

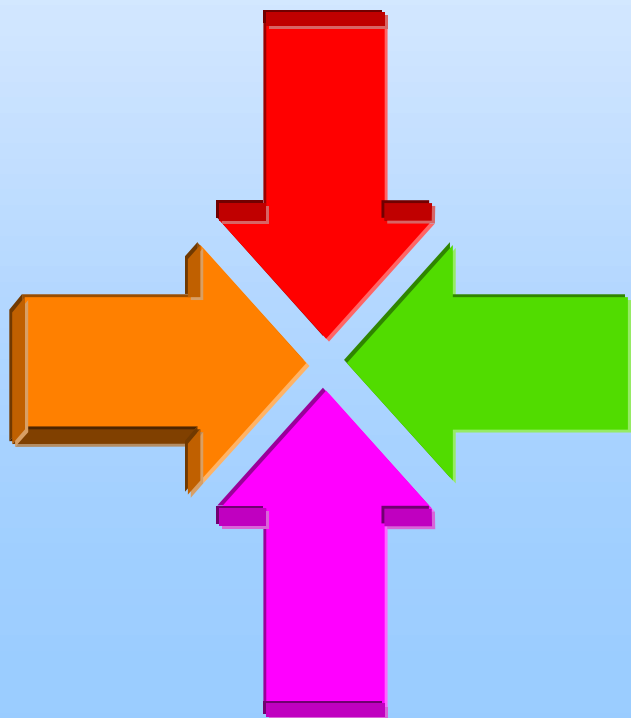


# IPAA Houston

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## Some Solutions to the Humor Shortage In the Energy Market

**Arthur L. Smith, CFA**  
**Chairman & CEO**  
**John S. Herold, Inc.**  
**July 14, 2004**





# Roy Pitches – Houston Yankees Win 13-5





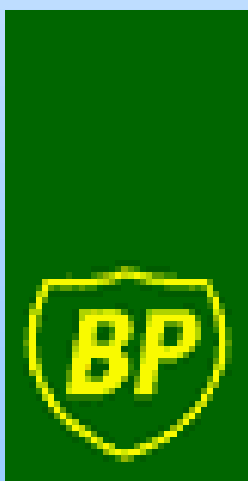
# How to Solve the Humor Shortage

- **Discuss key issues facing the IPAA today**
- **Review the performance records of the top public independent oil and gas companies**
- **Mix in a lot of previously used humorous material -- and a lot of pictures**





# LORD JOHN BROWNE of Madingly

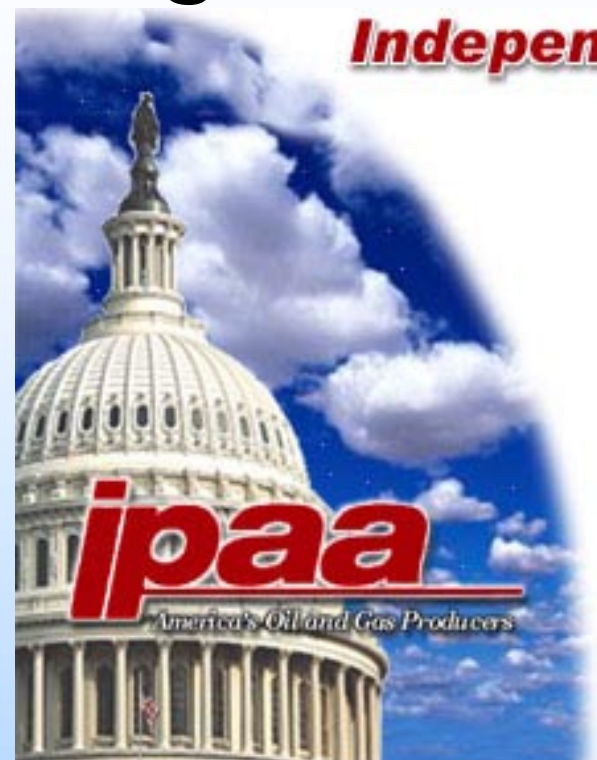


***“Should We Spend \$1 Billion More to  
Grow Production 2.5% faster?”***

**October 29, 2002 – Less than two years ago**



# LORD JOHN WALKER of Hunter's Creek Village



***“Should We Spend \$1 to Grow  
Production 25% faster?”***

**June 14, 2004 – One month ago, today**



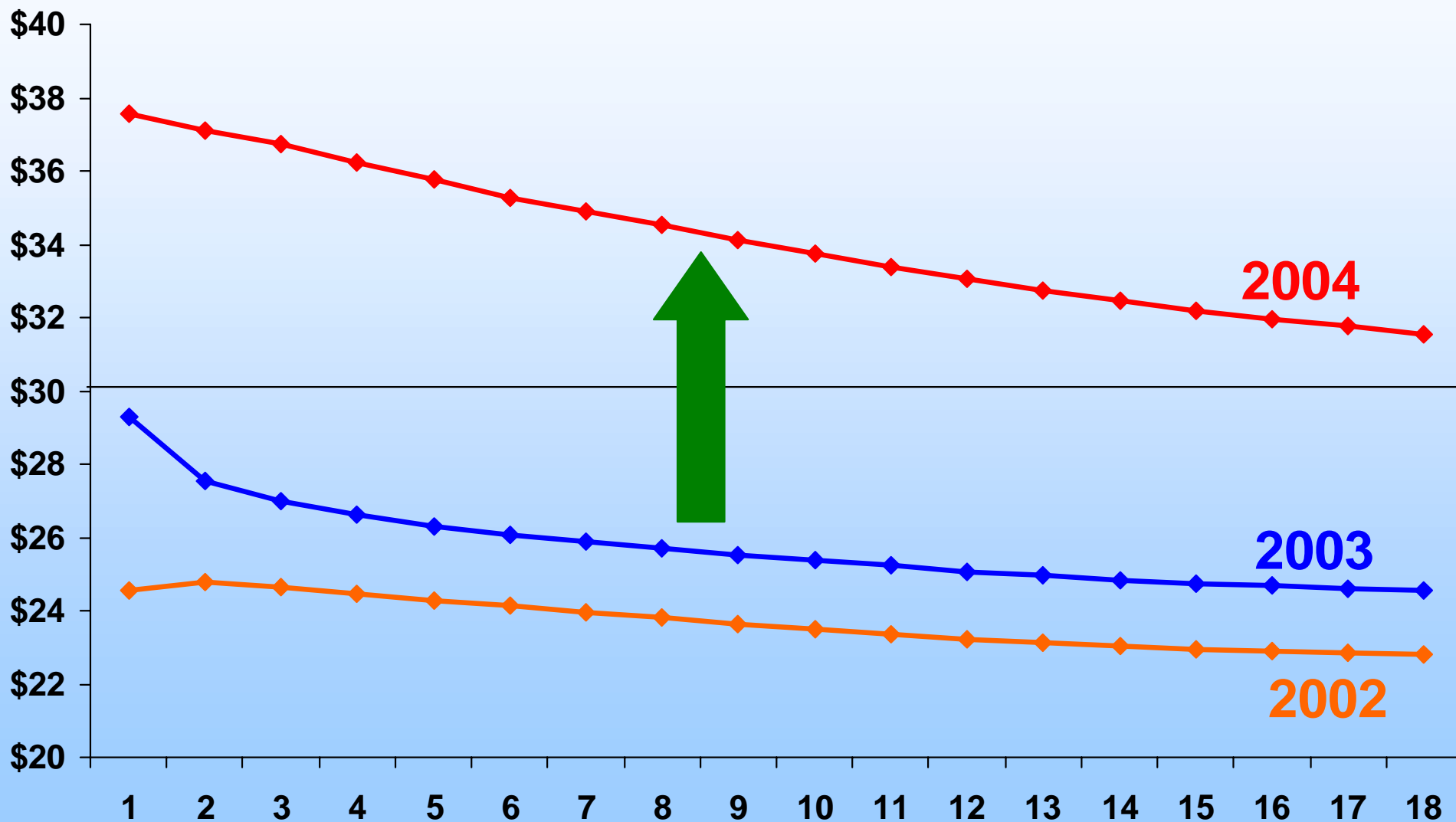
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What will it take to make us  
happy?

**Even Stronger  
Wellhead Oil Prices?**



# NYMEX Crude Futures Price Expectations







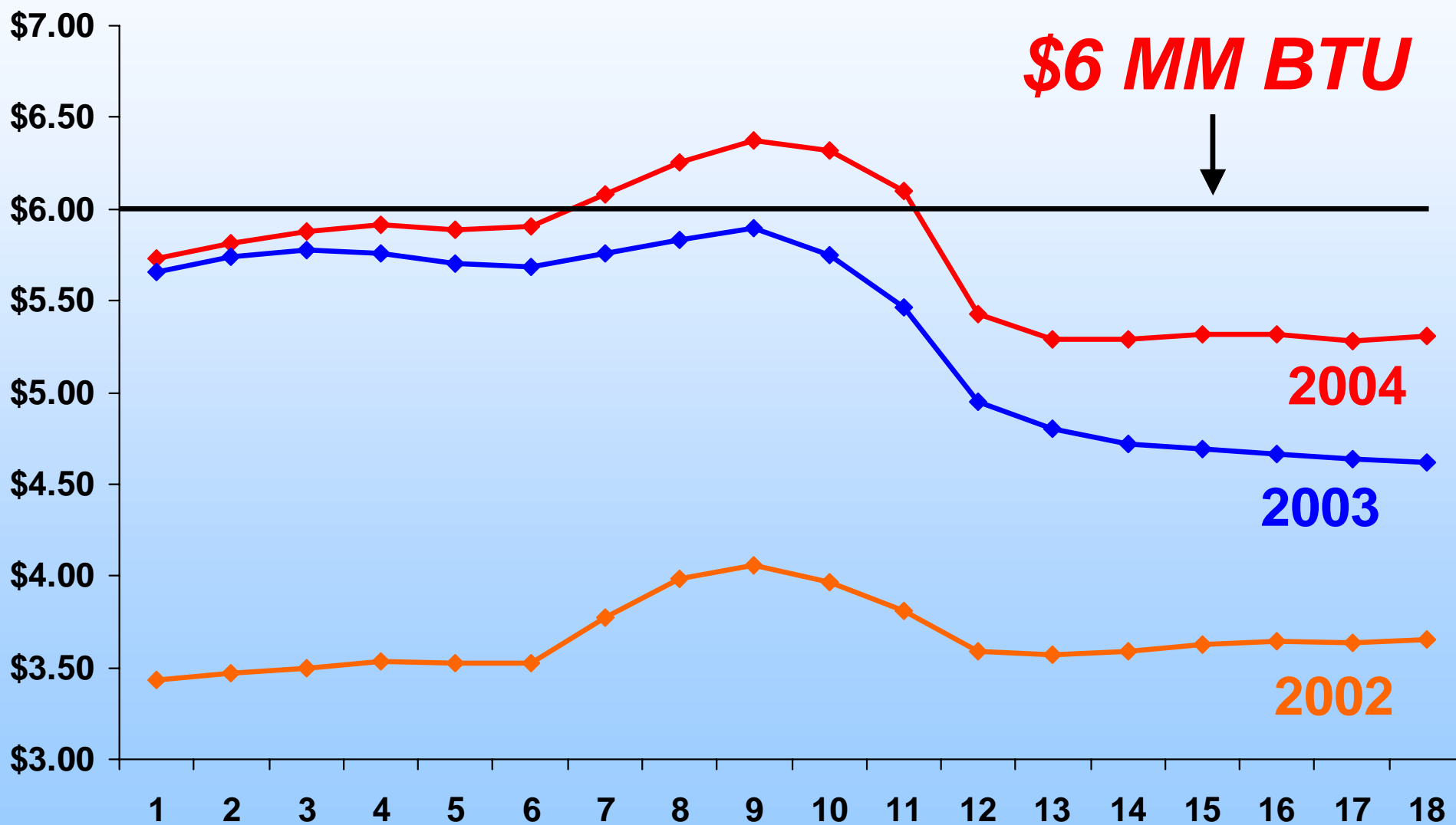
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What will it take to make us  
happy?

**Even Stronger  
Wellhead Natural Gas  
Prices?**



# NYMEX Gas Future Strip Price Expectations

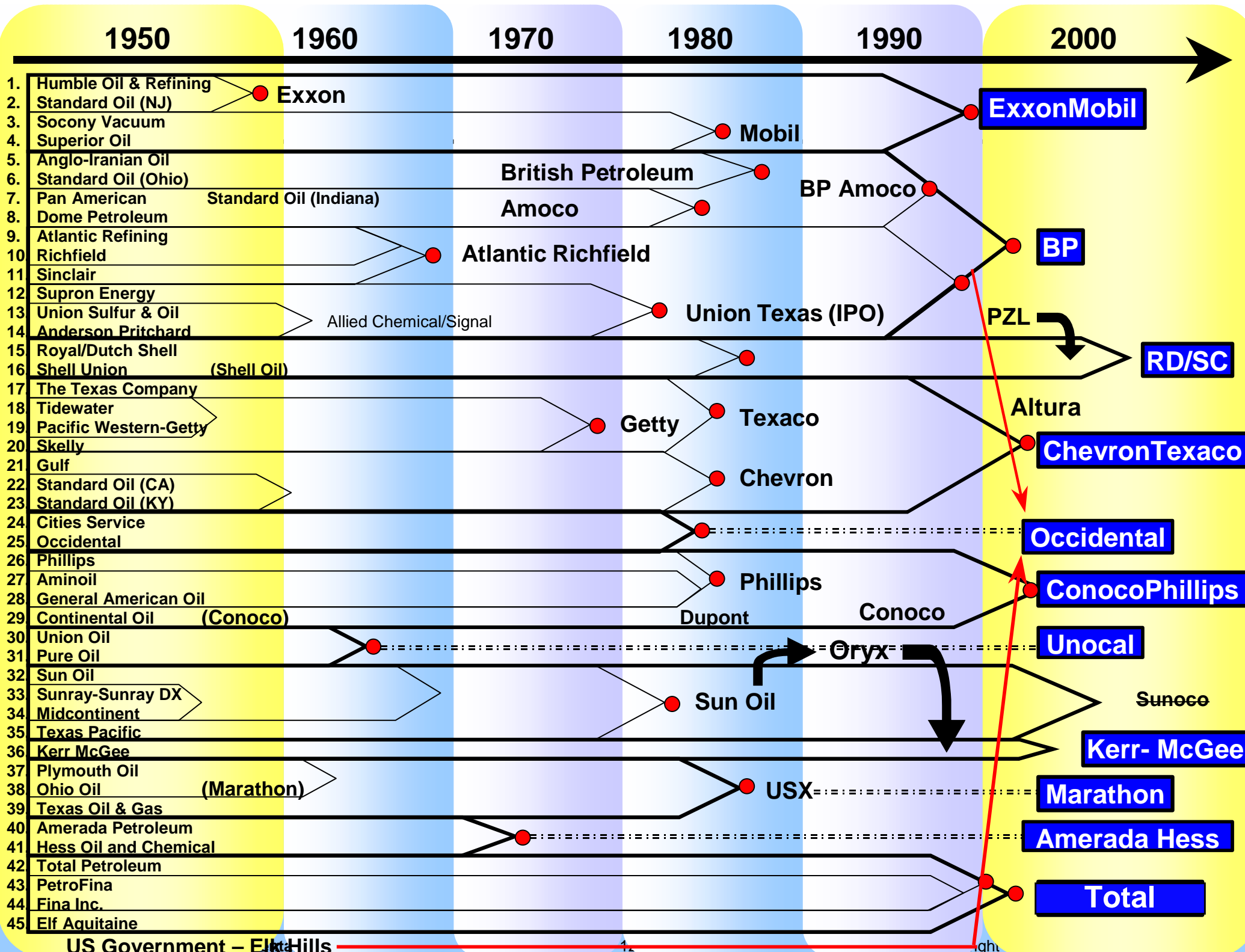




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What will it take to make us  
happy?

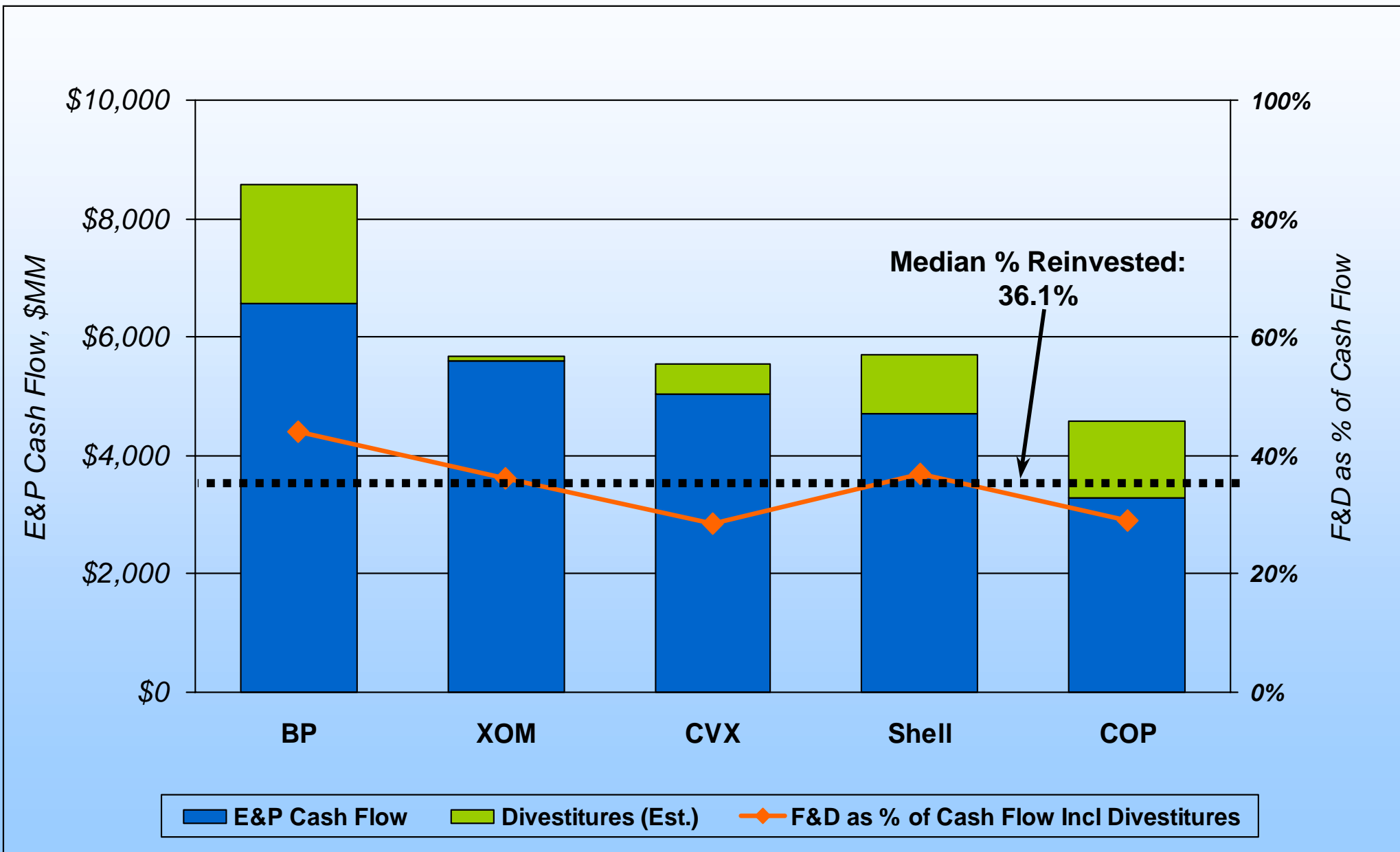
**Less Competition in  
North America from the  
SuperMajors?**



US Government – Elk Hills



# Majors 2003 U.S. Upstream Reinvestment Rates





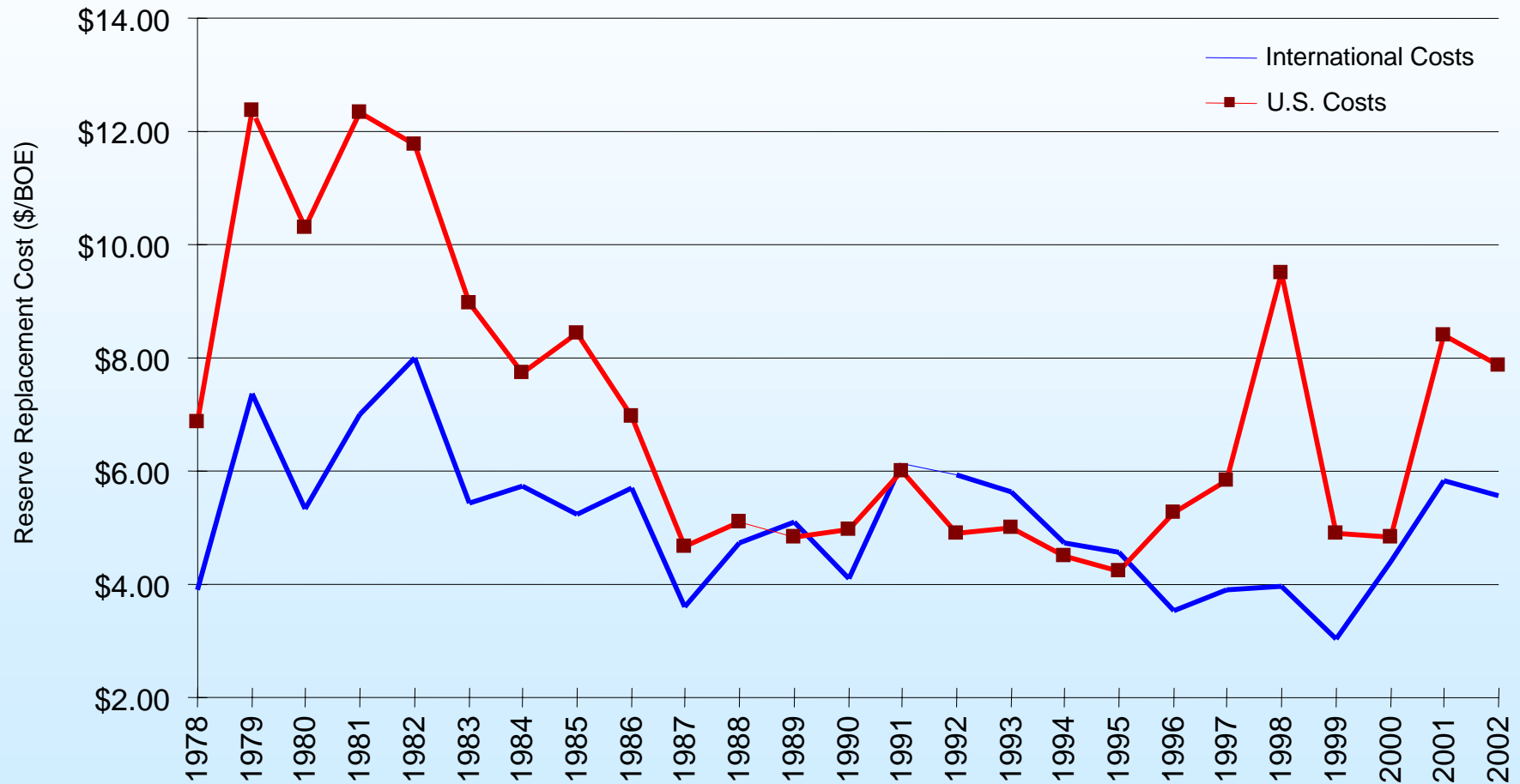
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What will it take to make us  
happy?

**Low Finding and  
Development Costs and  
Low-Cost Acquisitions?**



# US Reserve Replacement Costs Remain High; Overseas Retains Cost Advantage



Source: John S. Herold data and analysis

July 2004 – IPAA presentation

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# Key Questions

## Energy Capital Markets

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- **Too Much \$\$\$\$ -- Too Few Opportunities or are we lacking CREATIVITY?**
- **Is National Geographic Right? Is it, “The end of cheap oil?” (and cheap natural gas?)**
- **Why do we remain so cynical? Why is there a humor shortage in the energy industry?**



# Available for viewing at 8552 Katy Fwy

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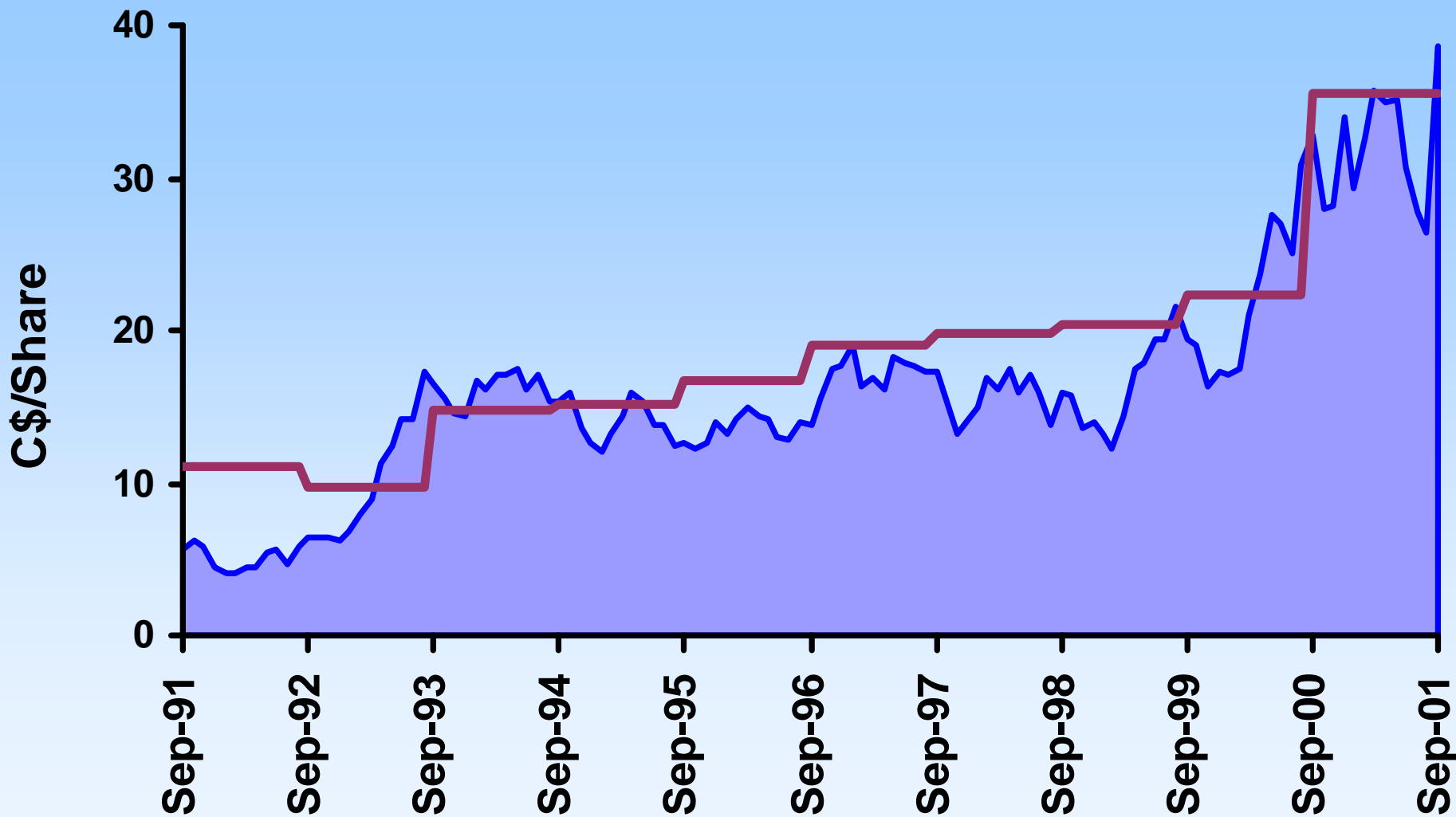
# Let's Get Serious about Creating Value in E&P

---

- **E&P is a wonderful business**
- **Creativity and Capital – not Manpower**
- **Great upside in today's fundamental environment**
  
- ***The key question – is it:***
  - **Exploration?**
  
  - **Exploitation?**
  
  - **Or pure Acquisition/Divestiture (M&A&D) – the EBay model?**



# Anderson Exploration Stock Price vs. JSH ANW



Source: John S. Herold data and analysis



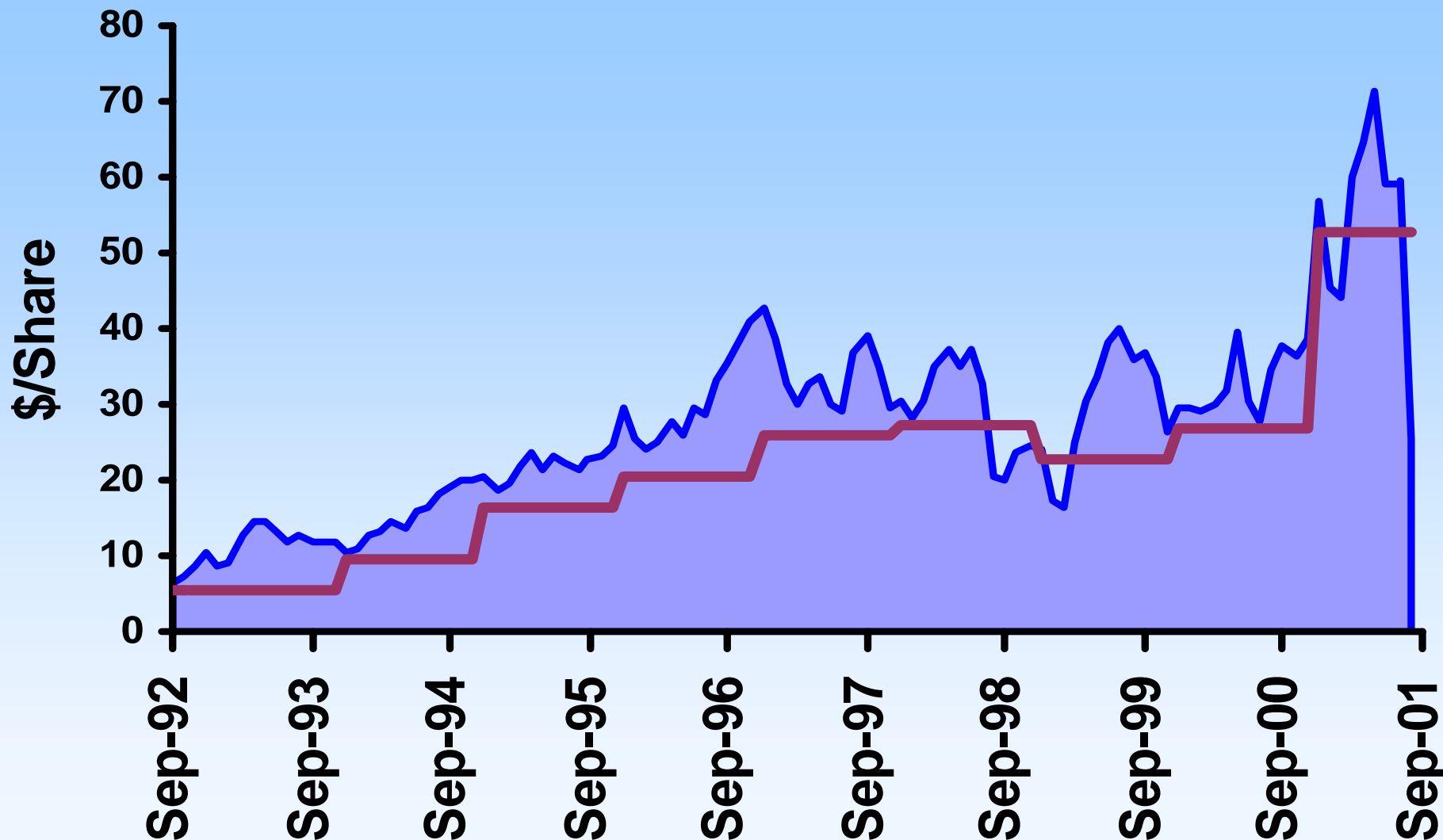
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# Acquisitions vs. the DrillBit

***Can upstream acquisitions deliver value to stakeholders today?***



# Barrett Resources Corp. Stock Price vs. JSH ANW

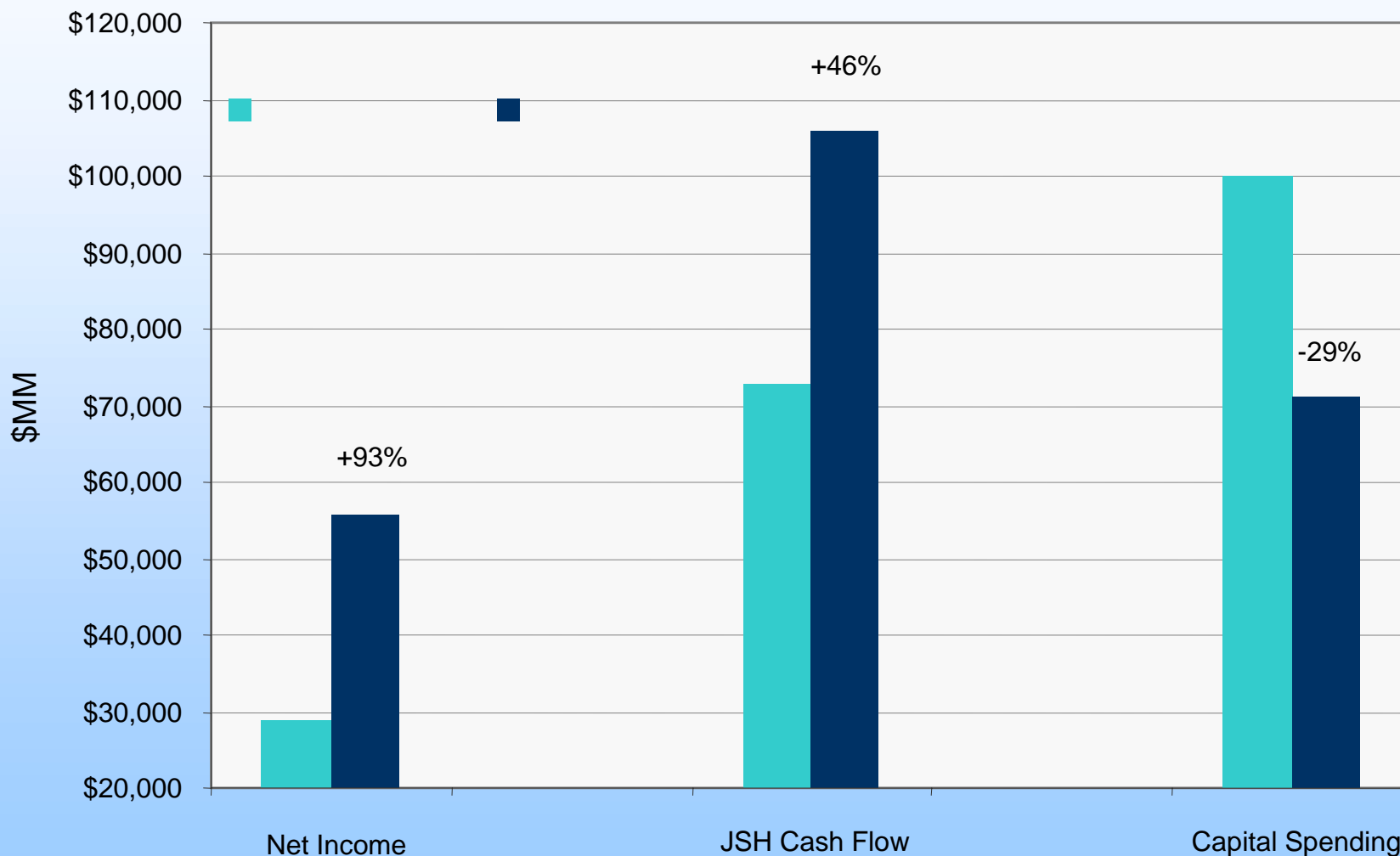


Source: John S. Herold data and analysis



# Profitable, & Now Self-Funded

## 2003 Cash Flow Surplus Estimated to Exceed \$40 Billion



Source: John S. Herold data and analysis



# Measuring Success

How is “value creation” measured?

Actual

Accretion  
in value  
per share

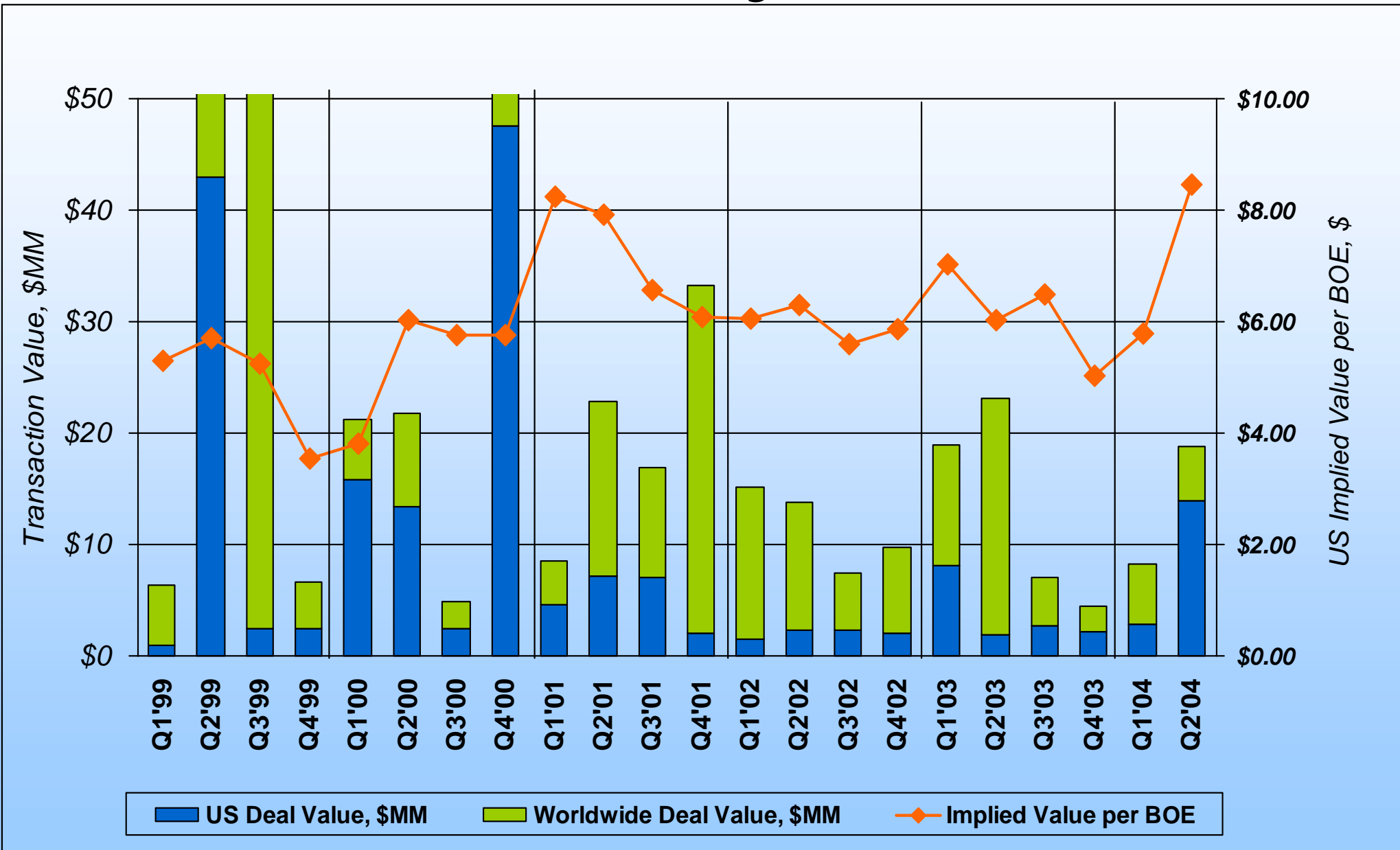


Perceived

Total  
Shareholder  
Return



# Worldwide Upstream Acquisition Deal Activity, 1999-2004



Source: John S. Herold data and analysis



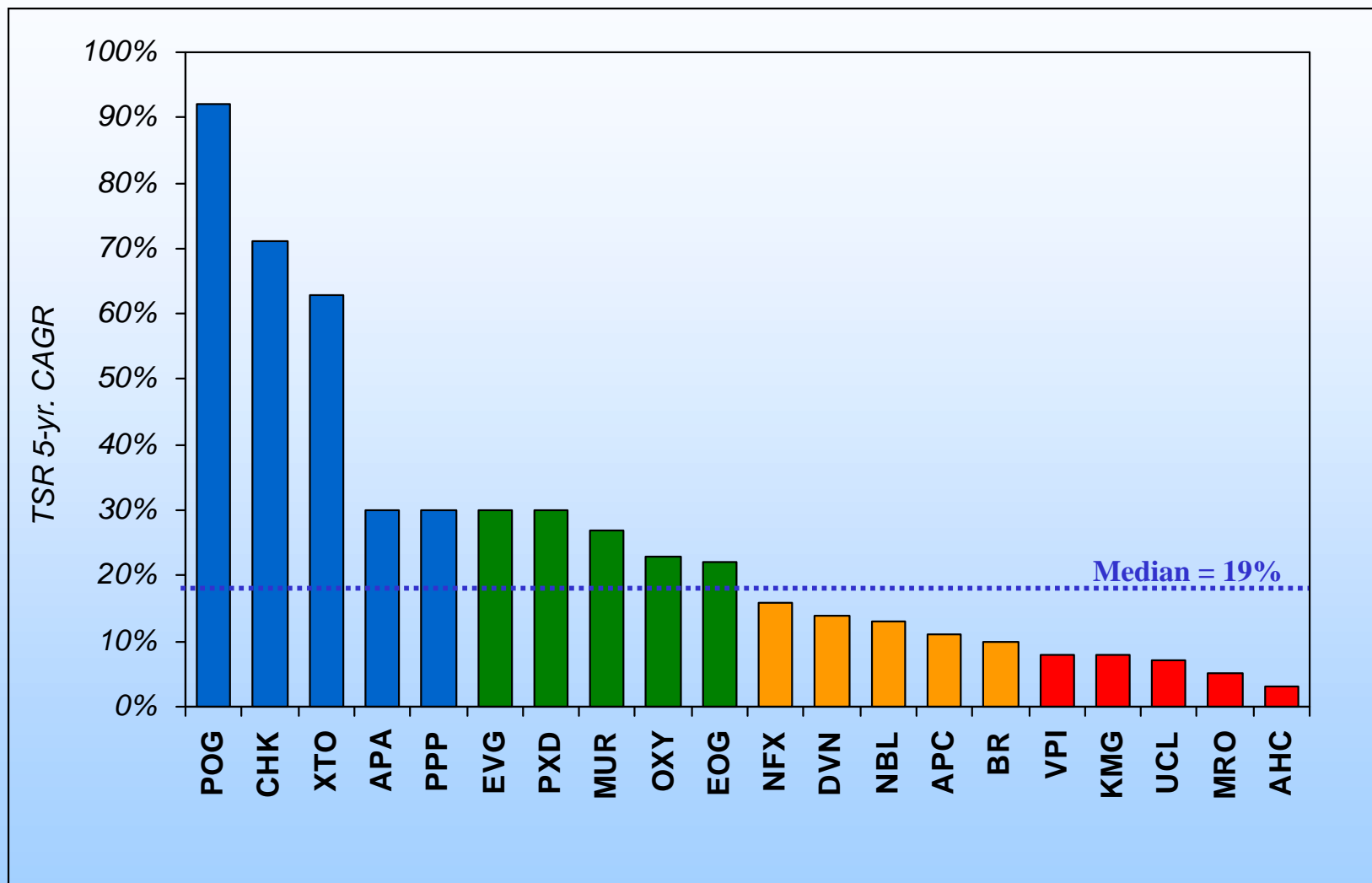
# Selected Industry Group (20)

---

- Amerada Hess (AHC)
- Anadarko (APC)
- Apache (APA)
- Burlington (BR)
- Chesapeake (CHK)
- Devon (DVN)
- EOG (EOG)
- Evergreen (EVG)
- Kerr-McGee (KMG)
- Marathon (MRO)
- Murphy (MUR)
- Newfield (NFX)
- Noble (NBL)
- Occidental (OXY)
- Patina (POG)
- Pioneer (PXD)
- Pogo (PPP)
- Unocal (UCL)
- Vintage (VPI)
- XTO (XTO)



# Total Shareholder Return (5-yr.)

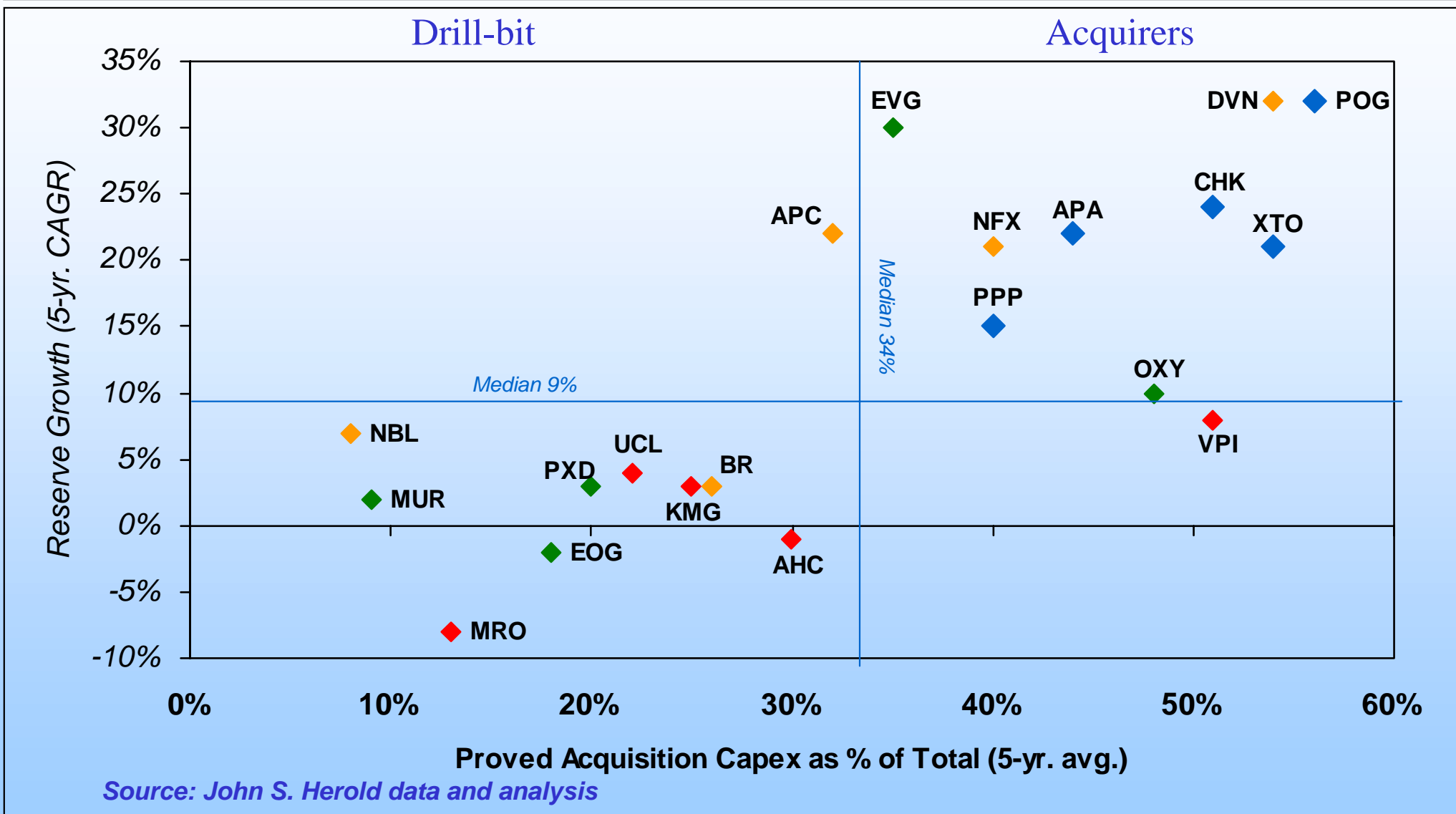


- ❑ Returns have been solid for the industry over the past five years –19%
- ❑ But returns have been better for some – than others

Source: John S. Herold data and analysis



# Reserve Growth vs. Acq. Capex %

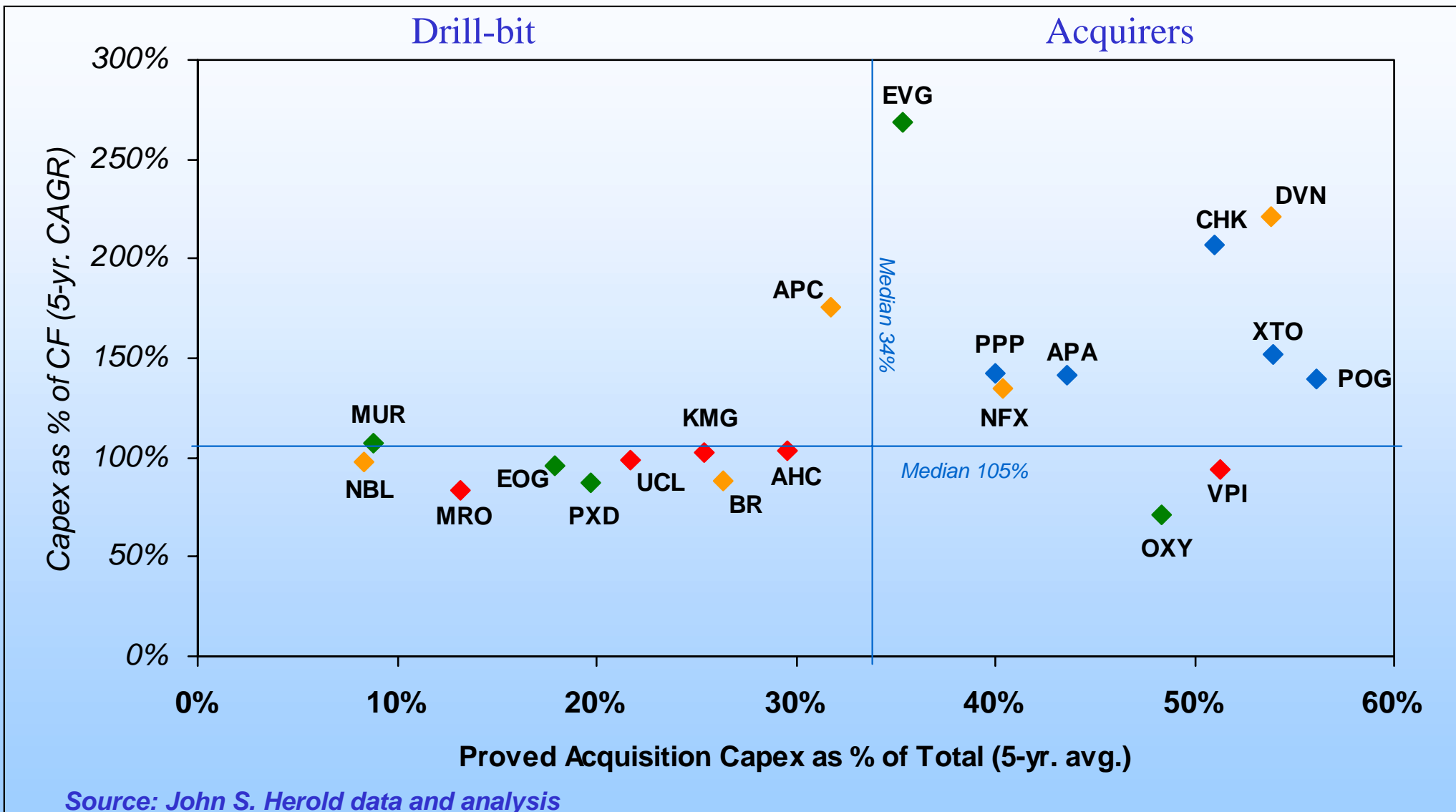


❑ We do know – if acquire more - will likely grow at a faster rate...

❑ Does growth translate into value...TSR



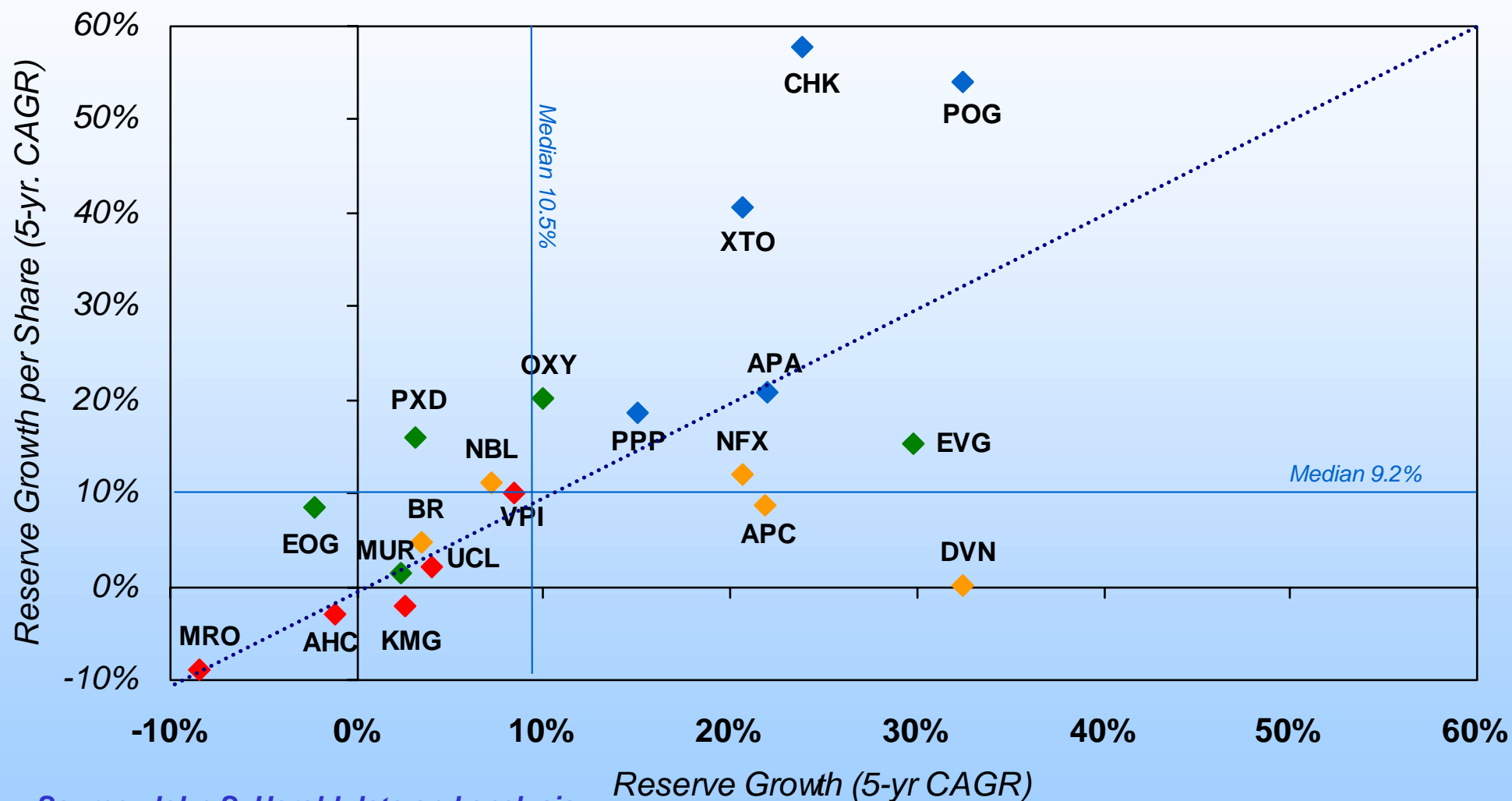
# Acq Capex vs. Capex as % of CF



- ❑ Higher component of acquisitions associated with higher reinvestment rates
- ❑ Does higher reinvestment rate translate into higher TSR?



# Reserve vs. Per Share Growth



Source: John S. Herold data and analysis

- ❑ Not all growth is equal – need to account for dilution
- ❑ Does per share growth translate into TSR?



# Impact of Acquisitions

---

**Companies making acquisitions delivered higher returns to shareholders (over the last five years)**

- Acquisition oriented companies:**
  - Reinvested a higher percentage of cash flow**
  - Resulting in higher reserve/production growth rates**
    - And often higher increases in reserve/production per share**

***But was the value driver acquisitions or sound execution?***



# First in the Clubhouse: Creating the Most Value

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## *Niche Resource Players*

*Existing Reserves: Patina, Evergreen*

*Acquired Reserves: XTO, Chesapeake*

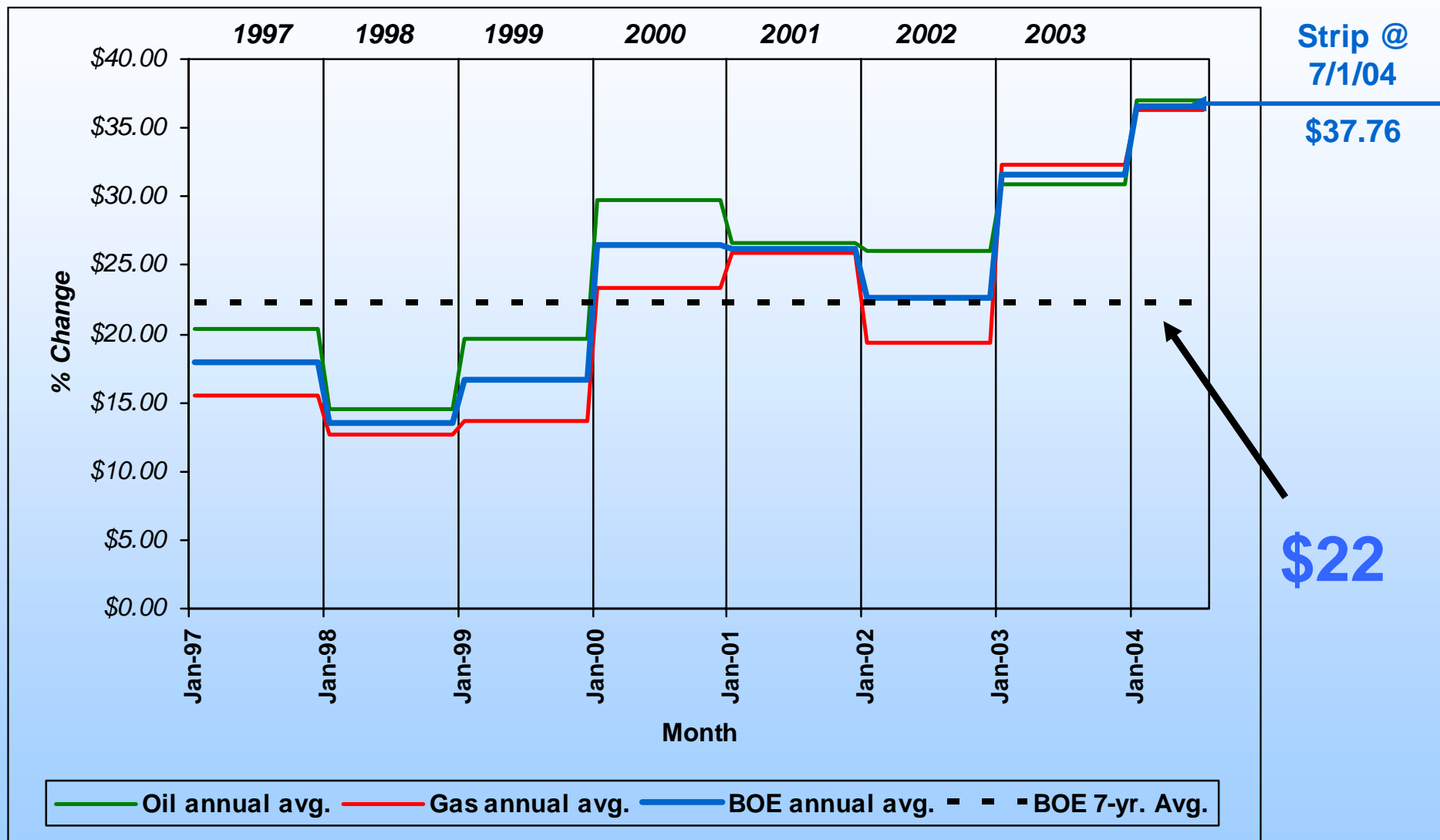
## *A Perfect Rising Tide*

- ↘ *Exploitable gas resources coupled with rising prices*
- ↘ *Enabling technologies*
  - ↘ *Reducing costs*
  - ↘ *Improving recovery factors*
  - ↘ *Repeatable low-cost reserve additions*

*Growth in reserves/production/NAV per share*



# Price per BOE(6:1) (50/50)



⇒ The 7-yr. avg. per BOE was \$22.16 on a 50/50 split

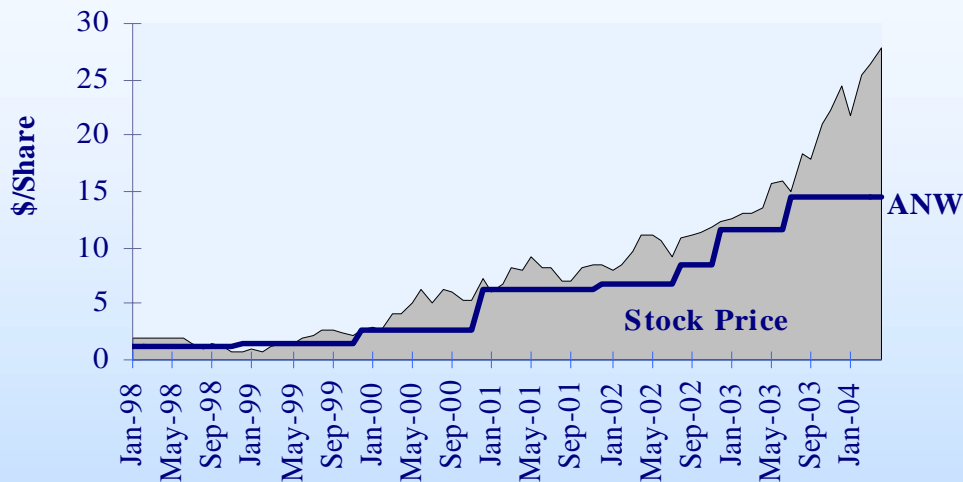
⇒ Prices for '01-'03 averaged \$25.12 – up 56% from '97-'99 average of \$16.06



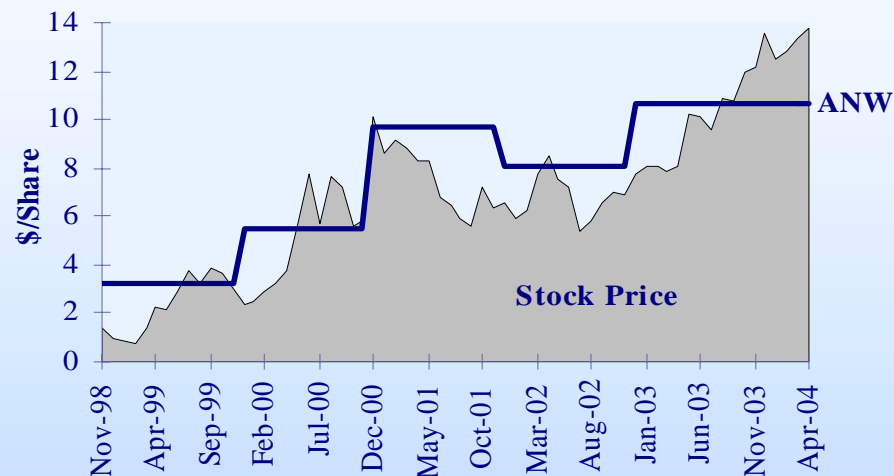
# The Leaders

Stock Price vs. ANW

## Patina Oil & Gas

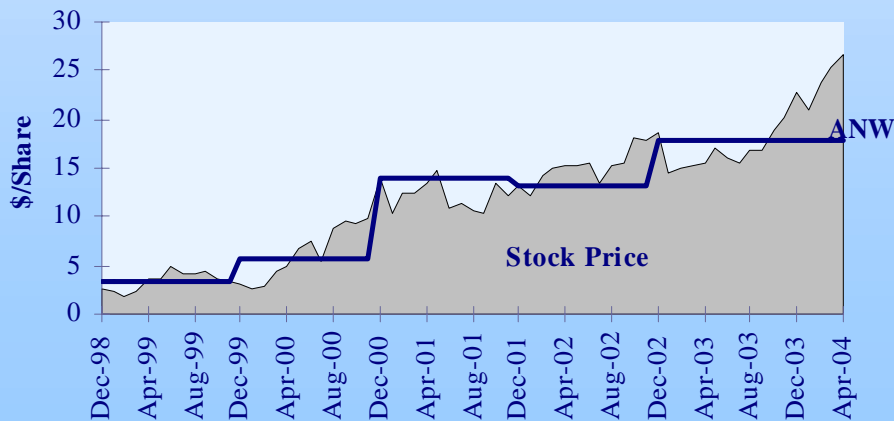


Stock Price vs. ANW Chesapeake Energy



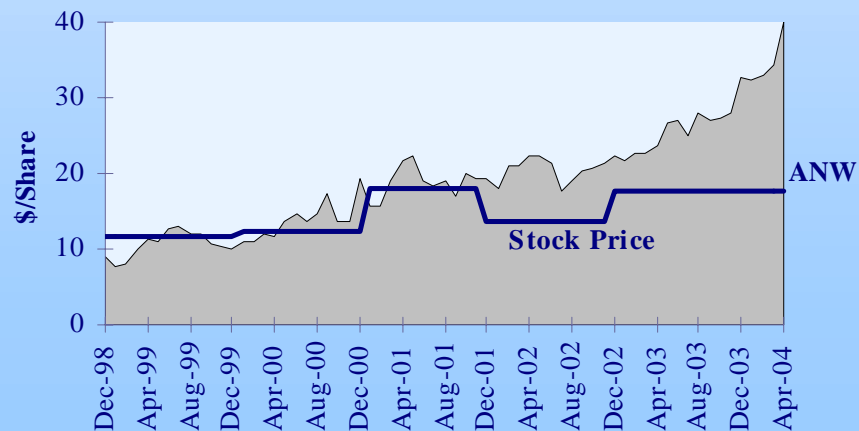
Stock Price vs. ANW

## XTO Corporation



Stock Price vs. ANW

## Evergreen Resources



Source: John S. Herold data and analysis



# Which Peers Created the Least Value?

## *Large Quasi-Independents*

*Amerada Hess, Kerr-McGee, Marathon, Unocal*

*Struggled – redirecting portfolio - addressing issues*

↘ *Asset base did not support strategy*

↘ *Awkward scale - unfocused*

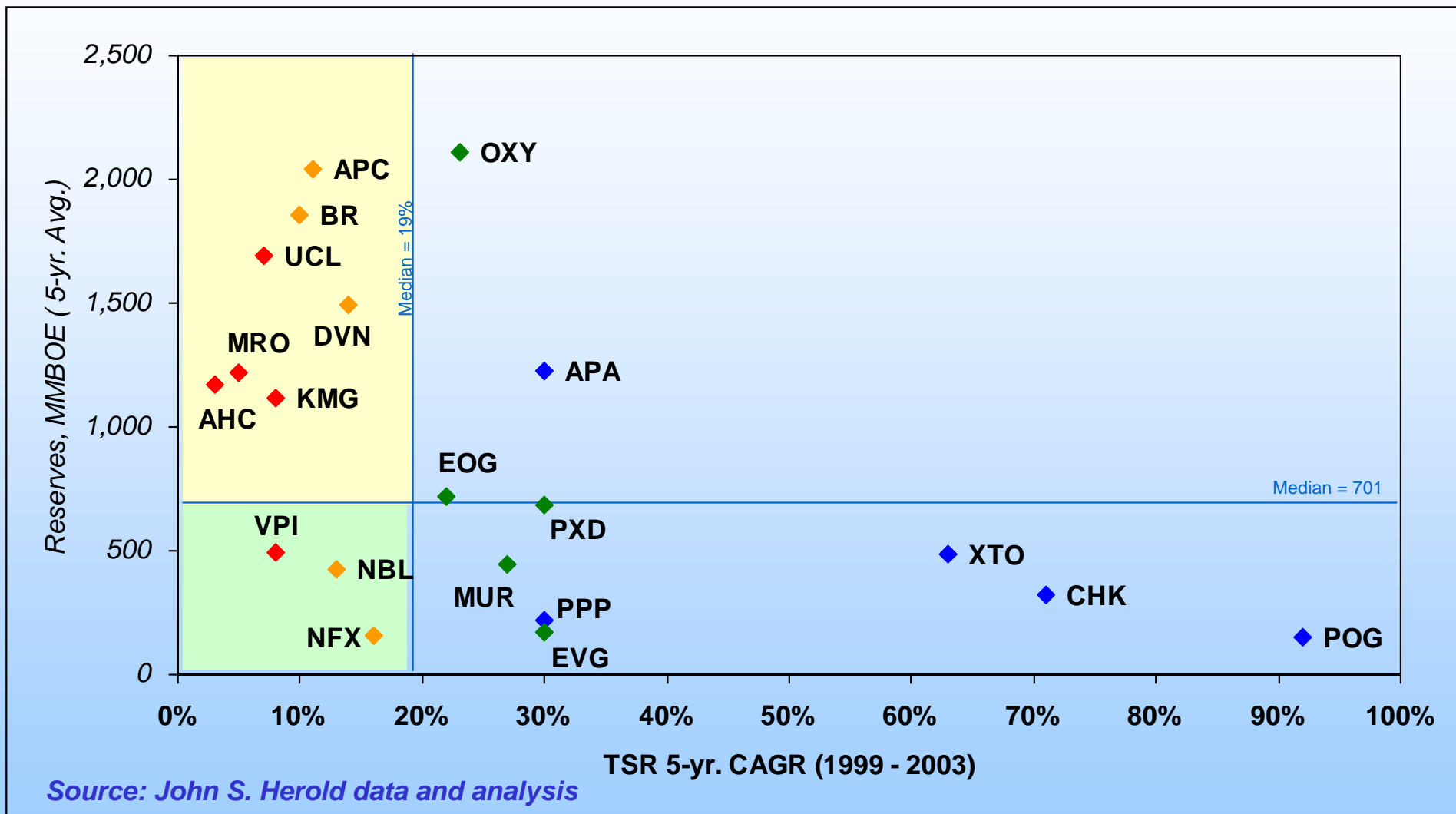
↘ *Questionable investments, a.k.a. overvalued  
M&A deals*

↘ *Poor capital efficiency metrics*

*Declines in reserves/production/ANW per share*



# TSR vs. Size (Reserves)

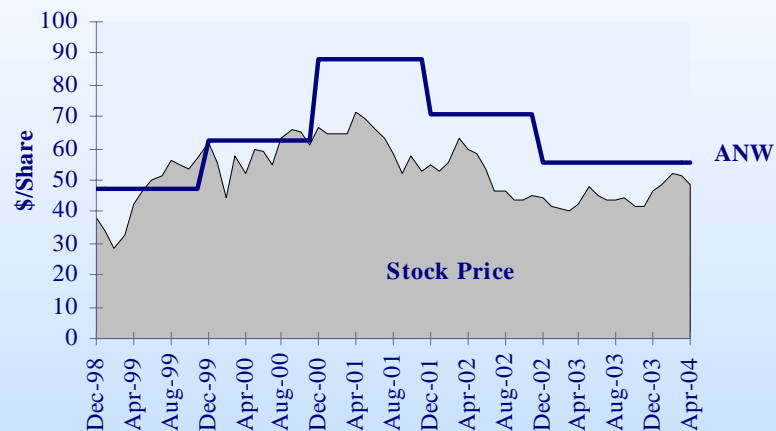


With the exception of Apache and Occidental, larger companies have struggled to deliver competitive returns.

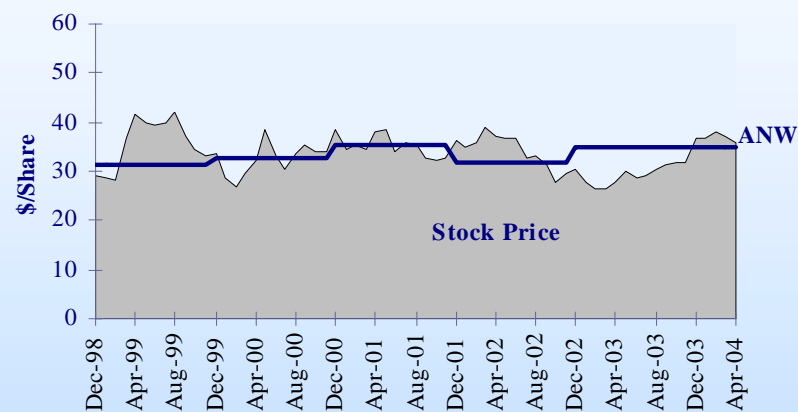


# The Laggards

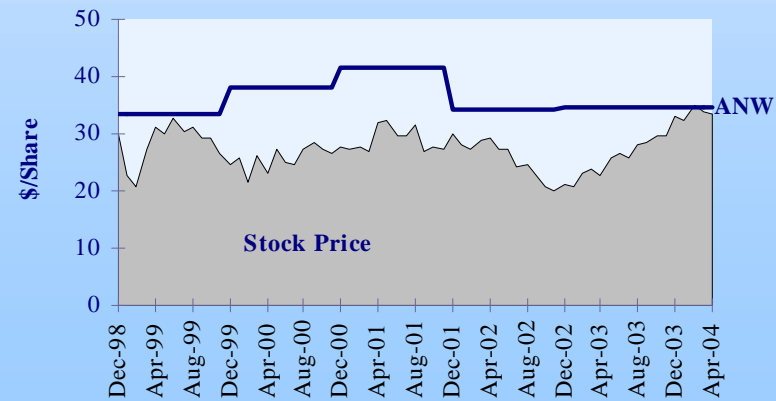
Stock Price vs. ANW **Kerr-McGee Corp.**



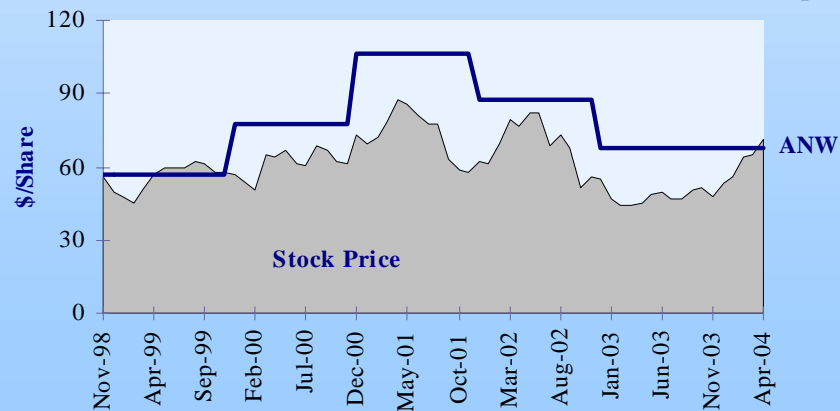
Stock Price vs. ANW **Unocal Corp.**



Stock Price vs. ANW **Marathon Corp.**



Stock Price vs. ANW **Amerada Hess Corp.**



Source: John S. Herold data and analysis



# F&D Success is a Critical Driver Too

---

*XTO (\*231%)*

*Chesapeake (\*141%)*

*Apache (\*127%)*

*Devon (\*83%)*

*Newfield (\*83%)*

*Vintage (\*\*70%)*

*\*5-yr. F&D Replacement Rate*

*\*\*4-yr. F&D Replacement Rate*

*Acquisitions were a critical component to their strategies....leaders supplemented acquisitions with strong F&D replacement rates.*



# Drill-Bit Enablers

---

*Pioneer*

*Murphy*

*Anadarko*

*Kerr-McGee*

*Acquisitions provided scale and diversity to portfolios to enable exploration programs....  
Murphy and Pioneer pursue organic exploration*

*Anadarko and Kerr-McGee back-fill with acquisitions*



# Transformation Tool

---

*Occidental*

*Amerada Hess*

*Marathon*

*Acquisitions provided avenue to dramatically transform asset profiles strategies...  
Occidental was an exceptional success....  
jury still out on Hess and Marathon.*



# Mixed

---

*Burlington*

*Evergreen*

*Patina*

*Pogo*

*Companies used acquisitions to diversify portfolios....Burlington built Canadian position with exploration component....Patina and Evergreen diversified, expanding from core region....Pogo targeted domestic gas.*



# Limited Role

---

*EOG (\*13%)*

*Noble (\*-2%)*

*Unocal (\*-1%)*

*\*2003 Reserve Growth*

*Acquisitions played a limited role...  
emphasis was on the drill-bit...leaving gaps  
in production profiles for Noble and  
Unocal... EOG has sustained moderate but  
efficient growth.*



# Final Assessment

---

- M&A activity works for those companies that do it exceptionally well
  - Strategic Model must Include:
    - Critical driver (Why this asset/company?)
    - Great strategic fit
    - Decent timing (use of hedging)
    - Follow on “low cost” reserve additions
      - Accretion in reserves/ANW per share
  - Results for balance of industry are mixed at best
    - Few successfully execute on integration
      - “Quick fixes” to problems are almost never successful
      - “Opportunistic” timing and motivation is like Las Vegas
      - Poor recognition of value drivers
        - Failure to assess dilution to ANW/Share



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