PARKS PATON HOEPFL & BROWN

ENERGY INVESTMENT BANKING, LP

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

What Does China Know About Future Oil Supplies?

China has established a national standard for methanol as automotive fuel

The *Financial Times* scooped the world with a story on the Friday after Thanksgiving indicating that China has established a national standard for methanol as automotive fuel. The story was buried at the bottom of page five, but its significance should have been worthy of page one. According to the newspaper, the new standard had not been officially announced, but was reported in a trade magazine and then confirmed by an official attached to the National Development and Reform Commission (NDRC). The NDRC is the organization responsible for approving rules and standards such as this.

The government would give subsidies and tax breaks to the bio-energy and bio-chemistry sectors

The following Monday, according to a release on the NDRC web site, at a State Council meeting, Vice Premier Zeng Peiyon said that the government would raise the proportion of alternative energies in the country's total energy consumption and that oil alternatives would receive priority. He went on to say that projects for liquefied coal, bio-diesel, ethanol, solar energy, wind power and hydropower would all be encouraged. More significantly, a circular jointly released by five government ministries, including the Ministry of Finance and the Ministry of Agriculture, said that the government would give subsidies and tax breaks to the bio-energy (bio-diesel and ethanol) and bio-chemistry (methanol from coal) sectors.

Local companies have under construction, or are awaiting approval to build, plants to produce methanol from coal equivalent to about 20% of China's present oil consumption. By the time the plants, which convert coal to liquids, start producing in 2011 to 2013, China's oil demand will have likely doubled, allowing methanol to supply about 10% of the market.

The methanol is derived from coal using the Fischer-Tropsch chemical process, which is the industrial process referred to as coal-

to-liquids (CTL). The process produces a sulfur-free and reduced aromatics alcohol that can be blended with conventional gasoline or diesel to create a cleaner-burning type of fuel.

Royal Dutch Shell and a Chinese partner have committed to a three-year study of the feasibility of a CTL plant equal to about 1% of Chinese oil demand

Within the past few years, China has been experiencing a surge in CTL plants. One recent announcement, for example, stated that Royal Dutch Shell (RDS.A-NYSE) and a Chinese partner have committed to a three-year study of the feasibility of a CTL plant, which, if built, will cost between $5-6 billion and produce the equivalent of 70,000 barrels per day (b/d) of methanol, equal to about 1% of Chinese oil demand, now just over 7 million b/d. The plant would be located in the western province of Ningxia and would represent one of China's largest single foreign investments.

Shell is one of the leaders in liquefaction technology and has already licensed its technology to 15 projects in China. Shell, with its partner China National Petroleum Corp. (Sinopec), already has one plant under construction. The Shell process uses oxygenated gasification that permits isolating carbon dioxide (CO2) during the manufacturing process, and this is more compatible with carbon sequestration than other leading fossil fuel technologies. If the Chinese actually sequester carbon, or use it for purposes such as enhanced oil production form older oil fields, this will be a big step forward for China's environmental protection efforts as well as for controlling emissions of greenhouse gases.

In mid November, *The New York Times* columnist, Thomas Freidman, visited China and wrote several missives about the environmental problems and challenges the country and its leaders face. His visit followed shortly after Beijing played host to a summit meeting of 42 African leaders. *Time* magazine reported that Beijing officials had "ordered half a million official cars off the roads and said 400,000 more drivers had 'volunteered' to refrain from using their vehicles" in order to clean up the air for their African guests.

The government has to find jobs for these migrants almost at whatever cost

Mr. Friedman's columns described the pollution and cited numerous deadly statistics. He pointed out that China's top leaders understand the crisis, but their response is complicated by the need to maintain political stability that can only come from finding employment for the masses abandoning rural areas for the metropolitan regions. This means the government has to find jobs for these migrants almost at whatever cost. In Mr. Friedman's view, "Without a new cultural revolution to make China more green, more sustainable, the Chinese growth juggernaut will destroy itself."

In an interview with Pan Yue, China's vice minister for environmental protection, Mr. Friedman was told, "It will only come from a shift of attitudes from the very top to the very bottom. My job is to educate and encourage this shift, so that officials don't just think about economic growth as G.D.P. growth, but also factor in environmental health." Mr. Friedman sees the Chinese challenge as recognizing that going green is not just a problem but an opportunity. He points out that when U.S. companies went green, they consistently

overestimated the costs and underestimated the savings.

There are at least 30 large-scale CTL projects in the detailed planning, permitting or feasibility stage

According to investment bank Credit Suisse, there are at least 30 large-scale CTL projects in the detailed planning, permitting or feasibility stage. These plants, which are very expensive to build, are generally considered financially viable when global oil prices are in the $35-40 per barrel range. Additionally, China has significant coal reserves. It has one of the world's most extensive coal mining industries, however, working in the industry is not particularly safe. According to the *Los Angeles Times*, well over 5,000 people per year are killed in Chinese coal mines, or a rate of over 100 deaths per week. The government has targeted the small coal mines in the industry to try to improve their safety record.

Energy consumption growth is making China more dependent upon imported oil supplies

China has abundant coal reserves, but rapidly declining domestic oil reserves. The government is hopeful of reversing the trend in oil reserves by stepping up exploration in the highly prospective South China Sea. But in the meantime, energy consumption growth is making China more dependent upon imported oil supplies. At the present time, China relies on imports for about 40% of its oil needs. At about 7 million b/d of oil consumption, China is the world's second largest consumer behind the United States' 21 million b/d use.

China's coal imports come primarily from Australia and Canada, both known to be politically stable suppliers

The growing dependence on oil imports has forced China to embark on a global search for oil reserves. It has been securing these reserves by going to regions where western oil companies are restricted from operating, or by making country-to-country political/military/economic deals. One major supplier to China is Angola, which is now China's largest single source of petroleum. Recently China purchased a huge oil field in Angola. Other significant suppliers to China include Saudi Arabia and Iran, which possess significant political risk even for the Chinese. On the other hand, China's coal imports come primarily from Australia and Canada, both known to be politically stable suppliers. From an economic planning viewpoint, the reduced political risk of interruptions in coal imports versus oil imports further boosts the case for investing in CTL plants.

Several of China's coal-rich provinces have issued interim standards for methanol

Several of China's coal-rich provinces, impatient with the NDRC's long deliberations over the fuel standard, have issued interim standards for methanol within their region over the past year. Shaanxi province, in north-central China, which produces about 600 million tons a year of coal, or about a quarter of the nation's output, has issued stickers allowing cars using methanol free passage on the province's toll roads. The province has issued two standards for fuels using 15% and 85% methanol. At the present time the province has 100 buses using M85 fuel and is in discussions with a local car manufacturer to build a fleet of taxis designed to run on the fuel.

Shaanxi officials have complained that NDRC officials have delayed the development of methanol in favor of ethanol, which is mainly produced from Chinese corn. The complaint reflects provincial

rivalries. Ethanol is produced from corn grown in the country's northeast provinces in the heart of China's poor rustbelt region and an area that has been given priority by the central government.

The oil alternative "gasohol" would account for more than half of China's projected 65 million tons of gasoline consumption by 2010

According to the NDRC, policies to regulate the development of China's ethanol industry have recently been presented to the State Council for its approval. Xiong Bilin, vice director of NDRC's department of industry, told a bio-energy conference recently, that the oil alternative "gasohol" would account for more than half of China's projected 65 million tons of gasoline consumption by 2010. He refers to gasohol as a blend of 90/10 gasoline and ethanol. China is now the world's third largest ethanol consumer after Brazil and the U.S., with gasohol consumption equal to about 20% of total gasoline consumption last year. There are four special ethanol fuel producers with annual production of 1.02 million tons and capacity targets to reach 3.25 million tons by 2010.

The production of ethanol is climbing, partly driven by the high prices available for exports on the world market. This has led critics of ethanol in China to say it is inappropriate to use corn to make fuel when China is struggling to keep precious agricultural land in production in order to ensure "food security" for the country and to slow the rapid migration of workers from rural to metropolitan areas.

China appears to be embarking on major, national-scale programs to generate electricity from wind power as well as photovoltaic systems

The reports out of China suggest the country appears to be embarking on major, national-scale programs to generate electricity from wind power as well as photovoltaic systems. These moves by a quasi-planned economy suggest that politically, the Chinese government recognizes several trends that need to be corrected. One is to slow the country's dependence on imported oil. The second is to improve the nation's environmental performance before global barriers to trade are erected against pollution violators. Adopting these policies will have minimal impact on the growth of energy and oil consumption in the near-term, but they will significantly alter the slope of long-term energy and oil demand, something countries awash in crude oil need to consider.

National Oil Company Competition Grows

Abu Dhabi National Energy Company has agreed to purchase BP plc's Netherlands-based exploration and production business

Mr. Khelil, Algeria's Minister of Energy and Mines, recently talked about the growing competition for American international oil companies from the Chinese and Indian companies, but the global competitive landscape with national oil companies is becoming increasingly more competitive. A recent announcement by a Middle East national oil company caught our eye in this regard. The Abu Dhabi National Energy Company has agreed to purchase BP plc's (BP-NYSE) Netherlands-based exploration and production business. The purchase includes both onshore and offshore production assets with net production in 2005 of around 1.8 million cubic meters per

day (62 million cubic feet per day) and a staff of 120.

We believe we have the financial strength and industry expertise to take the BP Dutch E&P business to new heights of performance and profit

Mr. Peter Barker-Homek, CEO of Abu Dhabi National Energy Company, known as TAQA, said about the acquisition, "The acquisition of these BP assets in the Netherlands represents a significant advancement for TAQA as we continue to expand into Europe. TAQA will own and manage these assets with the utmost integrity and commitment to all parties involved. The existing BP employees are the key to the continued success of the facilities, and they are our first priority. We believe we have the financial strength and industry expertise to take the BP Dutch E&P business to new heights of performance and profit."

We used to expect those sentiments from western independent oil companies as they bought the marginally profitable assets of Big Oil companies who were abandoning mature markets. Hearing it from a national oil company is eye-opening.

Climate Change Debate Escalates to New Level

The letter demanded that ExxonMobil cease supporting climate change "deniers"

Last week, *The Wall Street Journal* (WSJ) carried an editorial about a letter sent by two senior senators to the chairman of Exxon Mobil (XOM-NYSE) berating him over his company's position on the global climate change debate. The letter was written by Senators Jay Rockefeller (D-WV) and Olympia Snowe (R-ME) to ExxonMobil Chairman Rex Tillerson, demanding that his company cease supporting climate change "deniers," recognize that the debate about climate change has been settled and humans are causing or exacerbating it, and re-direct its "climate change denial pseudo-science funding" toward global remediation efforts. The WSJ editorialized about "bullies" in Washington and commented that the letter was "so over-the-top" it wondered if Sen. Rockefeller had actually read it before sending it, given that he represents the state of West Virginia, a leading coal mining state.

The profile of the climate change issue has risen steadily with the recent Democratic election victory

The profile of the climate change issue has risen steadily with the recent Democratic election victory. Clearly climate change has been a strong motivating issue for many of that party's leaders. We recently experienced a heavy dose of the climate change apocalyptic rhetoric. On our trip home from Norway, we were flying on KLM, the Dutch-based but French-owned airline, which offered as its second movie An Inconvenient Truth starring Al Gore. We haven't been able to find another airline that is highlighting that movie. We have been exposed to bits and pieces of the movie, but never the whole thing at one sitting. Unfortunately, we had to watch it twice to see what we missed as it put us to sleep the first go round. Mr. Gore could have used a few natives from Pirates of the Caribbean, the lead movie, to enliven his film.

Besides watching the movie, we indulged in reading the executive summary of Sir Nicholas Stern's report on the economics of climate change presented to the British government at the end of October.

Sir Stern predicts that the economic cost of global warming could be the loss of from 5% to 20% of world economic output "forever"

According to Sir Stern, the former World Bank chief economist, climate change "is the greatest and widest-ranging market failure ever seen." Based on his assumption that the globe will experience severe warming (+5-6°C in average temperature), he predicts that the economic cost could be the loss of from 5% to 20% of world economic output "forever." He further suggests that the appropriate estimate will be in the upper end of the range. Against this devastating economic cost, the investment needed to mitigate the impact will amount to only 1% of annual world GDP, or roughly $450 billion per year.

The report dismisses as "too optimistic" the current climate forecasting models that call for only a 2-3°C warming over the next 45 years, which would cost the world a permanent economic loss of merely 0-3% of global output. Sir Stern also denigrates potential benefits that might come from global warming such as longer agricultural seasons in Russia and Canada. While cold-related deaths would decline in higher latitudes under global warming, Sir Stern argues that there will be a significant increase in worldwide deaths from malnutrition and heat stress. Always focus on the negatives of each situation seems to be his mantra.

Given this dose of environmental horror scenarios – melting glaciers flooding the land holding potentially one-sixth of the world's population while also reducing water supplies; declining crop yields in Africa contributing to significant malnutrition deaths; ecosystem damage that could eliminate up to 15-40% of the world's species and significantly impact fish stocks – I began to wonder whether I should have taken a boat home rather than the environmentally unfriendly airplane.

The balance of political power in Washington will prevent draconian acts

This escalation of the global climate debate, as reflected by the senators' letter, suggests that the new Congress will zero in on the energy industry as a global villain. Retribution will be demanded, as implied in the ExxonMobil letter. So what could be the political outcome next year? Most likely there will be little in legislative action. The balance of political power in Washington will prevent draconian acts. We suspect it will even prevent enactment of a windfall profits tax, unless commodity prices explode to the upside from current levels.

The managements of Big Oil companies, however, are at a critical junction. They are under attack for working in such a "dirty" business, regardless of the critical role oil and gas plays in the world's economic and social wellbeing. But from a business perspective, the managers face a world of shrinking E&P opportunities coupled with heightened efforts to cut their profits at the same time their company's coffers are overflowing with cash. That cash has become a magnet drawing every two-bit politician to seek ways to capture some of this money so they can avoid the politically-unhealthy act of being forced to raise taxes to fund their grandiose social schemes. The race to grab that money is on!

The 'spend-it, or return-it-to-shareholders-before-the-politicians-can-get-their-hands-on-it' mentality will begin to gain traction

Likewise, the race to spend that money is on! Mega new oil and gas field developments coupled with stepped up drilling, increased dividends and greater stock buyback programs, acquisitions of oil and gas producers and stepped up investment in alternative energies will all become popular corporate strategies as the 'spend it, or return it to shareholders before the politicians can get their hands on it' mentality begins to gain traction.

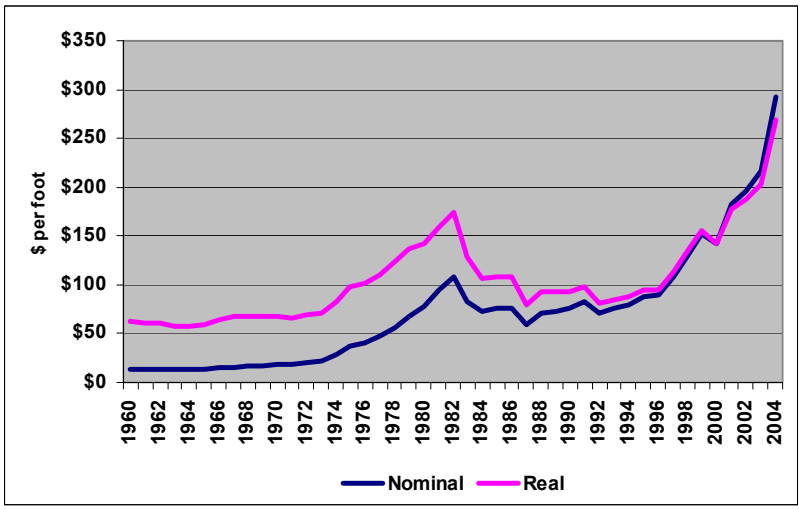
The energy business may be about to embark on a phase of its business cycle that will resemble 1979-1981

If we are right, then the energy business may be about to embark on a phase of its business cycle that will resemble 1979-1981. In those years no one could foresee an end to the energy boom. Geniuses in the industry were crowned every day. Ever-escalating E&P spending was the hallmark of those years. Commodity prices were never going down again. We were running out of oil and gas, just as our economic appetite for fuel appeared insatiable. Energy stock prices exploded. All roads led to Houston, or Houma, it really didn't matter. It only mattered that you got to the oil patch where healthy employment opportunities existed. It was the land of milk and honey.

The similarities between now and the late 70's are uncanny, even though we know history never repeats

The similarities between now and the late 70's are uncanny, even though we know history never repeats. President George Bush's "addicted to oil" State of the Union address earlier this year can be compared to sweater-clad Jimmy Carter's "moral equivalent of war" speech. President Bush's struggle to exit Iraq looks a lot like Jimmy Carter's Iranian hostage nightmare. Oil industry E&P spending is ramping up much like it did in those earlier halcyon days. Also, ramping up, however, is the cost per foot to drill wells in the United States, and one has to presume globally. It is the oilfield inflation trend that is beginning to worry oil company executives, but they, and their shareholders, may soon have to worry more about their lack of production growth than the cost of finding and developing it.

Exhibit 1. Footage Costs Are Rising Faster than in the Late 70's



Source: EIA, PPHB

Another similarity between today and the 1970s is the sharp climb in global oil prices. In April 1973, a U.S. state department official, James Atkins, wrote an article in *Foreign Affairs* entitled The Oil Crisis: This Time the Wolf is Here. He predicted that oil prices would rise to $5 per barrel over the next 12 years due to the relentless rise in consumption. He was looking at the tenfold increase in the volume of international oil trade that had occurred over 1950-1973. World oil prices of $2.69 per barrel jumped in 1973-74 to $11.65. By 1980, they were close to $40. That performance compares with oil futures prices, which stood at $25.60 per barrel on the last day of 1999, but by last Friday had climbed to $62.09 per barrel after having peaked in mid July at over $77. While the magnitude of increase through this half-decade is less spectacular than during the decade of the 1970s, the level of and jump in oil prices has been almost beyond comprehension.

Earlier this year, with falling natural gas prices, we saw Canadian producers, in particular EnCana (ECA-NYSE), cut back its drilling in marginally profitable areas. Lately, Chesapeake Energy (CHK-NYSE) announced that it would no longer pay fuel surcharges and expected a rollback of prices from the oilfield service companies. Thursday, James Mulva, the CEO of ConocoPhillips (COP-NYSE) announced a reduction in the company's upcoming 2007 capital spending budget and he singled out the impact of oilfield inflation and the need to be a better steward of capital to ensure returns for the long-term. A day later, Mr. Mulva was joined by Devon Energy (DVN-NYSE) that cut its spending due to Canadian oilfield inflation and the value of the Canadian dollar.

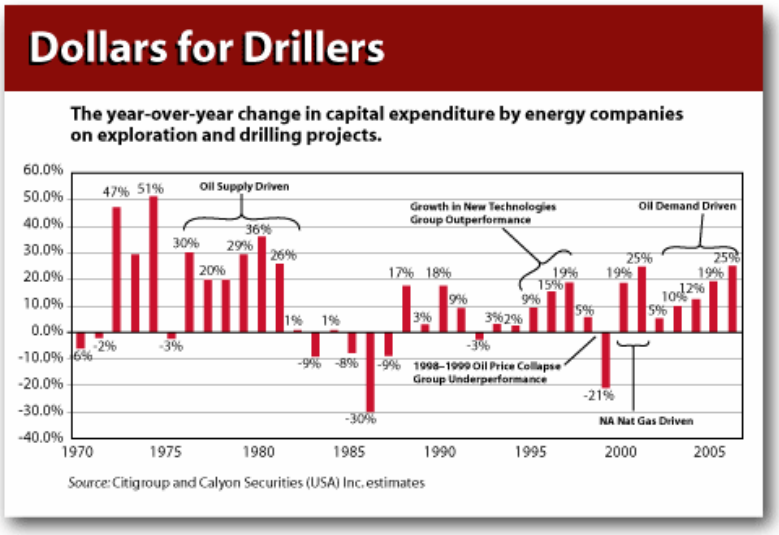
Managers are concerned about rising oilfield inflation

While managers are concerned about rising oilfield inflation, we also are seeing companies starting to mark down their production growth targets. Last week, Norske Hydro (NHY-NYSE), ConocoPhillips and Devon all reduced their future production growth forecasts. The performance failure of certain projects, drilling rig shortages, oilfield inflation and the weakening U.S. dollar are all being cited as contributors to the production shortfalls.

We believe the internal pressures for production growth and the threat of politician cash-grabs will push oil company CEOs to ramp up their capital spending over the next 24 months. If this happens, we could get a repeat of the environment of the late 70s. That would mean greater oil industry spending, higher drilling activity, oilfield service company earnings rising and their stock prices soaring. If so, get ready to strap on your seat belts.

The annual percentage increase in capital spending in the 1979-81 period was quite strong (+29%, +36% and +26%) compared to recent years. Spending in 2006 is estimated to have increased by 25%, but guesses are that spending may only rise by around 10% in 2007. Capital spending could be substantially greater next year, and in the future, if oil company CEO's give the green light. Greater oil-company spending should drive up oilfield activity and the earnings of these companies. We could be looking over the next couple of

Exhibit 2. Capital Spending Could Be Much Greater



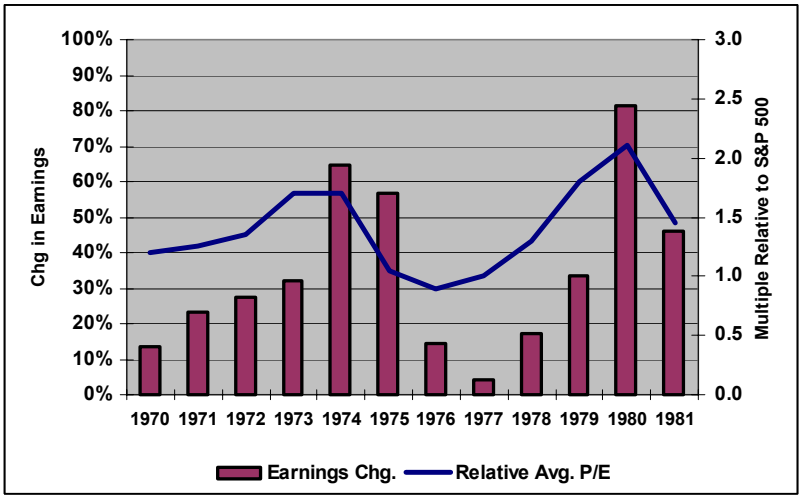
Source: Citigroup, Calyon Securities

years at an environment similar to the late 1970s when spending in 1979 drove the earnings of a group of oilfield service companies up by 80% the next year. We would not expect that magnitude of an increase given the current level of earnings, but the percentage gains could still be substantial.

If the oilfield service company earnings advance materially, then their stock prices will likely advance strongly

If the oilfield service company earnings advance materially, then their stock prices will likely advance strongly. That will boost P/E ratios. More than likely, however, as happened during the 1970s, the second multiple peak in the decade will not be sustained and will witness a trend toward lower P/Es. The big question will be how long this spending surge might last, which would influence how long

Exhibit 3. Earnings Growth Support Stock Price Performance



Source: CIBC, PPHB

oilfield service stocks outperform. At this point, we won't speculate on the duration. We suggest that one should continue to watch consumer energy consumption habits and the zeal of politicians to bleed profitability out of the industry as guides to the duration.

Efficiency: the New Energy Source

A new study by the McKinsey Global Institute claims that the yearly growth rate in worldwide energy demand could be cut to 0.6% from the current forecast annual rate of 2.2% over the next 15 years. The key to making this happen would be more aggressive energy-efficiency efforts by households and industry. This would save money for both consumers and companies.

Current regulations and fuel subsidies often favor consumption over efficiency

The McKinsey study's conclusions come after a year-long study of the issue. To take advantage of the energy-saving opportunities, some product standards would have to be tightened and some policy initiatives modified. Current regulations and fuel subsidies often favor consumption over efficiency. This is especially true in the electric power generation industry that we have written about before, where utility regulations do not pay companies to discourage consumption through variable pricing plans, for example.

The disparity in cost helps explain why compact fluorescent light bulbs have been so slow to gain meaningful market share

This disparity in policy is also demonstrated where energy-thrifty products have a higher purchase price than more energy-consuming products. This disparity helps explain why compact fluorescent light (CFL) bulbs have been so slow to gain meaningful market share even though they have been around for years. Years ago, these efficient light bulbs cost up to ten times as much as conventional incandescent bulbs, and their light had a somewhat different hue.

Exhibit 4. CFL Efficiency

Equivalent Light Output	
Incandescent	Compact Fluorescent
25W	5-6W
40W	10W
60W	11-13W
75W	18-20W
100W	25-27W
150W	40-42W

Source: Wikipedia, PPHB

The overall financial advantage of using fluorescent bulbs over conventional bulbs is clear

Today, the light spectrum has been corrected and CFL bulbs are only slightly more costly than conventional bulbs, yet they last ten times as long and consume 75% less electricity. Lighting accounts for about 20% of the electricity consumed in a home per month. The overall financial advantage of using fluorescent bulbs over conventional bulbs is clear, even though the initial purchase price is slightly higher. It appears that this cost differential continues to retard the market share growth of the CFL bulbs.

Exhibit 5. Light Bulb Economics Over Their Life

$$(60\,\mathrm{W}) \times (8000\,\mathrm{hr}) \times \left(\frac{\$0.10}{1000\,\mathrm{W}\cdot\mathrm{hr}}\right) = \$48.00$$

$$(15\,\mathrm{W}) \times (8000\,\mathrm{hr}) \times \left(\frac{\$0.10}{1000\,\mathrm{W}\cdot\mathrm{hr}}\right) = \$12.00$$

Source: Wikipedia, PPHB

Utilities are paid to produce power, not conserve it; therefore they are reluctant to press consumers to use CFL bulbs

The McKinsey study concludes that the pace of acceptance of these more efficient, but slightly more expensive bulbs might be accelerated if electric utilities were encouraged to promote efficiency. Over the six-year period from 1999, the market share of CFL bulbs has grown from 3.2% to 5.6%. However, utilities are paid to produce power, not conserve it; therefore they are reluctant to press consumers to use CFL bulbs. A few states such as California have made conservation a revenue generating tool. As James Rogers, president of Duke Energy (DUK-NYSE) put it, "The most efficient and environmentally responsible plant you can build is the one that you don't build."

2006 Hurricane Season Ends; What About 2007?

The most accurate forecaster of the 2006 hurricane season was Houston's Weather Research Center

The most accurate forecaster of the 2006 hurricane season, which was a bust for thrill seekers and a boom for insurance companies, turned out to be Houston's Weather Research Center (WRC). Led by Certified Consulting Meteorologist, Jill Hasling, the WRC March 2006 forecast for the tropical storm season stretching between June 1 and December 1, called for 11 named storms in the Atlantic basin with at least five growing into hurricanes. In reality, the year saw nine storms with five becoming hurricanes. The WRC forecast contrasted with Dr. William Gray of Colorado State University's forecast for 17 named storms and nine hurricanes and the National Oceanic and Atmospheric Administration's (NOAA) projection for 13 to 16 named storms with eight to ten becoming hurricanes.

Improving the forecast accuracy of both the number and location of where hurricanes will make landfall is of great importance

Equally impressive in her forecast was that of the five hurricanes Ms. Hasling predicted, she anticipated that four of them would make landfall somewhere along the U.S. coast. There were three hurricanes that made U.S. landfalls. Improving the forecast accuracy of both the number and location of where hurricanes will make landfall is of much greater human and economic value than merely correctly forecasting the total number of tropical storms, hurricanes and severe hurricanes in a season. It is for this reason that the dean of hurricane forecasts, Dr. Gray, has turned over the lead role in his group's storm forecasting while he works on trying to improve the landfall predictability.

There is little doubt that if we could develop significantly more accurate long-range forecasts for how many and where hurricanes would hit the continental United States, we would be better prepared

to deal with the potential human and property cost of storms. Unfortunately, we are quite a ways away from that goal.

Ms. Hasling had predicted that the highest risk for landfall of tropical storms in 2006 would be along the southeast coast of the U.S. and the west coast of Florida. She expected a total of four landfalls, but there were actually three. Her forecasting system predicted that the U.S. coast from Georgia to North Carolina had a 90% chance of experiencing the landfall of a tropical storm or hurricane. That area was followed by the west coast of Florida with a 70% chance. Both of these forecasts were verified by the landings of Tropical Storms Alberto (June 10-14, Adams Beach, FL), Beryl (July 18-21, Nantucket, MA) and Ernesto (August 24-Sepember 1, southern tip of FL and Long Beach, NC).

Her preliminary 2007 forecast calls for seven named storms with four becoming hurricanes and half of them becoming intense

So what does this forecaster extraordinaire predict for the 2007 hurricane season? Recognizing that the official forecast won't be made until March 2007, her preliminary forecast calls for seven named storms with four becoming hurricanes and half of them becoming intense (Category 3 or higher). She anticipates three of the storms will make U.S. landfall with the highest likelihood being the stretch of coast from Louisiana to Alabama (70%), followed by the west coast of Florida and the Georgia to North Caroline coast, each with a 60% chance. The Texas coast has only a 40% chance of experiencing a tropical storm landfall.

The WRC forecast would appear to suggest a more normal hurricane season next year with the orientation of storms remaining on the eastern coast of the United States. However, Louisiana appears to be a target next year that could mean trouble for the offshore oil and gas industry. On the other hand, the industry will have had almost two years to recover from hurricanes Katrina and Rita and to prepare for the next storms. Hopefully whatever storm or storms descend on the Louisiana coast will be weak and produce little chaos and damage.

The long-range forecast just issued by Tropical Storm Risk, a London-based forecaster, predicts an above-normal Atlantic hurricane season

In contrast to this forecast, the long-range forecast just issued by Tropical Storm Risk (TSR), a London-based forecaster, predicts an above-normal Atlantic hurricane season with a strong probability that more hurricanes will slam into the U.S. than usual. It is predicting a total of 16 tropical storms with nine becoming hurricanes and four likely to be severe ones. TSR expects five tropical storms are likely to hit America, of which two will be hurricanes.

The TSR forecast is based on its anticipation that a combination of conditions will produce a higher-than-average hurricane season. They believe the trade winds that blow from the tropical Atlantic and Caribbean Sea will be weaker than normal, while they anticipate sea temperatures between West Africa and the Caribbean will be warmer than normal. The heat will generate the storms, and the lack of wind will reduce the chance of the storms being cut down before spinning up into hurricanes. TSR commented that there were a series of conditions that prevented 2006 from being as active a

hurricane season as forecast, i.e., considerable African dry air, Saharan dust during August and September and the onset of El Nino conditions from mid-September. As TSR put it, "There is no precedent for these factors together having been so influential before." We can always hope that the precedent will be repeated next year.

The Colorado State University team is forecasting 14 named storms with seven hurricanes and three being severe

We also got the first 2007 forecast from Philip Klotzbach and William Gray of Colorado State University (CSU). They too are anticipating a more active tropical storm season than normal, which means more storms than the average experienced during the 1950-2000 period. According to their new forecast, there should be 14 named storms with seven hurricanes and three being severe. CSU is expecting the odds for at least one tropical storm hitting the U.S. coast. They foresee a 64% probability of a storm hitting the entire coast compared to a 52% chance based on data for the last century. The odds for a storm hitting the U.S. East Coast including the Florida peninsula are 40% compared to the historical average of 31% and there is a 40% chance of a storm hitting the Gulf Coast versus the record of a 30% chance.

Exhibit 6. Early 2007 Hurricane Forecasts

	Houston Weather Research Center	Tropical Storm Research	Colorado State University	Historical
Named Storms	7	16	14	9.6
Hurricanes	4	9	7	5.9
Intense Hurricanes	2	4	3	2.3

Source: PPHB

The interesting question is whether people will heed these forecasts after the dismal track record of forecasting the past two years? Those people, who live on the coasts, and especially those facing difficult times in securing homeowners insurance, should certainly pay close attention to these forecasts.

Algerian Energy Minister Needs *The New York Times*

Mr. Khelil suggested that it will be tough for U.S. international oil companies to compete with their Chinese and Indian counterparts for oil deals in Algeria

Since the global reach of CNN appears to have failed, maybe Algerian Energy and Mines Minister Chakib Khelil needs a subscription to *The New York Times* to better understand the changed political climate for U.S. international oil companies before he suggests government largess for the industry. Speaking at an industry conference, Mr. Khelil suggested that it will be tough for U.S. international oil companies to compete with their Chinese and Indian counterparts for oil deals in Algeria. This comes at the same time Algeria has put in place tougher investment terms for energy multinational companies.

Mr. Khelil commented, "The challenges for U.S. companies are going to be very tough in the future because now we have two big

countries – India and China – who are seeking to penetrate lots of these markets." By implication he was referring to the state support by China and India of their local petroleum company efforts to land energy assets in petroleum-rich countries such as Algeria. He later told reporters that "I'm concerned about the U.S. companies. They have to compete." When questioned by reporters what steps the U.S. oil companies need to take to better compete with state-owned companies with access to their country's coffers, he said they should be talking to the Bush Administration rather than him. "Tell them, 'look, make us a big fund for oil companies, American companies, to help them move into these countries,'" he said.

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Mr. Khelil's remedy for the U.S. oil industry's challenges would require the incoming Democratic Congress to remove the bull's eye firmly planted on the industry's back and replace it with a glad hand and a bag full of money. If you believe that scenario will come to pass, I have some wonderful beachfront property to sell you. Clearly Mr. Khelil has not been reading *The New York Times*, or he would know that the oil industry is Public Enemy No. 1 on Capitol Hill. All "tax breaks" ever granted to the U.S. oil industry will be under review for elimination come January 2007, even if they contribute to delivering low-cost energy to U.S. citizens, merely because they are tax breaks.

The Algerian government announced amendments to the country's hydrocarbon law that include a new tax on profits

On the other hand, Mr. Khelil and his government are well aware of the global movement to capture the perceived excess profits being earned by the oil industry now that prices are so high. In July, the Algerian government announced amendments to the country's hydrocarbon law that include a new tax on profits and obligates state oil company, Sonatrach, to take at least a 51% share in every new oil and gas exploration contract awarded to foreign companies. These moves are in keeping with the recent actions of other oil producing countries such as Venezuela, Ecuador and Bolivia.

The tax change amendment provides for a 5% to 50% tax on profits made while oil prices are over $30 per barrel. While the amendment was announced in July and took effect August 1st, the details of how the tax will be applied have not been made public. According to the government, the details should be spelled out in the next several weeks. However, Mr. Khelil has said that the amendment should net the Algerian government $500 million to $600 million in the final five months of 2006 and $1 billion in 2007.

"The tax on exceptional profits is not an injustice, but a restoration of justice"

When Mr. Khelil was briefing foreign oil officials, he stated, "The tax on exceptional profits is not an injustice, but a restoration of justice. The tax on exceptional profits restores the equilibrium between the interests of the state and the interests of the oil companies." He further made the point that with such high oil prices, the "rate of return is now excessively much larger than expected" at the time some contracts were signed. He acknowledged that some oil company contracts did contain provisions to ensure a balanced sharing of profits, but others did not. The oil companies with the latter type contracts questioned the fairness of the tax changes since

they appear to breach existing contracts by imposing a supplementary tax not agreed to when the contracts were signed.

Algeria's attractiveness for oil and gas investments could be altered significantly

The details of Sonatrach's obligation to take at least a 51% share of every new E&P contract have not yet been spelled out. Foreign oil companies have to be wondering whether Sonatrach will participate as a full partner in these new ventures, i.e., paying their share of ongoing costs, or will their share have to be carried by the companies. Depending on the financing mechanism, Algeria's attractiveness for oil and gas investments could be altered significantly. But then again so has the U.S. oil and gas landscape changed with the Democrats seizing control of both houses of Congress a few weeks ago.

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