

MUSINGS FROM THE OIL PATCH

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Note: *Musings from the Oil Patch* reflects an eclectic collection of stories and analyses dealing with issues and developments within the energy industry that I feel have potentially significant implications for executives operating oilfield service companies. The newsletter currently anticipates a semi-monthly publishing schedule, but periodically the event and news flow may dictate a more frequent schedule. As always, I welcome your comments and observations. Allen Brooks

Look What's Keeping Oil Prices High

Crude oil futures traders are worried about the approaching peak in hurricane season activity on possible supply from the gulf

This morning, tropical depression #11 was upgraded to a tropical storm and named Katrina. The storm is projected to make landfall on the eastern coast of Florida possibly by early Friday morning and then likely head into the Gulf of Mexico. We have been hearing that crude oil futures traders are worried about the approaching peak in hurricane season activity on possible supply from the gulf. As a result they have been bidding futures prices higher. We found the following charts on storms on the AccuWeather web site, which helps explain these traders concerns. The tropics do appear to be quite active currently.

Exhibit 1. Active Tropics Making Oil Traders Nervous



Source: AccuWeather

The immediate concern for traders and the industry is TS Katrina that may be following a path similar to that of Hurricane Andrew in 1992, which was one of the strongest storms in U.S. history. Katrina doesn't appear to have Andrew's strength, and, as a result, will probably not produce the damage Andrew did when it got into the gulf. Weather forecasters are suggesting that when Katrina gets into the Gulf of Mexico it will strengthen into a hurricane due to the very warm waters there, but it will start from a very low energy base.

Hurricane Andrew, it was one of the most damaging storms to hit the United States

For those who do not remember Hurricane Andrew, it was one of the most damaging storms to hit the United States. It leveled parts of south Florida, areas that have still not fully recovered. The damage Andrew did to the oil and gas drilling and producing infrastructure in the Gulf of Mexico resulted in a sharp increase in activity and spending, along with a reduction in capacity. This damage was a catalyst for the oilfield service industry recovery, and as a result, industry participants began calling the storm Saint Andrew, the patron saint of the oilfield recovery. With current oil prices where they are, the oilfield service industry doesn't need another saint to prosper.

Exhibit 2. TS Katrina's Projected Path

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Source: AccuWeather

Exhibit 3. Saint Andrew Helped Revive Oilfield Service Industry

Source: AccuWeather

If hurricanes and tropical storms don't continue to develop, then be prepared for crude oil prices to start to weaken

The earnings outlook for oilfield service companies looks very solid for the balance of 2005 and early 2006

If hurricanes and tropical storms don't continue to develop, then be prepared for crude oil prices to start to weaken. The latest economic data and anecdotal evidence suggest that high petroleum prices are beginning to have a negative impact on consumption. However, the oil markets are so jumpy that any storm-related problems or other geopolitical or industry disruptions could send current futures prices toward \$70-\$75 per barrel.

While the near-term trend in crude oil futures prices may have some bearing on the movement of oilfield service stock prices, it will have little impact on industry activity. Drilling and field development activity is ramping up, and will continue to increase. The earnings outlook for oilfield service companies looks very solid for the balance of 2005 and early 2006. The question is becoming the momentum for earnings in the second half of 2006 and into 2007-2008. If, as industry data is suggesting, oil companies are opening their purses and stepping up their spending, then this industry cycle will last for a number of years at the current healthy pattern.

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