

Summary perspectives

- ▶ Current global economic environment is uncertain, with potentially significant implication for oil and gas markets.
- ▶ But buoyed by \$100/barrel oil prices and confidence in long-term energy demand growth, primarily driven by the emerging market economies, the oil and gas industry remains cautiously optimistic.
- ▶ The oil and gas industry remains consistently focused on a growth agenda, and transactions are expected to continue to be a major part of that agenda.
- ▶ Since the 2008 collapse, the oil and gas industry has steadily reduced its leverage and has taken the necessary measures to improve operating efficiency and strengthen its financial position, enabling it to weather the economic storms.

Economic outlook

Spring and summer of 2011 marked a sharp return to intense volatility, levels of volatility not seen since the early days of the economic crisis in 2008. The US credit downgrade, the debt crisis in the Eurozone and generally weakening economic data from around the world sparked dramatic stock market activity and ultimately the global repricing of risk. At the same time, the fallout of the political unrest in North Africa and the Middle East, compounded by the broader impacts of the Japanese disasters, has roiled global oil and gas markets.

Nonetheless, more than one-half (52%) of the oil and gas respondents said that they felt that the global economy was at least stable, if not moderately improving. When asked their perspective on the state of their local economy, 73% of the oil and gas respondents cited a stable or improving economic environment. The confidence in the local economy has, however, declined over the last year; in the October 2010 survey, confidence in a stable/improving economy was pegged at 88%, and it was pegged at 83% in the April 2011 survey.

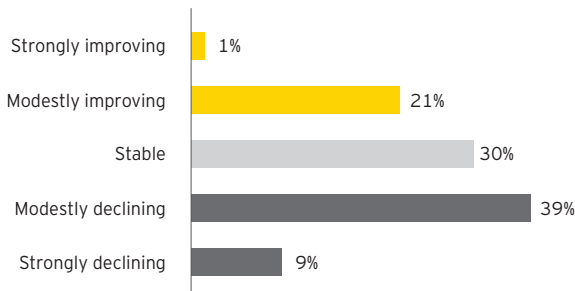
52%

Asked their perspectives on the state of the global economy, 52% of the oil and gas respondents cited a stable or improving environment, somewhat less than the 63% of the broader global sample.

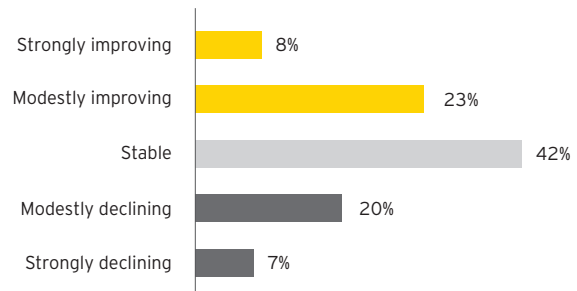
73%

Asked their perspectives on the state of their local economy, 73% of the oil and gas respondents cited a stable or improving local environment, slightly more than the 71% of the broader global sample.

Perspectives on the current global economy



Perspectives on the current local economy



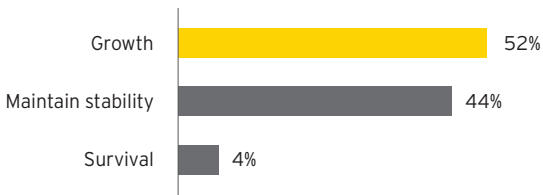
Strategic directions and challenges

Despite the market turbulence, this is not a rerun of 2008. Companies have strengthened their balance sheets, cut costs and reduced overall financial risk. Our survey results paint a picture of corporate confidence amid the turmoil. Growth tops the agenda of more than half (52%) of the oil and gas respondents, with only a few (4%) citing survival as an imperative.

When asked about the main regulatory risks that could derail the growth agenda, environmental risks were seen to be the biggest threat to our oil and gas respondents, ranking ahead of banking/financial reform and taxes, which the broader global sample of respondents had seen as greater threats.

52% Asked their expected organizational focus over the next year, 52% of the oil and gas respondents cited growth, slightly more than the 49% of the broader global sample.

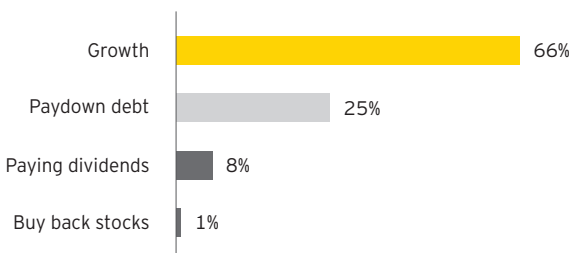
Organizational focus – next 12 months



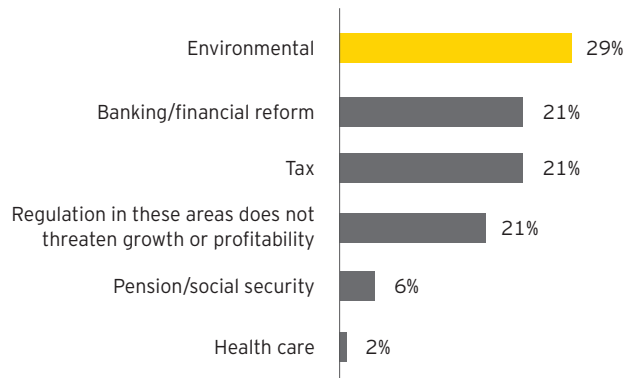
For those companies expecting excess cash flows over the next year, nearly two-thirds (66%) are expecting to prioritize growth, substantially more than the next-most-favored option, paying down debt.

66% Asked where their excess cash flows would be directed over the next year, 66% of the oil and gas respondents cited growth, slightly more than the 64% of the broader global sample.

Excess cash focus – next 12 months



Regulatory risks to growth – next 12 months



Transaction outlook

In an unprecedented departure from the historical norm, the outlook for deal volumes is stable against a backdrop of significant short-term volatility. In fact, dealmakers' appetite has increased marginally in the last six months, with almost half (48%) of the oil and gas respondents expecting to make acquisitions in the next year, compared with 42% in April 2011.

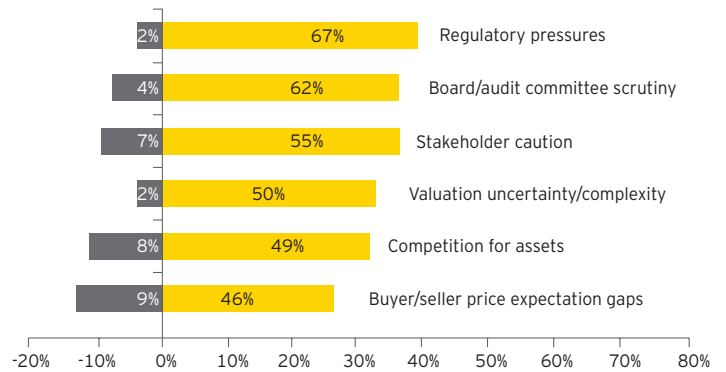
Many companies have learned to adapt and operate in a new and uncertain world. They are well positioned to seize opportunities and plan to do so, as many have reduced their financial risk and have the ability to take on more business risk. Notably, the acquisition expectations of the oil and gas sample of respondents are consistently higher than those of the broader global sample.

48%

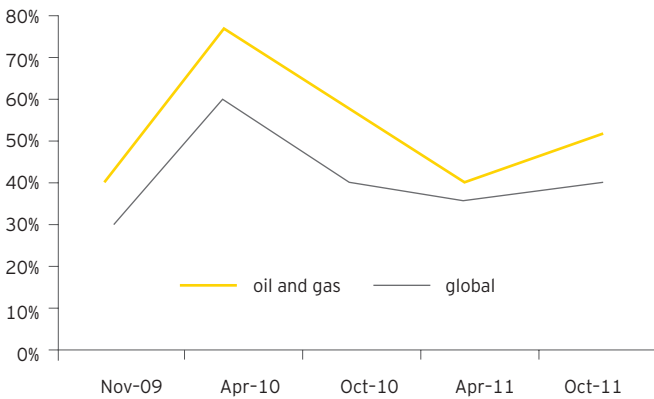
Asked if they expected to make an acquisition in the next year, 48% of the oil and gas respondents responded positively; in comparison, only 41% of the broader global sample responded positively.

As might be expected given the broader turmoil, deal pressures generally increased sharply over the last six months, with the oil and gas respondents notably flagging the sharply increased external regulatory pressures along with the internal pressures around board and/or audit committee scrutiny.

Deal pressure changes – last six months



Expectations for acquisitions – next 12 months

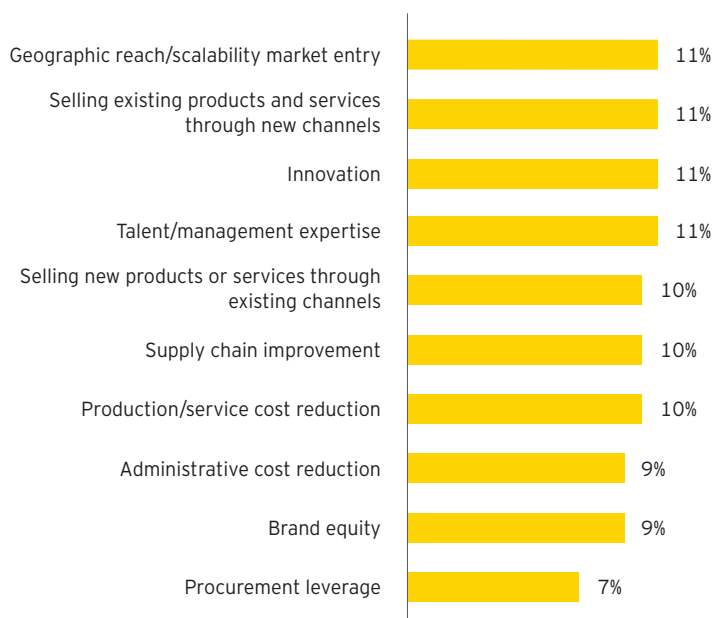


Transaction activity can create value, both from expected as well as unexpected variables and factors. Looking at transaction activity for the last year, our oil and gas respondents noted that value creation did not always come from where they had expected it would. Notably,

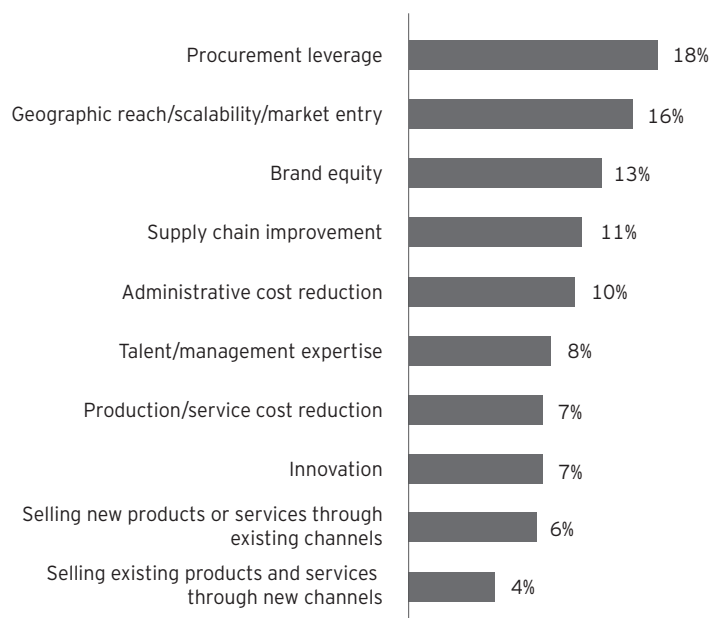
procurement leverage, geographic reach and brand equity delivered more value than was anticipated, while conversely, innovation and the selling of new or existing products and services through new or existing channels delivered slightly less value than anticipated.

Deal value creation – last 12 months

Expected

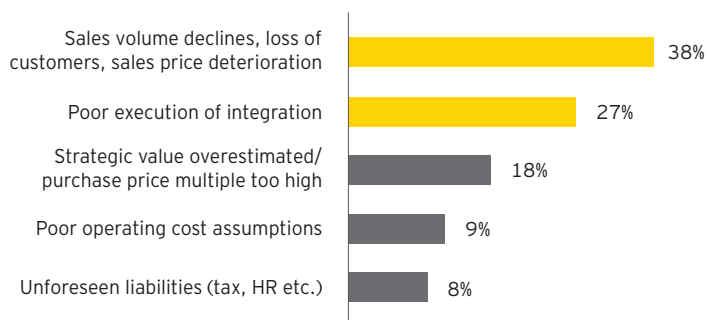


Unexpected



Asked to identify the issues most likely to contribute to missed expectations for deals over the last year, the oil and gas respondents saw thorough market due diligence and poor execution of integration as the most significant issues contributing to missed expectations.

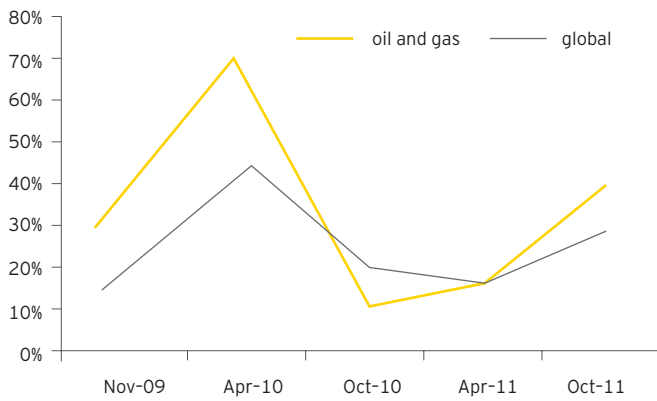
Issues contributing to missed deal expectations – last 12 months



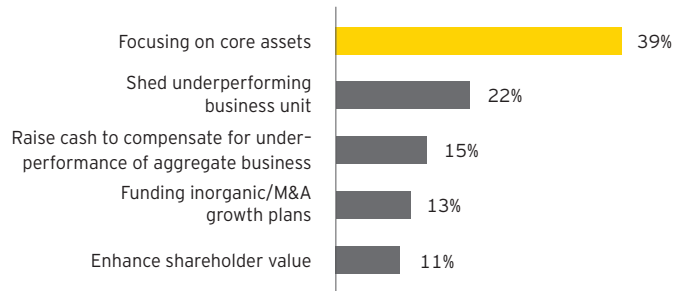
The willingness of companies to divest assets is also an important element in the deal market. More than one-third (37%) of oil and gas respondents expect to execute some type of divestiture over the next year, up slightly from their expectation in April 2011. Notably, oil and gas respondents are generally more likely to use divestitures than is the broader global sample.

For the oil and gas respondents, the main driver of divestment activity is a desire to focus on core assets.

Expectations for divestitures – next 12 months



Drivers of planned divestiture activity



37%

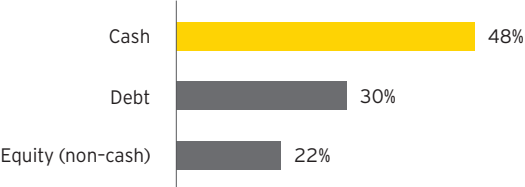
Asked if they expected to make a divestiture in the next year, 37% of the oil and gas respondents responded positively; in comparison, only 26% of the broader global sample responded positively.

Capital market outlook

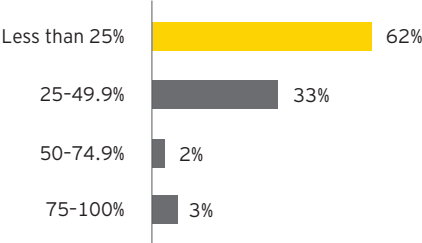
With relatively high cash balances and a growing aversion to leverage, 70% of the oil and gas respondents plan to use cash or non-cash equity as their primary funding source for deals. The trend toward debt reduction continues, with 62% of the

respondents reporting debt-to-capital ratios of less than 25% and another 33% with ratios between 25%-50%. Even those companies planning to use debt in their acquisitions are typically planning to use less than in previous years.

Likely sources of deal financing – next 12 months



Current debt-to-capital ratios



How Ernst & Young's Global Oil & Gas Center can help your business

The oil and gas industry is constantly changing. Increasingly uncertain energy policies, geopolitical complexities, cost management and climate change all present significant challenges. Ernst & Young's Global Oil & Gas Center supports a global practice of over 9,000 oil and gas professionals with technical experience in providing assurance, tax, transaction and advisory services across the upstream, midstream, downstream and oilfield service subsectors. The Center works to anticipate market trends, execute the mobility of our global resources and articulate points of view on relevant key industry issues. With our deep industry focus, we can help your organization drive down costs and compete more effectively to achieve its potential.

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