

2005 Energy Recap / 2006 Energy Predictions



January 6, 2006



Member NASD/SIPC

What a ride!

Every January there is a plethora of research chock full of predictions for the year ahead. We throw our hat into the ring with two simple objectives in mind: 1) help our clients make money investing in the energy industry in 2006; and 2) provide a succinct, yet entertaining read for those down at the gym on the treadmill trying to shed a few holiday pounds.

Energy investing is like bullriding – plenty of ups and (heart-palpitating) downs. Our thematic takeaway – stay involved / long / overweight in 2006. The results aren't likely to be as impressive as 2005 (+40-60%), but energy is still going to be an 85 point ride*.

* In bull riding, the best possible score for a particular ride is 100 points – allocated 50 points for the quality of the bull and 50 points for the rider's performance. We've got a 45 point bull (market) and as a rider (investor), you should be able to net at least 40 points from a long-only, low turnover strategy. Not satisfied with 85 points? Apply the spurs and ride harder!

Robust commodity prices will translate to strong earnings and cash flow and market-beating stock performance. Aggressive players will have plenty of volatility around which to trade, but the general trend for energy is higher.

Enjoy the rodeo!

The Pickering Energy Research Team

Dan Pickering
Byron Pope
Jeff Tillery

Dave Pursell
Stacy Nieuwoudt

David Heikkinen
Marshall Carver

References prices as of January 6, 2006

Crude oil \$64.21/bbl, Natural gas \$9.63/mcf
OSX 198, S&P1500 E&P 427, XOI 1,051
S&P500 1,285; DJ Industrials 10,959

*****IMPORTANT DISCLOSURES ON PAGE 14 OF THIS REPORT*****

Can't wait for the 2006 predictions? Skip to Page 6

2005 Review: Who would have thought...

- ...we'd be happy to see the price of crude oil near \$60/bbl. After talks of Superspikes and other doomsday peak oil scenarios, we're glad to be able to report back to our college Econ101 professors that the laws of supply/demand still work just fine. The argument for cycle sustainability remains much stronger with crude in the \$50's than \$65+.
- ...Mother Nature would trump terrorism as "Wildcard of the Year". Hurricane Katrina/Rita combination was an entirely different source of U.S. Gulf Coast energy infrastructure destruction and disruption than anyone could have anticipated. Gulf of Mexico (GoM) drilling contractors and operators had better call Geico because insurance premiums are headed through the roof.
- ...U.S. natural gas cupboards would start the winter full. With a cumulative 500+bcf of GoM natural gas off-line because of KatRita, storage still managed to start the withdrawal season at 3.3tcf. This suggests the incremental 175 rigs drilling for gas during 2005 actually found something (supply growth) and high prices do have an impact on demand.
- ...OPEC would become relegated to afterthought in the minds of energy investors. In a world with negligible excess crude oil supply capacity, even OPEC jawboning wasn't enough to rattle commodity markets. Words don't work anymore. OPEC member countries (especially Saudi Arabia) will have to "show us the money" via drill bit success.
- ...energy stocks would have to bear an Atlas-like burden for broad equity market. During 2005, the energy component of S&P 500 generated a higher return (+29%) than the nine other economic sectors combined. Energy out-performance was impressively consistent to boot...the OSX outpaced the S&P 500 in 10 of 12 months.
- ...oil service earnings would surprise by 25%+ in 2005. This is part of what fueled the strong OSX run this year. These robust earnings are particularly impressive given the fact that activity (U.S. rigcount +19% y/y, international rigcount +7% y/y) was generally a bigger driver than net pricing improvements. A useful reminder that drilling rigs turning to the right necessarily result in demand for a broad spectrum of oilfield services/equipment.
- ...we'd witness start of first major rig-building boom (land/ offshore) in nearly quarter-century. Yes...we used the "B" word – hard not to with 200+ newbuild U.S. land drilling rigs, 45 jackups and 18 floaters currently in the pipeline. Funny how dayrates in excess of replacement cost have a way of coaxing industry and financial players alike into adding capacity.
- ...Dan Pickering's goatee would prove an ironclad predictor of OSX performance. In the face of a vicious early October energy stock sell-off, Dan sacrificed his goatee...igniting a monster Q4 rally. Thankfully for those now long energy stocks, the Pickering Energy team sacrificed their year-end bonus to give Dan a lifetime supply of shaving essentials.

2006 Energy Predictions

2005 Tale of the Tape

2005 Performance							Major Energy Stock-Moving Events
Period	Crude Oil	Natural Gas	S&P 500	E&P ¹	OSX	XOI	
JAN	11%	3%	-3%	4%	5%	3%	* Companies upbeat at Goldman Sachs energy conference.
FEB	7%	6%	2%	17%	9%	16%	* Bullish IEA Monthly Oil Market Report. * CVX says "end of the era of low oil prices".
MAR	7%	14%	-2%	2%	-2%	-1%	* UCL takeout rumors generate E&P buzz. * Energy stocks take breather after huge February.
APR	-10%	-14%	-2%	-6%	-7%	-4%	* Bearish IEA Monthly Oil Market Report. * Strong Q1 earnings can't fight falling crude/gas prices.
MAY	5%	-3%	3%	3%	4%	1%	* Oil dips (briefly) below \$50/bbl...lessens global economy fears.
JUN	9%	9%	0%	10%	9%	8%	* Bullish OECD inventory data propel energy commodities higher. * BP CEO says \$40/bbl+ crude with us for next few years.
JUL	7%	13%	4%	8%	10%	6%	* Hurricane Dennis focuses attention on GOM energy vulnerability * Monster Q2 oil service earnings; widespread upside surprises
AUG	14%	45%	-1%	8%	6%	8%	* Stocks benefit from Q2 earnings afterglow. * Hurricane Katrina makes landfall...and history.
SEP	-4%	21%	1%	10%	2%	6%	* Hurricane Rita adds insult to injury...storm season from hell. * E&P's follow natural gas prices higher...way higher. * Hydro/SKE deal sparks E&P speculation.
OCT	-10%	-12%	-2%	-10%	-5%	-8%	* Demand concerns resurface on gasoline price over \$3/gal * Demand destruction a reality; US gasoline consumption -1% y/y * Storm-impacted Q3 results for energy companies.
NOV	-4%	3%	4%	0%	6%	-1%	* Market forward-looking...affords oil service firms free pass on storm-impacted Q3 results, excitement about 2006 prospects.
DEC	7%	-11%	0%	8%	3%	1%	* Natural gas prices hit record level, then retreat. * COP/BR deal renews investor interest in E&P space.
2005	41%	82%	3%	66%	47%	38%	Heck of a year for energy stocks! Energy outperforms S&P 500 in all but 2 months (April/October), both times when economic concerns pushed macro fear and oil/gas prices declined by 10%+.

¹S&P 500 Oil & Gas Exploration & Production Index. Comprised of APA, APC, BR, DVN, EOG, KMG, XTO.

2006 Energy Predictions

2005 Post-mortem: How'd our predictions pan out?

- *Good news* – We got the trends and stockpicking right...consistently (see below for recap).
- *Bad news* – 2005 is history. “So what have you done for me lately?” Our current forecast starts on Page 6.

2005 Top Predictions Recap

Prediction	Grade	Reality
Gas Market Scare	A	Year of volatility: gas trades \$5.79-\$15.38/mcf.
Price Matters	A	Oil demand growth slows (3.8% to 1.6%) as price rises (\$42 to \$57/bbl).
ETFs develop for oil/gas	A	Signed, Sealed and Delivered.
OPEC abandons price floor	A	OPEC disbanded "price band".
Saudi 2005 drilling program answers debate	C	No answer yet, but Saudi clearly putting dollars into the ground. Saudi rigcount +20% in 2005; expected to double in 2006.
Iraq production, more talk than action	A	Too much military work to be done, adding capacity via drill bit still TBD
China slower growth	A	Growth slowed from 14% in 2004 to ~3% in 2005.
More exploration, capex budgets +20-50%	A	E&P big cap independents increased capex 33% in 2005 vs. 2004.
Windfall profits tax	A	Senate held hearings, more fear than fangs.
Improved visibility with LNG	B	5 projects began in 2005, list of new proposals continues to grow.
Foreign consumers wean to market level pricing	A	Indonesia, Nigeria and China phased out some government fuel subsidies.
Governments press for more pie	A	Venezuela forces new JV structure, calls prior contracts "illegal".
Ultradeep drilling results pushed to 2006	A	We're still waiting for Blackbeard/Joseph results...
US energy bill finally passes	A	Toothless bill passes Congress in August, wasted opportunity.
Rigcount makes 15 yr highs	A	Easily surpassed prior 15 year high (now approaching 1500).
Spec upgrades/newbuilds re-emerge	A	45 Jackups (22 by Speculators) and 18 Floaters (6 by Speculators) underway.
Capital markets activity accelerates	A	\$12BB in deals; 13 energy IPOs, numerous equity offerings.
Capital spending discipline by OSX	A	Good problem of what to do with so much free cash flow emerges.
No tech breakthroughs	A	No game changers...yet
CNBC expands energy coverage	A	Now has a countdown to inventory data.
OSX becomes more volatile	A	Can we say whiplash? 2005 saw 5 Rallies (>10%) and 4 Pullbacks (>5%)
Oil Service Earnings growth	A	On average, our coverage universe earnings grew 72% in 2005. Expected to grow ~40% in 2006
No multiple compression	A	Multiples don't compress in an up-cycle.
OSX \$150	D	Too conservative. OSX tops \$190 (easily beats our target)
Energy grows as a % of SPX	A	Energy started 2005 at 7.2%, ended year at 9.2%. Easily outperforms: +29% vs. SPX +3%

Performance of Pickering Energy Top Oil Service Picks for 2005

Pickering Energy Prediction	Top Pick 2005 Return	Peer Group 2005 Return ^{1,2}	Relative Performance (basis pts)	Stock Performance Commentary
Best Large Cap Stock of 2005 (Halliburton - HAL)	58%	44%	1,400 bps	*HAL performance in 2005 illustrates upside potential in stocks that go from being hated to adored. As asbestos cloud lifted and strong pressure pumping business drove positive earnings surprises, it was off to races for HAL stock.
Best Mid Cap Stock of 2005 (National Oilwell Varco - NOV)	78%	57%	2,100 bps	* Market fell in love with rig capital equipment plays in 2005. Pre-eminent rig builder NOV (+78%) was second only to GRP (+120%) in 2005 stock performance among mid caps.
Best Small Cap Stock of 2005	We punted on this one. The exact wording was "...probably a name 98% of investors (including us) have never heard of".			* We should have gone for it as two micro caps took top-billing in 2005 with 300%+ returns. We got to know both Flotek (FTK, +334%) and NQL Energy Services (NQL CN, +304%) during 2H'05 and both are solid oil service citizens with attractive growth prospects.

¹Large Cap peer group includes BHI and SLB.

²Mid Cap peer group includes BJS, CAM, FTI, GRP, SII and WFT.

2006 Predictions Summary

<p style="text-align: center;"><u>MACRO</u></p> <p>Energy Cycle Continues</p> <p style="padding-left: 40px;">\$60/bbl oil</p> <p style="padding-left: 40px;">\$9.50/mcf gas</p> <p>Tight supply/demand</p> <p>Commodity volatility</p> <p>Oil supply grows 1.7%</p> <p style="padding-left: 40px;">Gas storage 1.4tcf+</p> <p>GOM returns to normal</p> <p>Multiple demand/economy scares</p> <p style="padding-left: 40px;">Geopolitical turmoil</p> <p style="padding-left: 40px;">LNG activity increases</p>	<p style="text-align: center;"><u>STOCKS</u></p> <p>Energy Cycle Continues</p> <p style="padding-left: 40px;">5th Inning</p> <p>Energy outperforms S&P 500</p> <p style="padding-left: 40px;">Oil service beats E&P</p> <p style="padding-left: 40px;">Oil service +15-35%</p> <p style="padding-left: 40px;">E&P +15-25%</p> <p style="padding-left: 40px;">More IPO's / Offerings</p> <p><u>Favorite large cap, midcap, small cap, microcap</u></p> <p>Oil Service: BHI, BJS, OIS, TMI</p> <p>E&P: XTO, SWN, CMZ, ARD</p>
<p style="text-align: center;"><u>OIL SERVICE</u></p> <p>More rigs delivered</p> <p>Continued pricing improvement</p> <p style="padding-left: 40px;">US rigcount +15%</p> <p style="padding-left: 40px;">Int'l. rigcount +6%</p> <p>US land rig dayrates plateau</p> <p>US still world's strongest market</p> <p style="padding-left: 40px;">Awash in cash</p> <p style="padding-left: 40px;"><u>Earnings growth</u></p> <p style="padding-left: 40px;">service/equipment ~40%</p> <p style="padding-left: 40px;">drillers ~150%+</p>	<p style="text-align: center;"><u>E&P</u></p> <p style="padding-left: 40px;">Awash in cash</p> <p>Rising costs, compressing margins</p> <p style="padding-left: 40px;">Equipment constraints</p> <p style="padding-left: 40px;">Resource play mania</p> <p style="padding-left: 40px;">More consolidation</p> <p style="padding-left: 40px;">GOM gets attention</p> <p style="padding-left: 40px;">More exploration</p>

2006 Forecast: What's in store for energy big picture?

- *Overall* – More of the same (and that's a good thing). Strong prices, intermittent but strident concerns about both too much and too little oil. Between two and four “demand/economy scares” - at least one driven by fears of faltering China and one driven by concerns of possible additional US interest rate increases. Average inventory levels. Higher refining throughput via capacity creep.
- *Economy* – Strong enough to keep global hydrocarbon demand and supply tight.
- *Oil demand growth moderates* – With very little (read zilch) spare capacity in the system, oil demand remains constrained by incremental supply. We think 2006 global oil demand rises 1.7% y/y (+1.5mmbpd) to 85mmbpd.
- *No peak oil* – Peak oil remains a hot debate item, but aggregate oil supply grows. Non-OPEC grows faster than OPEC (main drivers are Russia, West Africa, Brazil and Canada).
- *More spending on exploration and production* – Overwhelmed with cash, enticed by higher internal commodity price decks and a desire to accelerate long-term growth rates, E&P companies further loosen purse strings...much to delight of oil service industry.
- *Gas supply and demand both grow* – Higher rigcount drives onshore supply growth of 3%. GoM production returns to normal during late 1H '06. Net, net gas supply grows 1% y/y. Positive demand response as gas prices slink back toward parity with crude (\$8-\$10/mcf). Industrial users gradually re-enter the market as plants left inoperable by KatRita are eventually brought back online.
- *Winter ends with above-average storage* – The 2005 injection season ended with near record levels of inventory (3.3tcf) even with 500+bcf production off-line due to KatRita. Some ugly weather and weak withdrawals in early 2006 will put storage around 1.4tcf at the end of withdrawal season.
- *Our 2006 price predictions* – We're looking for \$60/bbl oil and \$9.50/mcf natural gas. Unfailingly, commodity price predictions are wrong. We just hope to be in right ballpark in terms of direction and magnitude of the moves.
- *Continued commodity volatility* – It would not shock us to see natural gas trade between \$7-\$15/mcf during 2006. Oil will trade in a tighter band (\$50 - \$65/bbl). Expect Dr. Gray's hurricane predictions to attract more internet hits than Paris Hilton Hardee's commercial. Your choice – Paris (<http://www.spicyparis.com/paris.html>) or Gray (<http://tropical.atmos.colostate.edu/forecasts/>).
- *Price matters!* – Must continue to harp mantra that \$50 crude is better for energy cycle longevity than \$60. Higher prices = slower demand growth. Case in point?...2005 global oil demand growth slowed to 1.6% (in the face of \$57/bbl crude oil) after having been +3.8% in 2004 (\$42/bbl).
- *OPEC continues to be ignored* – Inability of OPEC member countries to provide incremental barrels global economy has cleared room of interested spectators faster than a Houston Texans football game. OPEC remains a paper tiger through most of 2006.

- *Saudi becomes clearer* – Aramco is on a mission for 3mmbbls/day of incremental capacity by 2009. With better data transparency and a doubling of rigcount, the world will finish 2006 feeling more comfortable about incremental Saudi supply in 2007 and 2008.
- *Iraq production, more talk than action* – Still too much military work to do before serious oil production additions can be achieved. Expect vendor maneuvering for contracts, but any gains in Iraq supply will stem from rejuvenation of existing fields rather than new exploratory or development programs.
- *Geopolitical events* – Inevitable that at least one geopolitical event sparks an impressive oil rally. Will it be Iranian nuclear issues, Israel - MidEast tensions, Venezuela saber rattling, oil-focused terrorism? We're hopeful said rally will be short-lived as sky-high oil prices often cause global economic growth concerns to resurface.
- *LNG moving dirt* – 2006 sees at least 6 LNG terminals under construction (4 Gulf Coast, 1 Canada, 1 Mexico) targeting the North America market with capacity of ~15bcf/d by the end of the decade.
- *LNG worries emerge* – Pundits fall into one of two LNG camps: 1) the US will be awash in natural gas by end of decade; or 2) non-existent liquefaction capacity will make new regas capacity less relevant. While we believe liquefaction capacity slippage is inevitable, and the early years (2008-2012) of LNG will be “sloppy”, we are believers that long term, LNG will be a meaningful gas market factor in the U.S.

2006 Forecast: What's on tap in oil service land?

- *Earnings grow – fast!* The average oil service/equipment company in our coverage universe will grow earnings by 38% in 2006, with increasing visibility on continued 2007 growth. Drillers post 150%+ eps growth as older contracts roll to spot market dayrates. Bank vaults bulge with greenbacks as cash builds.
- *More rigs surface from every nook and cranny –* With the industry's inventory of stacked rigs essentially exhausted, look for newbuild rig deliveries to propel US and international rig count higher by 15% and 6-8%+ respectively in 2006. The pace with which under-the-radar players building land rigs is the supply/demand X-factor...rumors of do-it-yourself rig-building kits soon to be available at Home Depot.
- *Oilfield service / equipment pricing...gone wild!* – Solid in 2005 (particularly in North America), pricing likely supercharged in 2006 as equipment/service crews now generally working flat out...irrespective of oil service market segment, irrespective of geographic region.
- *Dayrates rise slower* – Offshore leading edge dayrates continue to drift higher, but at a slower pace than explosive 2005 growth rates. Land rig rates plateau as new capacity takes the edge off E&P's panic to procure equipment.
- *Oil service capital spending steps up a notch* – As E&P customers demand more services, equipment and people, oil service companies increasingly throw caution to the wind and expand capital spending by 20%+ from initial 2006 budgets.
- *Oil service supply chain bottlenecks become more visible* – With a limited universe of equipment suppliers (particularly for key components like engines, pumps, specialty steels), we suspect some requested oil service equipment won't ship until 2007. Favor the big boys...larger players are generally at the front of the queue with suppliers.
- *Energy industry labor constraints work themselves out* – Where there's a will, there's a way. In this case, the will translates into oil service companies needing to provide attractive wages, benefits, well-site conditions, etc. to attract laborers from other industries. The oil service industry collectively takes recruiting effort up another notch and successfully crews new rigs/equipment...Necessity truly is the mother of invention.
- *Alex, I'll take "2006 Oil Service Thematic Plays" for \$1,000 please* – Solid growth next year from a) reservoir enhancement services and tools (stimulation, completion tools); b) drilling efficiency enhancers (drill bits, fluids, rigs with ample hydraulic horsepower); c) formation evaluation tools (LWD, open-hole wireline); d) precise well path enablers (MWD, directional drilling services and tools). Commonality?...all market segments where biggest players dominate.
- *Oil service M&A: not huge, but lurking* – Always a few deals done every year. 2006 sees nothing transforming, but there is a growing possibility of industrial players (think GE, Tyco, Dover, etc) making increased bets in the energy space.

2006 Forecast: What's on tap in E&P land?

- *Money, money, money.....money* – With \$60/bbl oil and \$9.50/mcf gas, E&P companies remain printing presses for cash. The longer the cycle lasts, the better the industry balance sheet and the higher the proportion of cash flow E&P's are likely to redeploy for acquisitions and/or drilling.
- *Margin squeeeeeeeeeeeze* – A 6% y/y boost in commodity prices cannot offset a 15-30% increase in costs. E&P companies still generating great returns, but making less margin per mcf.
- *Brother can you spare a rig?* – Even with new equipment arriving almost daily, US-focused E&P's will battle to execute drilling plans. Companies with contracted rigs and equipment get gold stars – and will have less risk of disappointing Wall Street on the production front.
- *E&P acquisition & divestiture activity/speculation continues unabated* – Chevron and Unocal, Hydro and Spinnaker, Conoco and Burlington were the big-fish deals of 2005. Potential feeding frenzy during 2006 as buyers will be afraid of missing opportunity. Potential buyers: COP, RD, CVX, DVN, XTO, CHK. Potential sellers: ECA, EOG, MUR, NBL, KWK, UPL, SWN, WGR, NFX, EQT, STR, BBG, CMZ...and a host of small caps.
- *Pickering, Pursell and Heikkinen unveil the "West Houston Shale"* – favored clients may begin leasing now at preferential prices.
- *Resource plays stay hot* – 2005's sexiest two words (resource play) are sexy once again in 2006. E&P players continue to race to exploit horizontal drilling and completion techniques in previously unprofitable reservoirs. Emerging plays that gather steam in 2006 include:
 - Fayetteville Shale (Arkansas) - SWN, CHK, XTO
 - Pinedale Anticline (Wyoming) - UPL, STR, WGR
 - Mannville CBM (Canada) - KWK, EBR CN, NXY/Trident, PXD
 - West TX Barnett - EOG, RRC, SWN, KWK, CRZO, TXCO
 - Woodford Shale (Oklahoma) - NFX, SM
 - Blackhawk/Lower Mesa Verde, Uinta Basin (Utah) - GSX, EOG, BBG, BRY, NFX/SGY
 - Columbia River Basin sub-Basalt (Oregon) - ECA, DPTR
 - Floyd Shale, Alabama (Nascar isn't the only thing in Talladega) – private companies
- *Gulf of Mexico leaves penalty box* – Despite production treadmill issues, rig constraints and hurricane risk, interest in Gulf of Mexico assets begins to revive. Strong returns and private equity capital combine to pull GoM from the doldrums.
- *Exploration looking appealing* – Flush with coin and confident in the energy cycle, expect more E&P willingness to take risk. Prepare to spend more time well-watching and hearing rumors about "the big one". Really want the scoop? Get familiar with the best bars in oilfield towns – but it's a long drive from Wall Street to Rifle, Colorado or Cleburne, Texas.

2006 Forecast: Stock stuff

- *Energy stocks outperform again* – Great start to the year gives this prediction a little head start. Don't expect to match 2005 numbers (+40-60%), but E&P and oil service stocks will once again beat the broad market as commodities remain robust and industry profitability shines. Don't miss the forest for the trees. Be long / overweight in 2006.
- *It isn't different this time.* Our obligatory reminder that the energy industry always has been...is now...and always will be cyclical, not secular. Healthy dose of skepticism wards off cycle complacency. Still only the 5th inning, but it never hurts to stay vigilant for signs of fraying around the edges of the energy up-cycle.
- *OSX \$230-\$265* – Oil service earnings grow 20%+ thru 2007. Service and equipment multiples hold steady (they don't contract in up-cycle as investors assign growth stock valuations). As we move through 2006, investors start to pay up for 2007. Implies 15-35% upside from current levels. As our grandpappy used to say: "Better than a poke in the eye with a sharp stick!"
- *Long-term price assumptions keep drifting up* – For stock valuation, long-term price assumptions are the key driver. And people will keep paying more in 2006. Our NAV's assume \$50/bbl and \$8/mcf.
- *E&P stocks +15-25%* -- The "average" E&P stocks will discount \$8/mcf natural gas prices during 2006. This moves the E&P sector higher by 15-25%. Obviously, name of game is to find stocks which do better than peers. Think smaller not bigger (more below).
- *Look to small cap E&P's once again in 2006* – Some E&P companies grow their asset value through the cycle. We continue to believe smaller E&P companies that have a meaningful inventory of projects with contracted rigs and services are the best bet. Several examples include CMZ, GMXR and PLLL.
- *Time for large/mid-cap oil service to stand up and be counted* – Small-cap oil service stocks put a hurting on their larger brethren during 2005 (small-caps +107%, mid-caps +63%, large-caps +53%)...definition of "hurting" is all relative with these types of outsized returns. We declare 2006 "Year of the Large/Midcaps" as their geographic breadth, stronger negotiating leverage with suppliers/customers, and broader product/service portfolios translate into impressive earnings growth (20%+) in 2006.
- *Favor hybrid (floaters/jackups) and deepwater offshore drillers over pure jackup plays.* Jackup-oriented stocks (particularly those with heavy GoM exposure) benefited tremendously from investor euphoria over step-function dayrate increases post-KatRita. Tougher for these names (RDC, ESV, THE) to maintain "sizzle" factor in 2006.

- *At least one sell side analyst sabotages career by calling cycle over* – Tempting given monster run by energy stocks the last two years. Barring a disaster on the energy macro front, we're in the camp saying 2006 will be another good vintage for energy stock connoisseurs.
- *Energy stock volatility...redundant terminology.* Unfortunately, energy stocks and volatility go hand-in-hand. 2006 will be no exception – overweight energy is still the right answer, while tactical trading offers an opportunity to boost portfolio performance.
- *More IPO's, more scrutiny* – There were \$12 billion of energy offerings (including secondaries) in 2005. As cycle stretches, waiting list of companies attempting to access markets will be longer than ladies bathroom line at Mariah Carey concert. Investors must get more jaded and work with a sharper pencil to determine participation. Must have some trust in your favorite sellside broker(s) to separate the wheat-from-the-chaff.

Forecasting the 2006 Oilfield Service Awards

- *Best Large Cap Stock of 2006* – Baker Hughes (BHI – currently \$67)
- *Best Mid Cap Stock of 2006* – BJ Services (BJS – currently \$39)
- *Best Small Cap Stock of 2006* – Oil States (OIS – currently \$37)
- *Best Micro Cap Stock of 2006* – Team Inc. (TMI – currently \$25)

Forecasting the 2006 E&P Awards

- *Best Large Cap Stock of 2006* – (XTO – currently \$46)
- *Best Mid Cap Stock of 2006* – (SWN – currently \$37)
- *Best Small Cap Stock of 2006* – (CMZ – currently \$15)
- *Best Micro Cap Stock of 2006* – (ARD – currently \$30)

Other Prognostications/Pontifications

- *Least Likely Event* – 2006 energy stock volatility less than that of S&P 500
- *Most Likely Event* – Weekly whiplash from oil/natural gas inventory stats
- *Back From The Brink* – Horizon Offshore (HOFF - \$0.56); Seitel (SELA - \$2.39)
- *At the Brink* – Times too good for any oil service/E&P company to be in this camp
- *Beyond The Brink* – Calpine (CPNLQ - \$0.21)

Conclusion

What's the difference between a professional golfer and his caddy? The caddy is long on strategy, while the professional golfer is long on execution. Consider us your caddy – we've talked strategy in this report and will continue to talk tactics in our daily commentary (Pickering Energy Thoughts).

Bottom line: The energy sector in 2006 is bound to be beset with transitory periods of gut-wrenching energy commodity/stock pullbacks. Stay the course as we think energy stocks bring home the hat trick in 2006...out-performance relative to S&P500 for third consecutive year.

We end the report as we began – enjoy the rodeo!



Analyst Certification:

I, Dan Pickering, do hereby certify that, to the best of my knowledge, the views and opinions in this research report accurately reflect my personal views about the company and its securities. I have not nor will not receive direct or indirect compensation in return for expressing specific recommendations or viewpoints in this report.

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Ratings: **B** = buy, **A** = accumulate, **H** = hold, **T** = trim, **S** = sell, **NR** = not rated

Investment Rating Distribution:

As of December 31, 2005

<u>Coverage Universe</u>	<u>Count</u>	<u>Percent</u>
Buy	15	94%
Neutral	1	6%
Sell	0	0%

Pickering Energy Partners, Inc. has not provided investment banking services to any of the securities we have rated.

Price Target Methodology:

Any price targets that are mentioned in our research are generated by: employing a combination of the stock's historical valuation ranges, the relationship between the stock and the market valuation, comparable company multiples of earnings, EBITDA, book value and sales, and net asset value analysis. There is a risk that the stock will never reach the price target. These risks include market conditions and unforeseen events that may affect the company's business.

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Ratings: **B** = buy, **A** = accumulate, **H** = hold, **T** = trim, **S** = sell, **NR** = not rated

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www.pickeringenergy.com

Institutional Research

Houston, Tx
713 333-2960

New Orleans, LA
504-371-5563

Institutional Sales

Houston

Hance Myers
hmyers@pickeringenergy.com
713-333-2987

C. Paige DiMaggio
pdimaggio@pickeringenergy.com
713-333-2969

Mike Bradley
mbradley@pickeringenergy.com
713-333-2968

Lori Yentzen
lyentzen@pickeringenergy.com
713-333-2974

Denver

Chuck Howell
chowell@pickeringenergy.com
303-300-1902

Jon Mellberg
jmellberg@pickeringenergy.com
303-300-1995

Jason Foxen
jfoxen@pickeringenergy.com
303-300-1960

Trading Desk
800-507-2400

Michael du Vigneaud
mduvigneaud@pickeringenergy.com
713-333-2976

Matthew Pham
mpham@pickeringenergy.com
713-333-2977

Josh Martin
jmartin@pickeringenergy.com
713-333-2982

Email: info@pickeringenergy.com

Clearing through Bear, Stearns & Co. Inc.