

ON POINT

Vol 2, No. 11 November 2007



GORDON ENERGY
SOLUTIONS

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

IN THE NEWS

Browse Basin Sale – In an interesting reversal of direction, ConocoPhillips sold interests in three exploration blocks in the Browse Basin.

Inpex and Total acquired the interests in WA-341-P, WA-343-P and WA-344P. These blocks are in relatively shallow waters (50 to 250 meters) and are adjacent to the Ichthys project. Interests in the blocks will be Inpex (60%) and Total (40%).

Kurdistan Signs Five PSCs -- TNK-BP, a Korean consortium lead by KNOC, Hillwood International, Sterling Energy and Aspect Energy. The blocks were all associated with low or medium exploration risk. All of the specifics of the PSCs are not available including signature and production bonus payments. However, the generic terms include a 10% royalty, a variable cost oil or gas share that varies with oil and gas ranging from 36% to 48% of gross output and a profit oil split that varies with R factor.

Royalty Rate Increases -- Royalty rates applied to the deepwater Gulf of Mexico and Alberta's oil sands projects have been increased. More inside . . .

Tupi Reserves Announcement in Brazil -- Petrobras recently announced its reserve expectations for the Tupi sub-salt discovery. The field is in water depths ranging from 5,000 to 10,000 feet. At an estimated recoverable reserve of 5 to 8 billion boe (including associated natural gas) the field could profoundly alter Petrobras' long-term outlook and its strategic choices in the near to medium term. The company's withdrawal from Venezuela's Mariscal Sucre project was likely anyway but there should be little doubt that a stronger domestic outlook helped.

At the same time it has dramatic implications for Brazil's energy outlook and, potentially, the country's policy toward the future role of IOCs. A hint of what this might mean was signaled when 41 exploration blocks were removed from the upcoming round. Pressures to move to a more restrictive policy towards IOC access will be understandable, reflecting the likely perceived shift in the government's bargaining power. However, as has been recently demonstrated by Gulf of Mexico projects similar in technology, size and complexity, costs and risks are very high.

Central Sale 205 Results and Their Implications

As acreage acquired in the last half of the 1990s expires a number of companies see recent sales and those to follow next year as opportunities to re-configure land portfolios or establish themselves in the deepwater Gulf.

Sale 205 in the Central Gulf of Mexico was widely expected to be intensely competitive and, accordingly, a large industry capital commitment to build acreage positions was anticipated. Nevertheless, the \$2.9 billion in capital committed in winning bids was extraordinary.

However, in the global context there have been multiple warning signs that competition is driving up land costs in relatively more stable environments. In several past issues of On Point we noted, for example, the very high capital commitments made by a wide range of companies in Angolan deepwater re-issuances, recent offshore Australian acreage offerings in Australia and the Canadian Beaufort. These winning bids have been somewhat less spectacular in aggregate than Sale 205 (in part because a smaller number of companies compete in these areas). Nevertheless, the unit bids have been of an order of magnitude that is not dissimilar to Sale 205.

The broader significance of Sale 205 is rooted in several points our readers should note:

- There were multiple new entrants as well as companies re-entering the competition after playing a relatively minor role in recent GoM sales
- In a number of hotly contested blocks the winning bidders placed a very high premium on the block

compared to a general consensus with respect to value of the multiple losing bidders. Arguably more than a few of these new or re-emergent competitors over-estimated the level of competition and, in the process, left large amounts of money on the table

- While bidding strategies varied across companies, targeted bidding for specific, anticipated high-value prospect areas (from the perspective of the winning bidders) drove the competition
- Multiple National oil companies (NOCs) or quasi-NOCs played a significant role

New Entrants and Re-Emergent Players Driving the Competition

Shell's bidding program was a key driver of Sale 205. The company placed more than \$550 million in winning bids with 88% of this capital associated with contested bids.

The aggressiveness of Shell's bids was particularly noteworthy with \$270 million left on the table out of the \$483 million in winning contested bids. Moreover, the company left another \$50 million behind on three uncontested bids in Mississippi Canyon and De Soto Canyon.

These results are all the more noteworthy because (1) for an extended period of time Shell has not been a major competitor and (2) in the prior western sale its bidding was much more timid.

However, Shell was not the only company to display a renewed or more aggressive strategy.

OUR PERSPECTIVE



Gulf of Mexico Royalty Rates in the Deepwater Increased to 18.75%

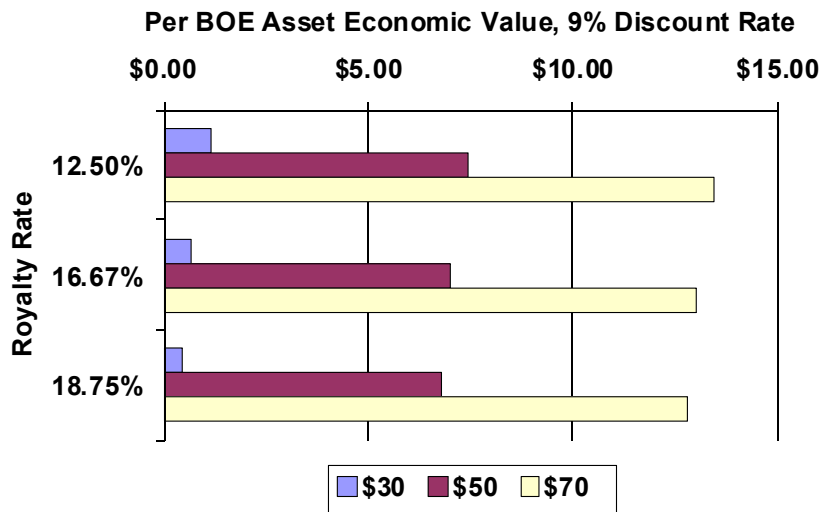
In the proposed Notice of Sale 206 in the Central Gulf of Mexico the MMS has announced that royalty rates will be increased from 16.67% to 18.75%. This, and the increase in oil sands royalty rates, is part of the continuing demand-pull pressures on industry costs including government take.

Coming on the heels of the previous increase from 12.5% the cumulative effect of rising royalties is now a material factor in project economics. The higher royalty rate will significantly increase price and cost risks in the deepwater Gulf of Mexico.

For purposes of illustration, the chart compares the present value of net after tax cash flows on a per boe basis at three price cases and at each royalty rate. The basic field and cost parameters are for a Tahiti-like discovery. At the newly announced royalty rate, the field only marginally adds value at a 9% cost of capital in the \$30 WTI case.

Higher royalties also cause earlier abandonment of fields. GES estimates that the cumulative impact of the royalty rate

Royalty Rate Impact on Gulf of Mexico Deepwater Reserve Values "Tahiti Class" Field



changes will reduce net recoverable reserves by 7%.

Alaskan Legislature Passes Increased Net Profits Tax

The legislature has just passed a bill to raise the net profits tax rate from 22.5% to 25%.

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.

Richard Gordon, Ph.D
President & CEO

rgordon@gordonenergysolutions.com

Steve Gordon
Vice President

sgordon@gordonenergysolutions.com

Gordon Energy Solutions
11286 Hadley St
Overland Park, KS 66210
(913) 451-9539

The cornerstone of our firm is supplying Research Services on Demand, enabling GES to deliver the analysis you want, when it's needed. Our services are uniquely tailored to fit your company's needs and reflects our role as a source of independent research and analysis.

Please feel free to distribute this to your colleagues. If you received this issue as a forward, and wish to receive it directly, please send an e-mail to subscribe@gordonenergysolutions.com. If you no longer wish to receive this newsletter and would like to have your e-mail address removed from our list, please send an e-mail to unsubscribe@gordonenergysolutions.com. Please let us know how we may improve this service.

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

Figure 1: Leading Bidders in Sale 205 Ranked by WI Capital Exposed in Winning Bids

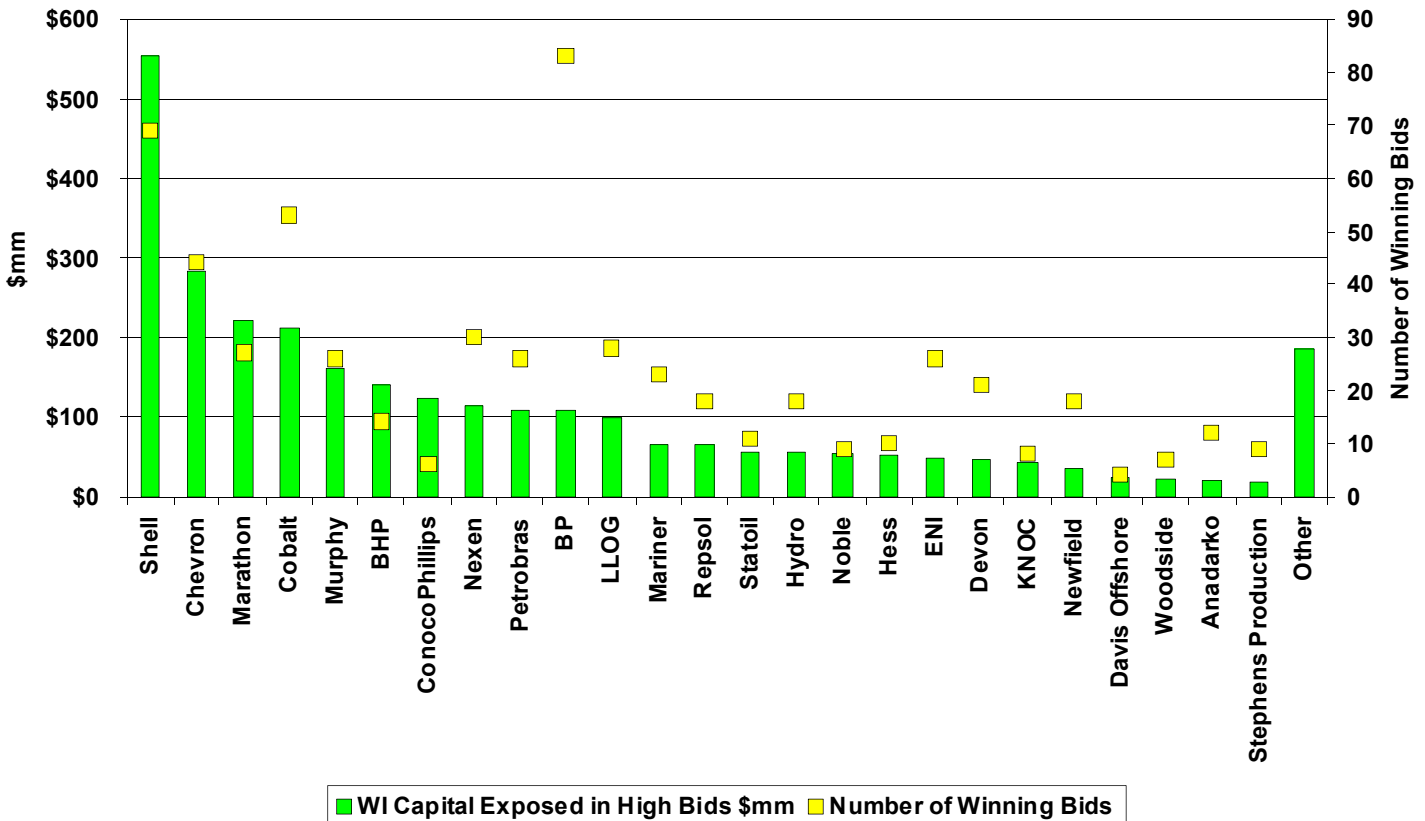


Figure 1 shows the leading bidders ranked by working interest capital exposed in winning bids. Three broad groups emerge. The first includes Shell, Chevron, Marathon and Cobalt with companies placing \$200 million or more in winning bids. The second group ranges from Murphy through LLOG with capital exposed in winning bids at \$100 million or more.

Marathon, Murphy, ConocoPhillips, BHP, and Nexen are all noteworthy. These companies rank in the top half of winning bidders. In recent prior sales these companies pursued relatively limited bidding programs or were absent.

Lots of Money Targeted at Relatively Few Blocks

Bidding was targeted at some very specific blocks or groups of blocks and valuation estimates of the contested blocks varied widely.

Among the top 20 bidders (measured by working interest capital exposed in high bids) the median percentage of winning bids exposed on contested blocks was 83%; among the top 8 companies, the median was

93%. Among them, these top 8 bidders left \$866 million on the table (30% of the MMS' total take from the sale).

There are multiple and often good reasons why this may occur. For example, differences in information or other related factors enhancing the expected value of a particular block to one company and not another. As a result, leaving money on the table is not, alone, cause for adversely judging a bidding program.

Nevertheless, the magnitude of the differences in valuation estimates was often very large. Also, the fact that wide variations occurred in multiple cases suggests that at least part of the reason was that (1) some companies may have over-estimated the level of competition and/or (2) some bidders went into the sale with a much stronger sense of need than others.

Figure 2 illustrates our point using bidding results for the 25 most highly valued blocks in the sale. This chart compares the competing bids for these

blocks and the labels show the winning company or partnership.

Note WR 7, GC 328, GC 996. In each of these cases the winning bids were very high (\$90 million for WR 7 and nearly \$70 million each for GC 328 and GC 996). Also note that (1) there were multiple other bids for each block and (2) these tightly grouped around a strong consensus as to the value of the blocks. The same is clearly true for multiple other blocks such as GB 954, WR 95, KC 71 or WR 363.

In many other cases shown in Figure 2 there was wider variation in values placed by the losing bidders on a block. However, the range of these alternative values was still radically lower than the winning bid.

NOCs

Referring back to Figure 1, of the 25 leading bidders in Sale 205, four are NOCs or quasi-NOCs (counting Statoil and Norsk Hydro as one case).

OUR PERSPECTIVE



The presence of these companies is not entirely new but it is safe to say that the NOCs are playing a continuing and growing role in the Gulf and the broader North American E&P sector. This is, of course, part of a broader trend witnessed, for example, by the KNOC lead group winning the Bazian Block in Kurdistan.

These companies add a new dimension to the competitive environment in the Gulf of Mexico and their presence has a very great deal to do with the broader global strategy of the companies and their host governments.

Implications of the Sale

Looking forward, there are three important implications to consider.

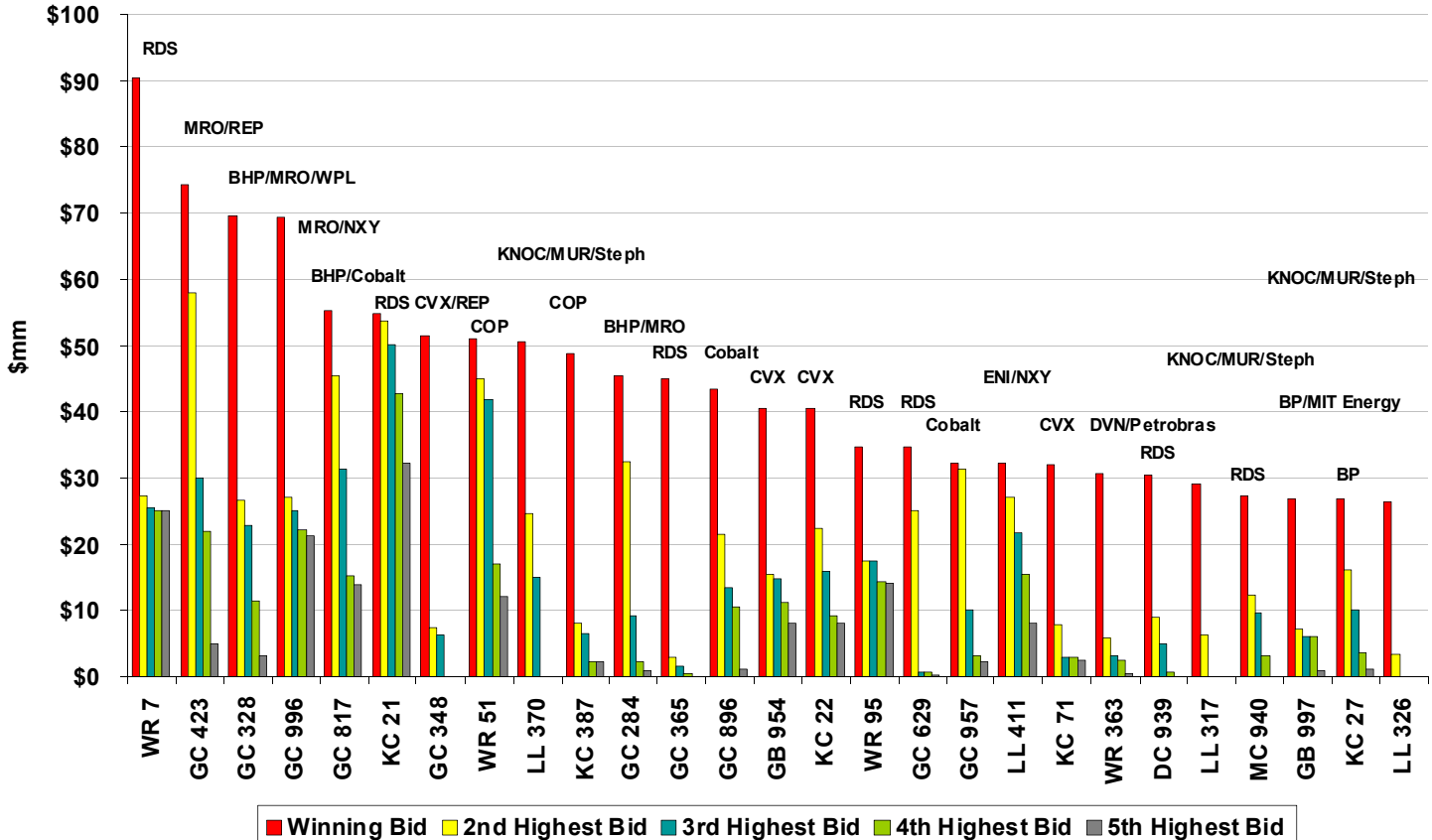
First, how will companies' bidding strategies respond to the results of this most recent sale? Will Shell continue to bid much higher than its competitors or will it re-adjust? For other companies, will bid levels be increased in response to Sale 205?

Second, at least some part of the globally based issues driving the NOCs' strategy in the Gulf is likely to be playing a major role in the re-emergence of companies like Shell, Marathon and ConocoPhillips as leading bidders. The narrowing scope of acceptable new business development opportunities and rising government take elsewhere in the world has the effect of funneling more capital into the remaining areas available. To the extent that this is true, look for this factor to also play a major role in the coming sale.

Third, as capital is funneled into opportunities like the Gulf, it is to be expected that the cost of building positions in this play, both bid costs and government take, is going to rise.

Sale 205 demonstrates this point with respect to bid costs where the top four blocks collected combined high bids of roughly \$300 million. The recent announcement that royalty rates in the next Gulf lease sales will rise, for the second time, to 18.75% from 16 2/3% is demonstration enough of the second point.

Figure 2: Top 25 Blocks Based on Winning Bids and Competing Bid Consensus Values



MERGERS, ACQUISITIONS, & DIVESTITURES



Beginning with this issue, On Point will include a regular feature on mergers, acquisitions and divestitures. Our focus will be global although commentary and analysis in particular issues will generally be focused on some specific deal or trends and strategic drivers in a play. This section will include data collected by GES with respect to deals that have occurred or been announced.

US A&D Market

Multiple factors have combined in the last three years to profoundly shape the character of the MA&D market in the US and to set the stage for significant company activity.

The run-up in oil and natural gas prices since 2003 generated what some have characterized as a "land grab". This has been true across all plays. But the situation especially impacted the demand for acreage with unconventional oil and gas resource potential such as (1) the Bakken oil shale play, (2) shale gas in multiple basins and (3) coal bed methane. These demand-side impacts have been reflected in all facets of the MA&D market as well as grass roots land building strategies.

As companies' land inventories have ballooned many firms must now make the transition to proving up the potential of these inventories and realizing value for them. This pressure offers opportunity.

However, the pressure to monetize is now greatest when industry costs,

including land acquisition costs, have risen dramatically and as natural gas prices have fallen very substantially this year.

In our view, the result of this combination of forces is now and will continue to be three-fold:

- A broad group of companies will be forced to conduct "strategic reviews" of their programs
- Diversified companies will opt out of E&P as Dominion did
- Land rich companies, even a number of very large companies, will act to "high-grade" their land inventories and focus their budgets on high priority portions of the portfolio

These adjustment processes are already evident across a broad spectrum of companies.

The implication is that a number of companies that (1) either missed the land grab or (2) are looking to build onshore Lower 48 positions can still position themselves in major plays of interest.

What we are describing here is the emergence of an unambiguous analogy between (1) the current and future state of the Lower 48 onshore sector and (2) the deepwater Gulf of Mexico sector in the years following the leasing boom of the last half of the 1990s .

Mergers and acquisitions will be essential tools to accomplish these goals. However, also look for a continuing proliferation of extended areas of joint ventures and alliances as well as more conventional farm-in agreements.

In coming months this section of On Point will focus on these issues and their strategic implications in much greater detail.

The data and analysis you will see in this section is prelude to the launch, early in 2008, of our new Mergers, Acquisitions & Divestitures service.

We are also pleased to announce that EnergyNet has agreed to supply data for this purpose drawn from their extensive inventory of completed transactions. Average EnergyNet transaction value metrics by major US region are provided in the table on the following page.

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. The food chain in the industry is enormous, and what may seem small or non-strategic to one company is an accretive acquisition target to another. While taking on an ongoing divestment program may seem like a daunting task, EnergyNet possesses the staff and techniques to make it easy, fast, and highly profitable.

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. When property packages are bundled to include many different counties, states, and interest types, a large number of Buyers are excluded from the competition. 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.

EnergyNet can prepare, market, and close a set of property transactions much faster than any other divestment-focused company in the industry. EnergyNet makes property divestiture faster and easier than ever before. 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.

MERGERS ACQUISITIONS & DIVESTITURES



US Asset Sale Value Indicators

EnergyNet Regional Sales Data 2006

Working Interests 6:1

	Average \$/BOE/D	Average \$/MCFE/D	Average Multiple (Average Income)	Average Multiple (Last Income)
Appalachians	\$73,565	\$12,261	43.62	50.38
Central Texas	\$48,902	\$8,150	37.81	40.12
East Texas	\$62,972	\$10,495	44.78	49.16
Gulf Coast	\$45,285	\$7,248	37.19	45.30
Michigan Basin	\$44,347	\$7,391	41.24	40.58
Mid Continent	\$52,819	\$9,148	50.14	54.44
Panhandle	\$43,592	\$7,028	43.84	51.81
Permian Basin	\$62,599	\$10,433	45.32	46.10
Rockies	\$66,418	\$11,070	45.93	68.58
South Texas	\$37,688	\$5,484	34.34	44.28
National Average	\$53,819	\$8,871	42.4	49.1

EnergyNet Regional Sales Data 2007

Working Interests 6:1

	Average \$/BOE/D	Average \$/MCFE/D	Average Multiple (Average Income)	Average Multiple (Last Income)
Appalachians	\$47,237	\$7,873	38.72	34.44
Central Texas	\$52,151	\$8,281	45.56	44.93
East Texas	\$49,862	\$6,599	50.39	56.93
Gulf Coast	\$32,371	\$12,734	37.56	44.08
Michigan Basin	\$50,574	\$8,429	31.79	75.45
Mid Continent	\$55,110	\$8,491	52.60	58.43
Panhandle	\$39,728	\$6,621	45.60	50.09
Permian Basin	\$49,800	\$7,609	51.07	47.98
Rockies	\$43,093	\$7,182	40.92	41.95
South Texas	\$33,828	\$5,032	38.56	50.07
National Average	\$45,375	\$7,885	43.3	50.4

For More Information Contact EnergyNet, Inc.: Toll Free: 877.351.4488
E-mail: energy@energynet.com Or visit their website: www.energynet.com

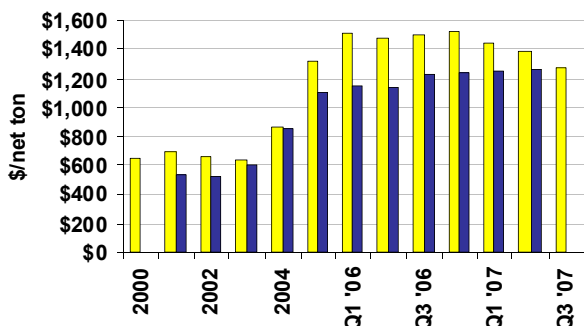
COST WATCH



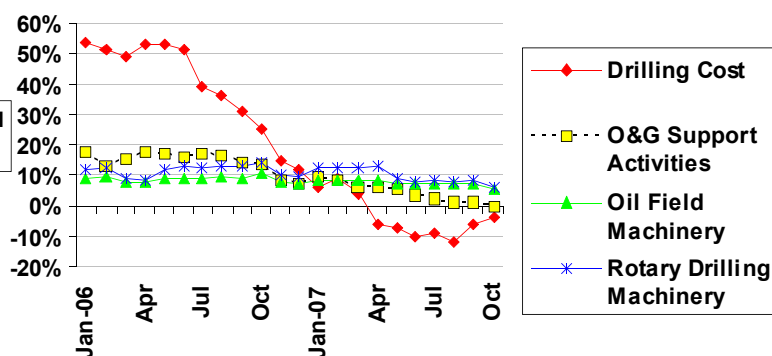
Several key costs are declining or stabilizing. As shown below this includes tubular steel which has fallen in each quarter this year, drilling costs and recently oil and gas support activities costs. Of course, this does not change the fact that costs are radically higher for a broad spectrum of goods and services used by the oil and gas industry.

This process is still at an early stage. It seems likely that it reflects both efforts by some of the larger independent producers to trim drilling programs and some increases in capacity in the drilling and services sectors. Nevertheless, the process can easily come to a halt or an inflationary spiral could re-emerge if industry drilling activity and investments rise due to higher oil prices or if natural gas prices rise in the near-term and trigger a similar spending reaction. Preliminary drilling cost estimates for September and October of this year are up compared to August. Also, on a year-to-date basis 2007 drilling costs are only down 3.7% from their 2006 average.

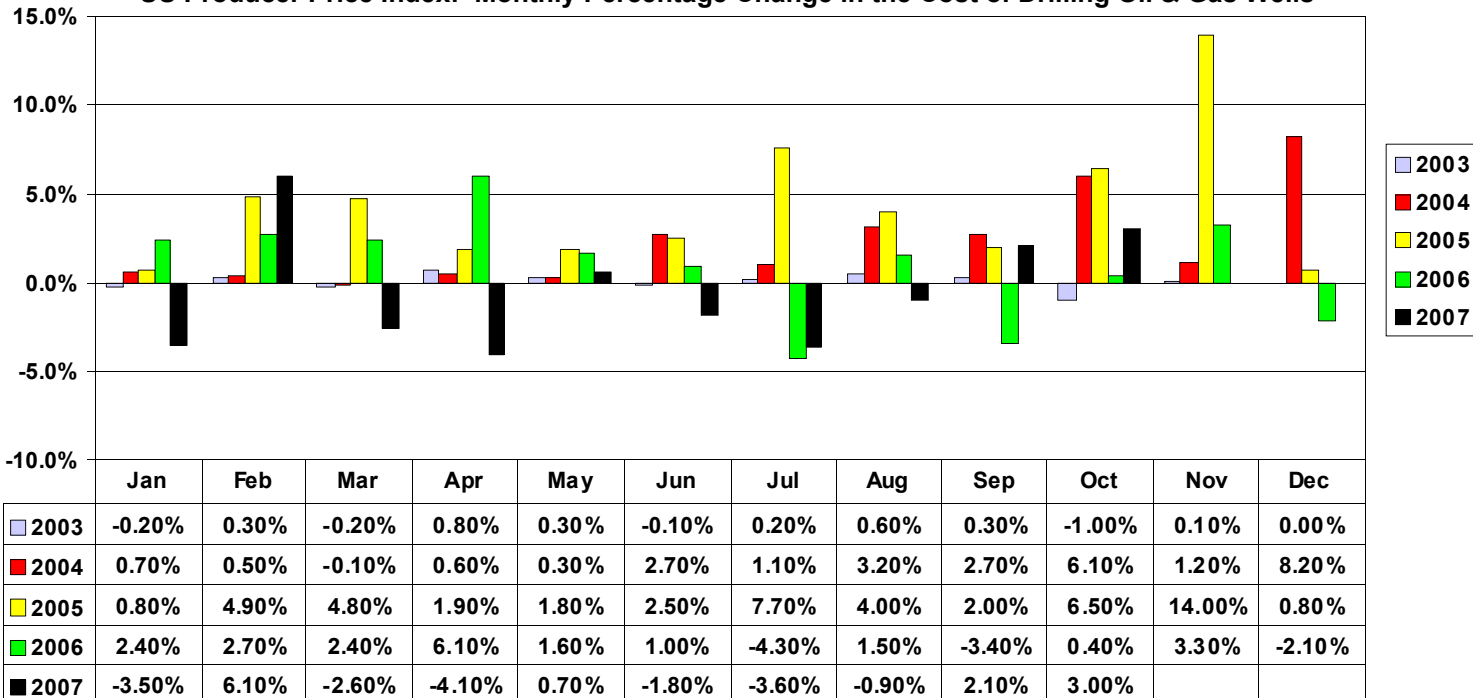
Tubular Steel Products Price



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%	25.2%	14.5%	11.6%	37.8%
2007	5.7%	9.1%	4.2%	-6.1%	-7.0%	-9.8%	-9.1%	-11.5%	-6.1%	-3.5%			