%	6.9%						

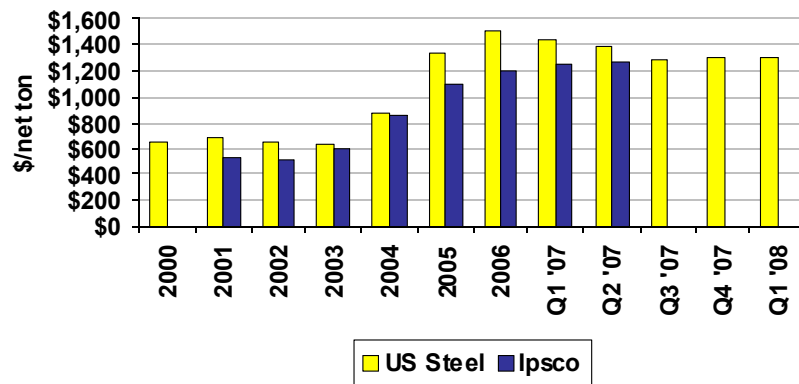
COST WATCH



Monthly Year over Year Inflation of Selected Industry Costs



Tubular Steel Products Price



Ipsco was acquired by SSAB and its Tubular Division was sold to Evraz