

# Oil & Gas Industry Overview

Fall 2010

## Supply and Demand Update

The global oil and gas industry saw increased growth during the first half of 2010, but the uncertain outlook for global economic growth has continued to impact oil and gas markets.

The Energy Information Administration (EIA) forecasts global oil demand to grow by approximately 1.7 million b/d in 2010 and 1.4 million b/d in 2011. This growth is attributed to stronger than expected demand during the first half of 2010 in China and in the Organisation for Economic Cooperation and Development (OECD) countries. Assuming that global oil-consumption-weighted GDP grows by 3.8 percent and 3.3 percent in 2010 and 2011, respectively, the EIA anticipates the average West Texas Intermediate (WTI) price rising to \$85/bbl by fourth quarter 2011 due to better global economic conditions.<sup>1</sup>

For the United States, the EIA projects that total liquid fuels consumption will begin to recover from its fall of 810,000 b/d in 2009 from 2008 levels. U.S. liquid fuels consumption is projected to grow by 200,000 b/d in 2010 and by 110,000 b/d in 2011. The EIA projects that total U.S. natural gas consumption will increase by 4.6 percent and 0.1 percent in 2010 and 2011, respectively, driven by the rise in demand in the industrial and electric power sectors.<sup>2</sup>

### Commodity Price Trend and Outlook

The decline in natural gas prices has continued since late 2008 due to record storage levels and weak industrial and power demand. The

first half of 2010 resulted in further reduction in natural gas prices attributed to the rise in domestic natural gas production and the rise in the gas rig count. However, oil prices continued to improve on the upside. As such, crude oil prices are expected to remain firm through the rest of 2010 and strengthen into 2011, as demand is strengthening in non-OECD countries and emerging markets.

### Regulatory Environment

On May 27, 2010, the Obama administration issued a moratorium on new deepwater-drilling activities in waters of 500 feet or more in response to the BP Deepwater Horizon oil spill; however, on October 12, 2010, the administration lifted the ban on the moratorium.

The government reaction to the spill will likely have a significant effect on the oil industry that will likely lead to reduced output. The higher regulatory and drilling costs associated with stronger regulation will also likely lead to reduced output. However, global oil production would likely be reduced by less than the reduction in U.S. production, as the size of the global market would mitigate the supply and price effects.<sup>3</sup>

The government reaction to the spill will likely have a lesser effect on natural gas, as the reduction in U.S. offshore production is small in proportion to the total U.S. natural gas market. Increases in other domestic sources as well as increases in imports would mitigate the price effects.<sup>4</sup>

In addition to possible regulatory changes, several tax proposals could affect the oil and gas industry. The Obama administration's current budget request would limit or eliminate approximately \$40 billion in favorable tax programs for oil and gas companies. These budget proposals affect intangible drilling and development costs (IDC), percentage depletion, passive loss exception for working interests in oil and gas properties, geological and geophysical (G&G) amortization, marginal well tax credit, enhanced oil recovery (EOR) tax credit, tertiary injectants deduction, the manufacturing tax deduction, and a proposed federal tax on Gulf of Mexico production.

Industry groups, including the Independent Petroleum Association of America (IPAA), oppose these changes and have argued that these tax provisions are intended to encourage the development of resources and reflect tax policy that is consistent with comparable treatment of other energy sources. The IPAA has also argued that oil will continue to be a key component of U.S. energy supply for the foreseeable future and any policies should rely first on U.S. domestically produced oil rather than on foreign sources.

<sup>1</sup> U.S. Energy Information Agency, Short-Term Energy Outlook, October 2010.

<sup>2</sup> U.S. Energy Information Agency, Short-Term Energy Outlook, July and October 2010.

<sup>3</sup> Stephen P.A. Brown, Some Implications of Tightening Regulation of U.S. Deepwater Drilling, Resources for the Future, June 2010 (<http://www.rff.org/rff/documents/RFF-BCK-Brown-Regulations.pdf>).

<sup>4</sup> Stephen P.A. Brown, Some Implications of Tightening Regulation of U.S. Deepwater Drilling, Resources for the Future, June 2010 (<http://www.rff.org/rff/documents/RFF-BCK-Brown-Regulations.pdf>).

## Oil & Gas M&A Marketplace

Rising crude oil prices have increased optimism and confidence in the M&A market. Global M&A activity accelerated in the second half of 2009, but the M&A market has not recovered fully in 2010 and financing remains tight.<sup>5</sup> Global upstream M&A deal volume and transaction values started low in early 2010 but picked up as a result of large E&P divestiture programs and global expansion by international oil companies and Asian national oil companies. North American transactions in

unconventional resources dominated activity during the spring, and shale natural gas assets attracted premium deal pricing.<sup>6</sup>

M&A activity is expected to increase in the Permian Basin, Bakken, and Niobara regions during the second half of 2010 and throughout 2011, and M&A activity in unconventional shale gas plays is expected to continue. International buyers are expected to continue to favor the United States as a stable region with significant resources and an opportunity to gain technical experience in developing

unconventional resources. Joint ventures, which have been an alternative source of funding for cash constrained oil and gas producers, are likely to accelerate in the coming months.

<sup>5</sup> HIS Herold, Global Upstream M&A Review, 2010.

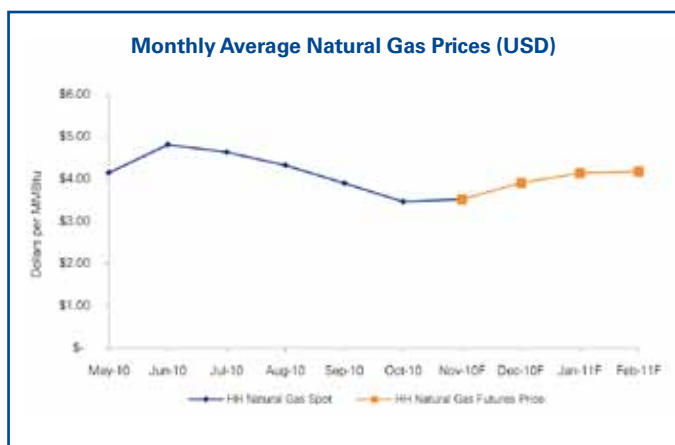
<sup>6</sup> Herold M&A Insights, Monthly Upstream M&A Perspectives: Key Trends and Insights from the Current Global Market, June 2010.

Select Upstream M&A Transactions						
Date	Buyer	Seller	Transaction Value (US\$million)	Total Bcfe	Implied Value (US\$/mcf)	Transaction Detail
9/20/2010	McMoRan Exploration Company	Plains Exploration & Production Company	818	60.0	2.47	McMoRan Exploration (MMR) agreed to acquire Plains E&P's (PXP) shallow water Gulf of Mexico (GoM) assets for US\$818MM in stock and cash.
9/7/2010	Linn Energy LLC	Undisclosed	352	183.6	1.96	Linn Energy, LLC agreed to acquire properties located in the Wolfberry trend of the Permian Basin in three separate transactions for a combined US\$352.2MM.
7/27/2010	Hess Corporation	American Oil & Gas Incorporated	379	-	-	Hess Corporation agreed to acquire Bakken Shale-focused American Oil & Gas Inc. in an all stock transaction valued at US\$378.6MM including working capital and liabilities.
7/21/2010	ExxonMobil	Ellora Energy Inc.	695	61.0	1.80	Ellora Energy announced that it has agreed to sell the company to ExxonMobil for US\$695MM in cash. The total transaction value is US\$570MM including a US\$125MM working capital surplus assumed by the buyer.
5/25/2010	Williams Companies Inc.	Alta Resources LLC Denham Capital	501	-	-	Williams Companies acquired 42,000 net acres in the Marcellus Shale from Alta Resources and partners for US\$501 million. Williams estimates the assets to hold approximately 1.2 Tcfe in total recoverable natural gas reserves.
3/29/2010	Linn Energy LLC	Undisclosed	305	108.0	2.82	Linn Energy acquired Permian Basin properties from an undisclosed seller for US\$305 million. According to Linn's transaction press release, the transaction covers 108 Bcfe (71 percent oil) of net proved reserves and 2,800 boe/d production.
3/23/2010	CCMP Capital Advisors LLC	Chaparral Energy Inc.	767	315.0	2.44	Private equity firm CCMP Capital Advisors, LLC acquired a 37 percent stake in Chaparral Energy for approximately US\$767 million. Chaparral's core properties are in the Mid-Continent and the Permian Basin regions, but also operates in the Gulf Coast, Ark-La-Tex, North Texas, and the Rocky Mountains.

Source: John S. Herold, October 29, 2010

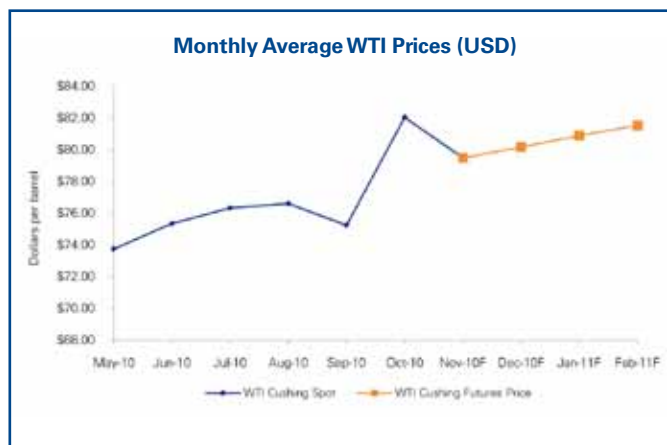
Select Joint Venture Transactions							
Date	Buyer	Seller	Transaction Value (US\$million)	Total Bcfe	Implied Value (US\$/mcf)	Implied Value (US\$/net acre)	Transaction Detail
10/20/2010	CNOOC Limited	Chesapeake Energy Corporation (U.S.)	2,160	-	-	10,553.00	CNOOC agreed to acquire a 33.3 percent undivided interest in Chesapeake Energy Corporation's 600,000 net acres in the South Texas Eagle Ford Shale (primarily in the oil window) for a total consideration of US\$2.16 billion (B) in a cash-plus-drilling carry transaction.
8/31/2010	Sumitomo Corporation	Rex Energy Corporation	140	-	-	9,000.00	Total transaction value includes 12,885 net undeveloped Marcellus acres (US\$116MM – 50 percent in cash, 50 percent in drilling carry); producing wells (US\$14.9MM in cash); reimbursement for seismic, wells & facilities in progress (US\$4.8MM); and associated midstream assets (US\$4.7MM).
8/5/2010	Reliance Industries Ltd. (India)	Avista Capital Partners LLP Carrizo Oil & Gas	392	-	-	6,262.00	Reliance Industries Ltd. agreed to acquire a 60 percent interest in Marcellus Shale undeveloped acreage and resources in Central and Northeast Pennsylvania that is currently held in a JV between Carrizo Oil & Gas and Avista Capital Partners for a total consideration of US\$392MM.
6/24/2010	Reliance Industries	Pioneer Natural Resources Company (U.S.)	1,145	-	-	12,014.69	Reliance Industries acquired a 45 percent interest in 212,000 net acres of Pioneer's undeveloped Eagle Ford Shale leasehold. The total acreage will support approximately 1,750 drilling locations with a gross resource potential of approximately 11 tcf (4.95 tcf net to Reliance).
5/10/2010	BG Group plc (U.K.)	EXCO Resources Inc.	950	-	-	2,905.20	BG Group agreed to acquire a 50 percent stake in EXCO Resources' Appalachian Basin assets (located primarily in Pennsylvania and West Virginia), consisting of producing assets and undeveloped acreage.
4/9/2010	Reliance Industries Ltd. (India)	Atlas Energy Inc. (U.S.)	1,700	-	-	14,166.67	Reliance Industries acquired a 40 percent undivided interest in 300,000 net acres of Atlas Energy's undeveloped Marcellus Shale leasehold. The acreage will support the drilling of over 3,000 wells with a net resource potential of approximately 13.3 tcf (5.3 tcf net to Reliance).

Source: John S. Herold, October 29, 2010



Source: U.S. Energy Information Administration, October 25, 2010.

Notes: Natural gas spot prices through October 25, 2010. Futures price is the NYMEX closing price on October 25, 2010.



Source: U.S. Energy Information Administration, October 27, 2010

Notes: WTI spot prices through October 27, 2010. Futures price is the NYMEX closing price on October 27, 2010.



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