

2011 BDO ENERGY OUTLOOK

EXECUTIVE SUMMARY



OIL AND GAS E&P SECTOR ENTERS 2011 WITH CONFIDENCE

► **2010 WAS A TUMULTUOUS YEAR FOR THE OIL AND GAS EXPLORATION AND PRODUCTION (E&P) SECTOR IN THE UNITED STATES. THE INDUSTRY GRAPPLED WITH BACKLASH FROM THE GULF OIL SPILL, AND LEGISLATIVE CHANGES THREATENED DOMESTIC GROWTH.**

Despite these challenges, it was a record year for mergers and acquisitions (M&A) in the industry and access to capital and credit improved dramatically. Companies are approaching 2011 with a renewed sense of optimism and direction.

In fourth quarter 2010, BDO conducted its third annual survey of 100 chief financial officers (CFOs) at oil and gas E&P companies. The survey asked them to look back at challenges and opportunities in 2010 and offer their expectations and predictions for 2011.

THE BDO 2011 ENERGY OUTLOOK SURVEY is a national telephone survey conducted by Market Measurement, Inc., an independent market research consulting firm, whose executive interviewers spoke directly to chief financial officers. The survey was performed within a scientifically developed, pure random sample of U.S. oil and gas exploration and production companies. It is the third annual survey and was conducted in fourth quarter 2010.

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► KEY FACTORS DRIVING INDUSTRY GROWTH

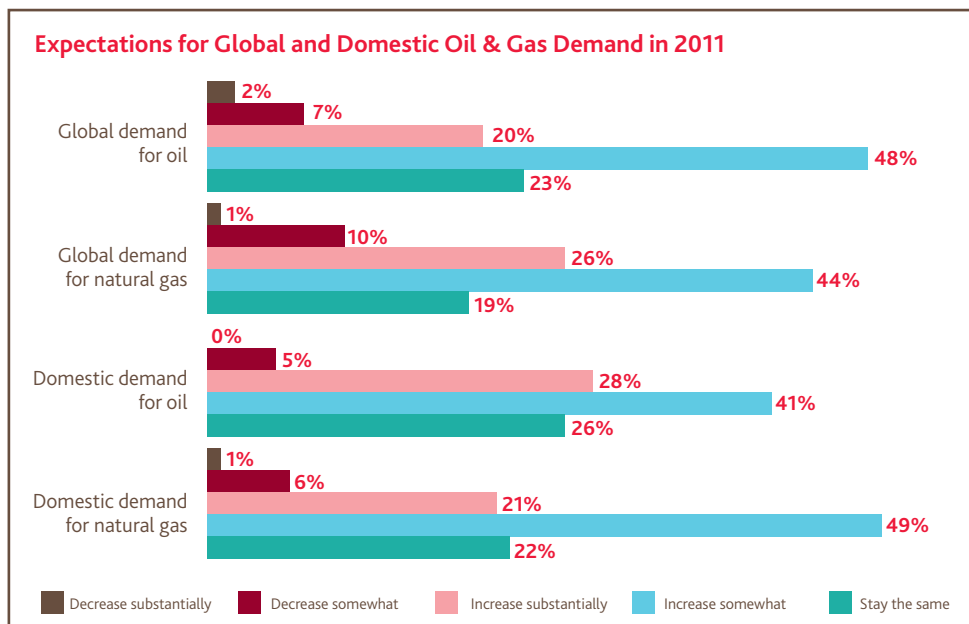
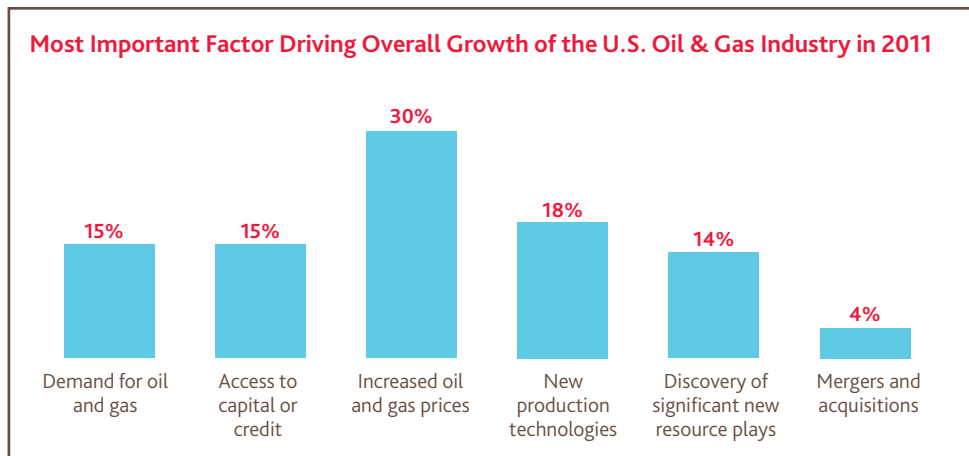
Helping to fuel a feeling of optimism, CFOs expect higher oil and gas prices to be one of the biggest factors driving overall growth of the industry in 2011. New production technologies, capital/credit access, demand levels for oil and gas, and the discovery of significant new resource plays are other primary growth factors.

“Nonconventional resource plays will be a major driver of growth for the industry. Everyone is jumping in the game – from the major oil and gas players to smaller companies acquiring attractive acreage.”

– KEVIN HUBBARD, partner and Natural Resources Industry practice leader

CFOs believe both global and domestic demand for oil and gas will increase in 2011, with slightly higher expectations overall for gas. Forty-four percent of CFOs feel better about the U.S. economy and its impact on demand for oil and gas compared to the fourth quarter of 2009.

To keep up with the expected increase in demand, nearly half (46%) of survey respondents plan to maintain the total number of oil and gas drilling rigs operated by their company in 2011, and another 34 percent plan to increase their count. However, it will come with a rising price tag – 66 percent of CFOs expect drilling and exploration costs to increase.

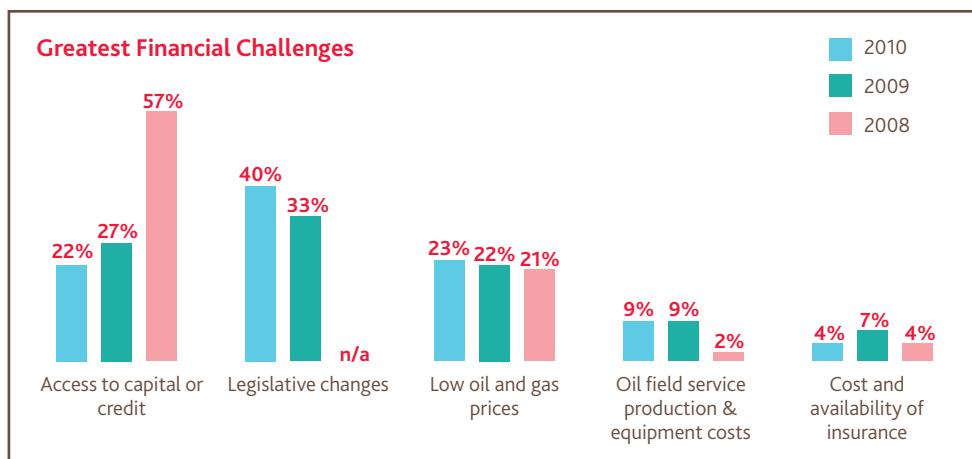


“Most CFOs see heightened demand for oil and natural gas in 2011, but drilling companies are reluctant to increase rig count until they see this materialize. The result will inevitably be increased drilling costs and this was borne out in the survey.”

– CHARLES DEWHURST, partner and Natural Resources Industry practice leader

IMPACT OF THE GULF OIL SPILL

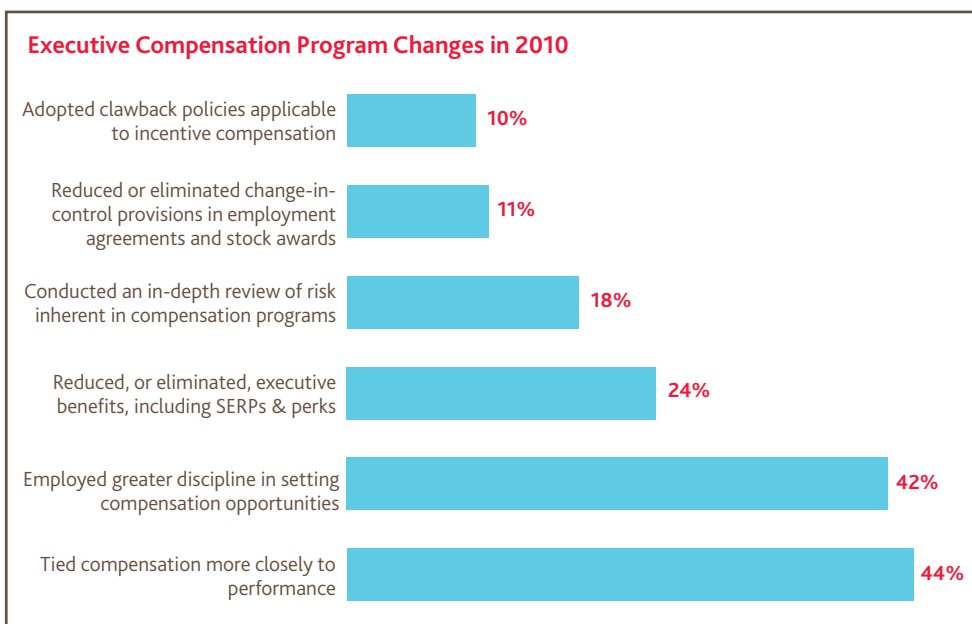
Many respondents do not anticipate a quick fix to drilling activity in the Gulf of Mexico – 38 percent do not expect drilling activity in the region to return to 2009 levels until 2012 or 2013, and nearly one-third (31%) say it will be after 2013 or never.



place, 46 percent of companies expect those increases to be more than 3 percent.

“CFOs are feeling more confident about the market and their ability to grow their companies. There is a renewed sense of security that is reflected by the uptick in CFO compensation and bonus predictions for 2011.”

– **LANCE FROELICH** regional leader of the BDO Compensation and Benefits practice



In addition to increasing salary, 42 percent of companies plan to pay bonuses for fiscal year 2010. Most of those bonuses (93%) will be the same or larger than the prior year, a significant change from 2009 (only 35% planned the same or larger bonuses). However, compensation is being examined more closely. For the third year in a row, more than 40 percent of respondents indicated that steps have been taken to tie compensation more closely to performance.

“Oil and gas companies have been making a concerted effort in recent years to clean up compensation programs and eliminate poor practices. The shift to “pay for performance” is taking hold in the industry, with many linking cash bonuses and equity ownership opportunities to the achievement of goals directly tied to earnings growth, improved operational efficiencies and shareholder returns.”

– **FROELICH**

► RETURN OF CAPITAL

Access to capital has been a primary concern for CFOs since the start of this survey in 2008. CFOs were markedly optimistic about capital and credit availability in our latest survey. More than half (56%) of CFOs report their ability to access capital and credit is either the same or better than in the fourth quarter of 2009. Capital access was a less frequent cause of delays or terminations of oil or gas exploration or processing projects during 2010 than it had been the prior two years (48% in 2010, 73% in 2009 and 80% in 2008). There were notably few respondents (22%) that cited access to capital or credit as their greatest financial challenge, which is a significant change from two years prior (57% in 2008).

► COMPENSATION AND HIRING OUTLOOK

The renewed access to capital within the industry is also being deployed to recruit and retain top talent. Ninety-five percent of respondents expect to maintain or increase the number of personnel employed by their company in 2011.

Looking at salary levels, most (90%) CFOs expect their own compensation to remain the same or increase. Twenty-eight percent of companies have, or will have, a salary increase budget for this year. This is more than double the figure from 2009, when only 12 percent of companies had a salary increase budget. For those that do have a salary increase budget in

The scrutiny on compensation is especially intense at the executive level, and 2010 brought the passage of the Dodd-Frank Act allowing shareholders to voice opinions about executive pay. While there was much ado about this development, nearly all respondents (99%) said it will not significantly impact compensation levels or compensation structure at their company.

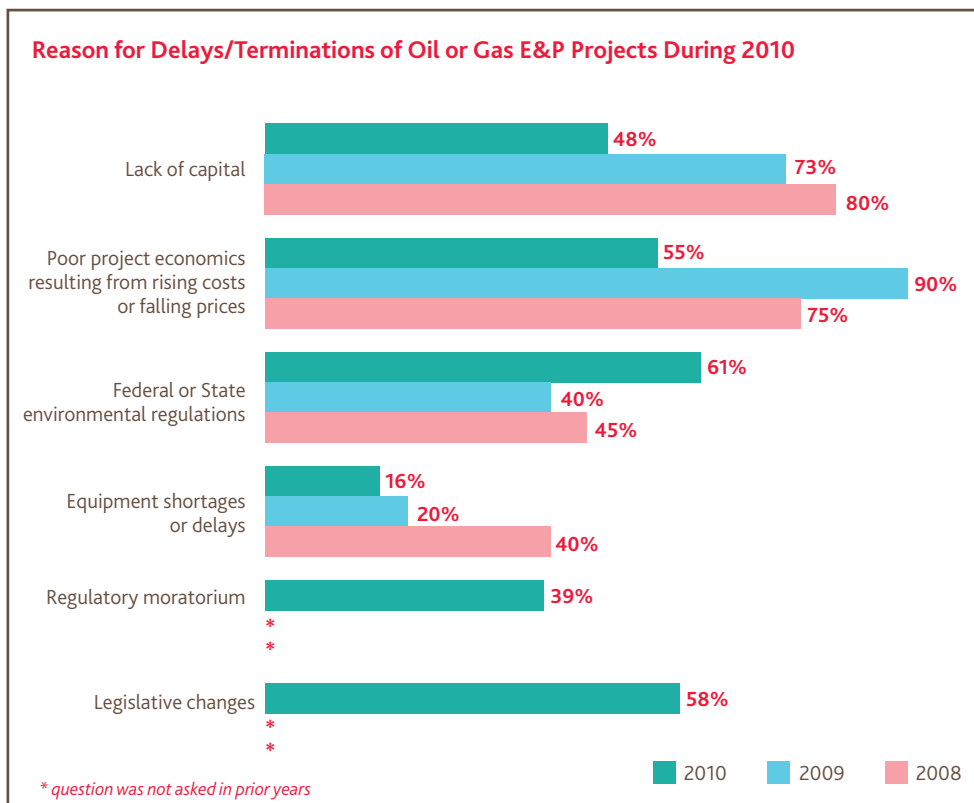
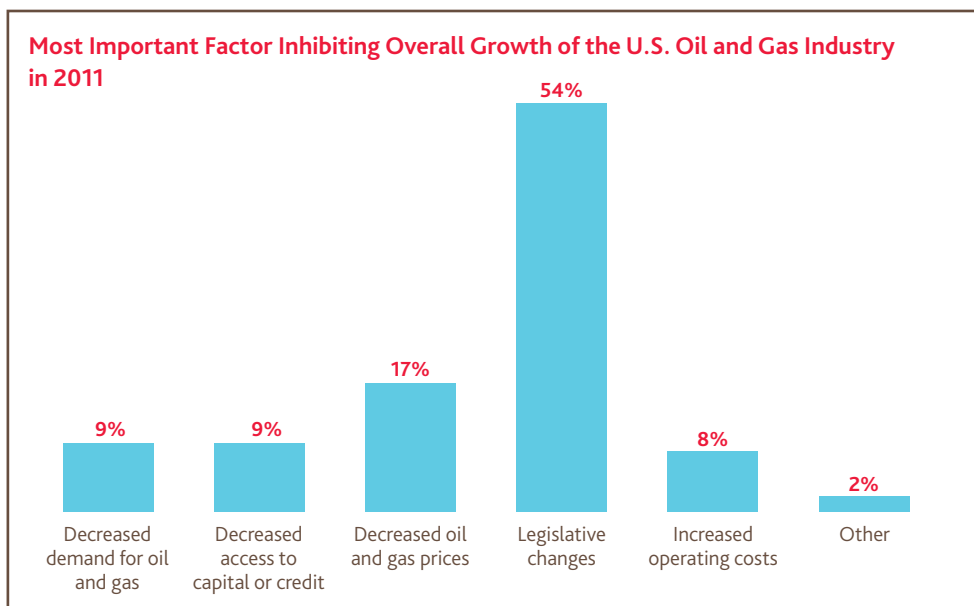
► LEGISLATION AND OTHER HURDLES

The legislative environment weighed heavily on the minds of CFOs in 2010, making many energy companies reluctant to deploy capital until a clearer picture emerges.

Slightly more than half (54%) of CFOs feel that legislative changes will be the most important factor inhibiting the growth of the U.S. oil and gas industry in 2011. In addition, 40 percent cite legislative changes as their greatest financial challenge for 2011 (a 21% increase from the prior year).

CFOs are also concerned about the rise of international competition as a result of proposed legislative changes. Fifty-seven percent of CFOs are concerned that President Obama's proposals to eliminate certain tax incentives for American oil and natural gas producers will cause increased dependence on foreign oil and natural gas, and send investment dollars and jobs overseas.

The legislative/regulatory environment was a major cause of delays or terminations of oil and gas E&P projects during the past year. Among respondents who experienced a project delay or termination, 61 percent cited "Federal or State environmental regulations," 58 percent cited "legislative changes" and 39 percent cited the "regulatory moratorium" on drilling activity.



“One message came through loud and clear in this year’s survey – legislative changes represent the biggest threat to growth in the oil and gas industry.”

– CHARLES DEWHURST, partner and Natural Resources Industry practice leader

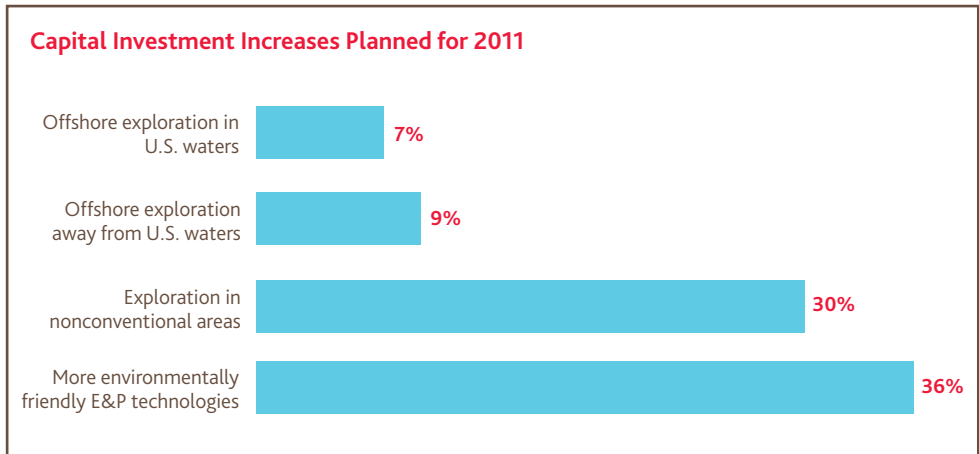
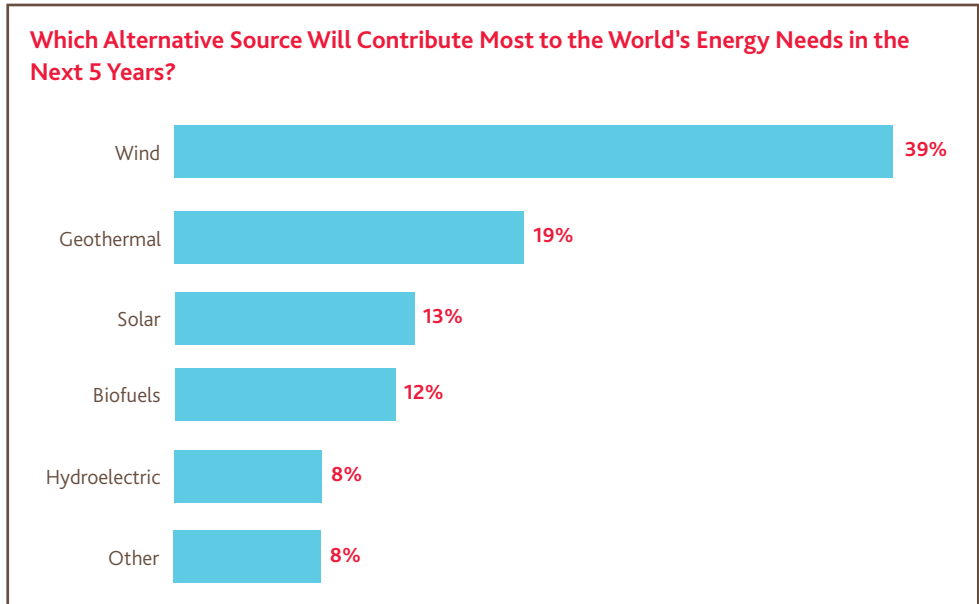
“There is growing interest in renewable energy sources; and, at this point, most CFOs are putting their money on wind power.”

– DEWHURST

▶ALTERNATIVE ENERGY GAINS TRACTION

U.S. oil and gas companies are increasing their focus on alternative energy. Thirty-six percent of CFOs plan to increase their capital investment in environmentally friendly E&P technologies in 2011, and 30 percent will increase their investment in nonconventional areas, such as shale plays. This compares to only 7 percent and 9 percent increasing investments in offshore exploration in U.S. and international waters, respectively.

When CFOs were asked about which alternative energy sources will contribute most to the world's energy needs in the next five years, wind power took a strong lead (39%), followed by geothermal (19%), solar (13%) and biofuels (12%).



BDO ENERGY INDUSTRY PRACTICE

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