

ON POINT

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GORDON ENERGY SOLUTIONS

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

IN THE NEWS

Projects –

Qatar -- The foundation stone for Shell's Pearl GTL project was laid this month. A total of \$10 billion of contracts have already been awarded for the project, including all major engineering, procurement and construction contracts. Construction began in the third quarter of 2006. At the same time, ExxonMobil and Qatar Petroleum announced a decision not to proceed with the previously planned GTL project. Instead, ExxonMobil will have a 10% share in the new Barzan gas project to supply gas to domestic markets. This agreement also specifies that ExxonMobil will have rights to participate in all future phases of the project. Cost inflation in GTL is a major problem area with Shell noting that total costs for Pearl could be as high as US\$18 billion.

Costs --

Alberta Oil Sands Royalty System Under Review –

Alberta Minister of Finance Lyle Oberg announced a wide ranging review of the province's energy royalty system. Oberg stated that

"We need to be certain that the royalty regime is providing Albertans with a fair return on the province's natural resources while maintaining an internationally competitive system that allows the Alberta economy to continue to prosper"

An independent panel will review all aspects of the province's current royalty arrangements with regard to oil and gas production, and will report by Aug. 31.

UPCOMING EVENTS

Gordon Energy Solutions to present at the James A. Baker III Institute for Public Policy of Rice University on "The Changing Role of National Oil Companies in International Energy Markets".

[Houston Conference](#)

[Dubai Conference](#)

James A Baker III Hall
Rice University
Houston, TX
March 1-2, 2007

Medinat Jumeirah Hotel
Dubai
United Arab Emirates
March 12, 2007

Canadian Oil Sands

The industry focus on Canada as a key alternative source of unconventional, world scale oil projects continues. Shell and Suncor have both announced plans for large and sustained expansion programs.

The Shell vision for heavy oil in Canada includes increasing upgrader capacity by 400 Mb/d in 4 equal phases in the period after 2008. The company also looks to increase bitumen production capacity to 770 Mb/d by further expansions of the Jackpine mine and two 100 Mb/d capacity additions from the Pierre River Mine.

Projected net Shell output from these and other leading heavy oil assets are shown in Figure 1. The aggregate volumes are substantial by any measure.

Also, Suncor announced plans for an expansion of its oil sands capacity through the Voyageur South project. Suncor indicated that it expects to file an application to develop the project in mid-2007. Pending regulatory approval, construction would begin in 2009, with operations beginning in 2011. Suncor is targeting bitumen production of approximately 120 Mb/d from the project.

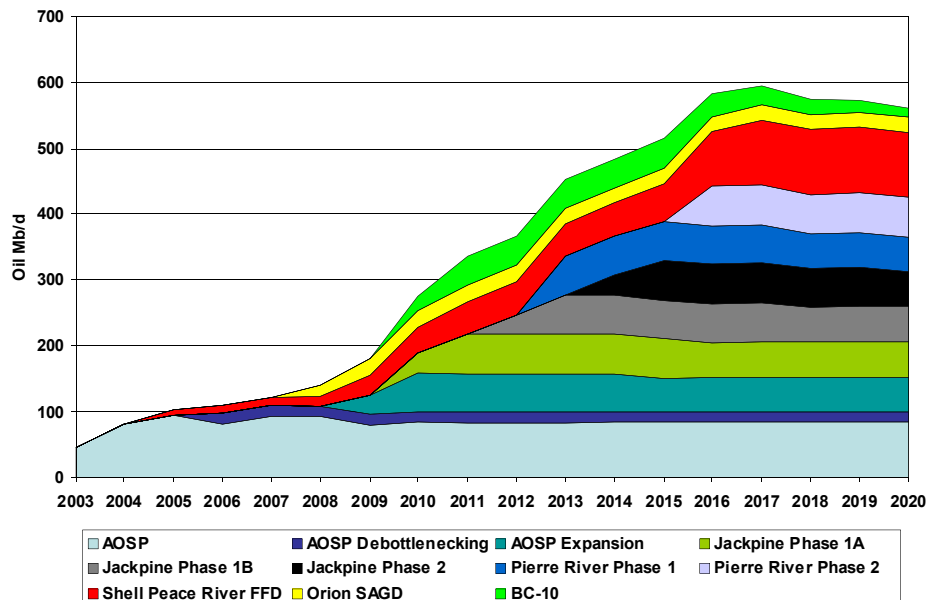
Cost inflation

There is significant evidence to suggest that cost inflation pressures will vary significantly in the near-term by region and type of project.

Recent cost inflation data in the US continue to point to a deceleration of inflation pressures, particularly drilling costs.

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Figure 1: Projected Shell Net Heavy Oil Output Including Newly Announced Projects



Source: GES estimates; \$50 WTI mid-cycle price scenario

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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.

By integrating the corporate and financial dimensions of strategy and performance with detailed project level analytics, we maintain a unique approach to your business. GES provides value to our clients through our forward-looking, critical analysis and unique perspective.

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These drilling cost data are dominated by onshore operations where we have seen a combination of cutbacks in drilling program plans and a likely faster response in rigs available than is probable elsewhere. Nevertheless, Transocean announced that it expects day rates to continue rising, perhaps even through mid-2008. The company specifically anticipates the potential for a 35% increase for high-specification floaters, which includes rigs used in ultra-deep-water drilling. This is despite what the company calls resistance.

While there is some hope for reduced cost pressures, adverse repercussions from cost inflation are evident in the large integrated projects around the world. Recent announcements in Qatar highlight this factor with potential cost increases at Pearl GTL and the decision not to proceed with the ExxonMobil GTL project. In addition, OMV just announced that conditions in steel markets may delay the Nabucco gas pipeline from Turkey to Austria

Role of Unconventional Gas Growing as it Spreads to International Strategy

In late January BP announced that it had been awarded a tight gas block in Oman. The 2,800 sq km block is located in central Oman. It includes two fields, Khazzan and Makarem, which were discovered in 1993 but have remained undeveloped.

A multi-year appraisal program is anticipated before initial production in 2010. While reserve estimates are obviously preliminary, this project is noteworthy for its potential size (as much as 20 to 30 Tcf of recoverable reserves).

At the same time BP announced plans to spend up to US\$2.4 billion to recover an estimated 1.9 Tcf of additional coalbed methane gas from its San Juan Basin operations in the US.

This and Shell's long-deferred Changbei tight gas project in China's Ordos Basin are two examples of the potential spread of unconventional technologies common in North America to previously untapped areas. The Changbei project startup was announced in mid-2005. Plans call for initial Changbei output of

115 mmcf/d to markets in Beijing, Shandong, Hebei and Tianjin by 2007, rising to 290 mmcf/d by 2008. Plateau output is expected to be sustainable for up to 17 years from an early estimate of 2.5 Tcf of recoverable reserves. Shell is estimated to have a 50% share in the project.

Total upstream development costs for the Changbei project will be about US\$ 600 million. These costs include construction of the central processing facilities, inter-field pipelines and development drilling of about 50 horizontal and multilateral wells over an estimated 10 year period. However, total costs of US\$3 billion were originally reported to be necessary once transportation and power generation investments are included. This estimate dates to 2000 and, therefore, is likely to be increased.

The BP and Shell tight gas projects are not the first unconventional gas initiatives outside North America. Burlington Resources signed a sales and purchase agreement in May 2002 to provide gas from its 100% working interest in the Chuanzhong Block which included the Bajiaochang field. Potentially recoverable tight gas reserves estimates at the time ranged as high as "several Tcf". However, Chuanzhong production rates have remained very modest and it is reported that ConocoPhillips is interested in selling its interest.

While unconventional gas is booming in North America, the long-term prospects for these types of unconventional projects in other parts of the world are unclear. In North America, a substantial portion of tight gas captures what, by international standards, is a very high price. It is likely to be difficult to realize the same value of tight gas reserves in most of the developing world.

Gas

Progress in Timor Sea Gas

East Timor and Australia have finalized two key treaties: the International Unitisation Agreement (IUA) and the Certain Maritime Arrangements in the Timor Sea (CMATS) Treaty. This step removes a substantial portion of the

prior barriers to development of gas resources in the Timor Sea between Australia and East Timor.

In part because of this agreement, Woodside announced that it will resume work on the previously stalled Sunrise LNG project. Partners in the project are Woodside (33.4%), ConocoPhillips (30%), Shell (26.6%) and Osaka Gas (10%). Government revenues from Sunrise will be shared equally between East Timor and Australia.

While the political problems with developing Sunrise have been addressed, the development plan remains problematic. In earlier discussions the partners could not agree on a development plan. Shell preferred an offshore liquefaction facility while ConocoPhillips argued for an onshore site near Darwin.

NW Shelf Sales Contracts

With the recent agreement signed by Kyushu Electric, all eight of the Japanese customers for NW Shelf LNG have renewed their long-term contracts.

Venezuela and Trinidad

Venezuela and Trinidad & Tobago have agreed to respective splits of the Loran field that straddles the two countries. According to the Venezuelan ministry, 73% of the estimated 10 Tcf of gas are allocated to Venezuela. It was also agreed that Dragon lies in Venezuelan waters.

Chevron operates the Venezuelan block containing the Loran field.

European Gas Contracts

In an important commentary on the changing character of European gas markets, Norsk Hydro noted that prices in future natural gas sales contracts are likely to be driven by gas-on-gas indexation terms rather than the previous usage of oil prices.

This shift was reportedly attributed to the effects of liberalization of the European (gas) markets, particularly the UK gas market. As the integration of the broader European gas market continues (particularly as the supply sources become more diverse) this gas-on-gas competition is likely to become more rather than less the norm.

Murphy Gas Sales Contracts in Malaysia

In a major step Murphy and Petronas will supply natural gas to the Bintulu gas liquefaction plant and to the Labuan methanol plant. The supply contract to Bintulu provides for first sales in 2009 with volumes of 250 mmcf/d for the first five years as well as a provision to increase supplies to 350 mmcf/d for another ten years.

Gorgon Group Continues to Build Position

The Gorgon group of companies (Chevron, ExxonMobil and Shell) were

awarded rights to Block W06-12. The location of this 3,000 sq km block is shown in Figure 2.

The continuing consolidation of acreage in the area of the Greater Gorgon project is reminiscent of ExxonMobil's land accumulation program in deepwater Angola. If it works, this Australian program could have an equally important and potentially more sustainable impact.

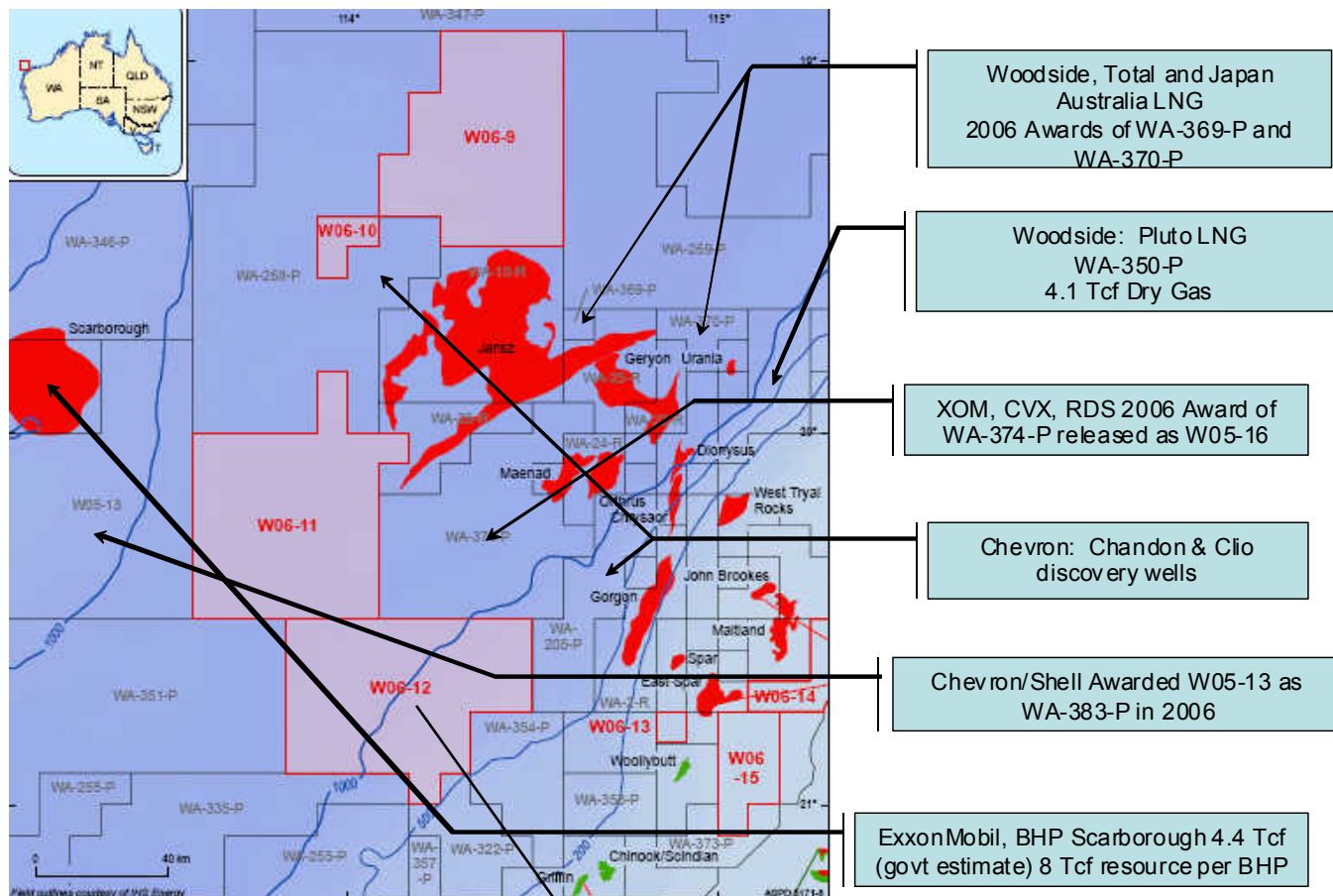
It is of potentially critical importance insofar as it is establishing the basis for this region to play a critical role in the

long-term prospects of all three Gorgon partners.

For Shell, it establishes a gas business play (both directly and indirectly through its Woodside interest) that stretches from the Timor Sea to Gorgon. For Chevron it establishes a prospective world class play.

Figure 2: Location of W06-12

Carnarvon Basin



Reserves are P90% estimates from government sources or company announcements of reserves

New block award to Chevron, ExxonMobil and Shell

Source: Australian Government, Department of Industry; Tourism and Resources

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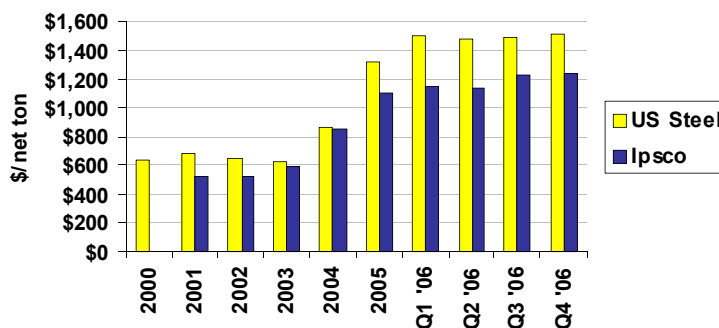
COST WATCH



Fourth quarter data on tubular steel prices is now available.

Tubular steel prices have held steady throughout 2006 at more than double the levels paid throughout the period from 2000 through 2003. On the positive side, there is not much evidence that tubular price pressures have been growing in 2006.

Tubular Steel Products Price

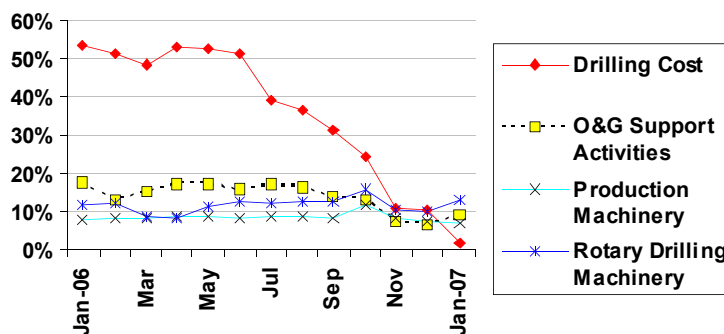


January Producer Price Indices

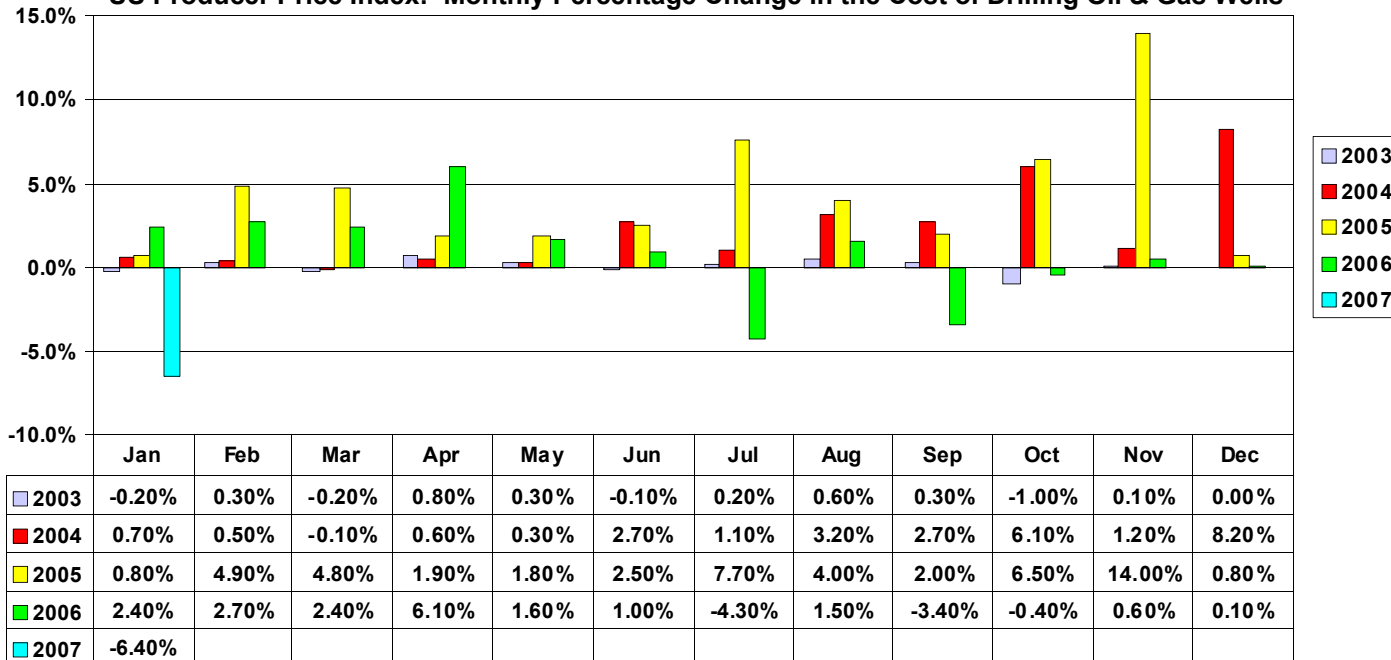
The run-up in oil industry costs moderated greatly in the last quarter of 2006. This was particularly true for drilling costs. Preliminary January 2007 drilling cost estimates show only a very modest 1.6% increase relative to January 2006. Moreover, preliminary January drilling costs are actually down significantly when compared to December 2006. It appears that a combination of increasing capacity and drilling program cutbacks may be having an impact on drilling costs. Details on US drilling cost estimates are shown below.

The sharp swings in drilling cost inflation have been mirrored in other segments (support activities and machinery) but the range of variation is much more narrow as the year progressed.

Annual Inflation of Selected Industry Costs



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
2005	27.2%	31.7%	36.5%	37.8%	39.4%	39.2%	45.8%	46.6%	45.9%	46.3%	59.1%	51.7%	43.2%
2006	53.3%	51.1%	48.7%	53.0%	52.7%	51.3%	39.2%	36.7%	31.3%	24.4%	11.1%	10.4%	37.4%
2007	1.6%												