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IAEE – Challenges Facing Independent Oil Companies October 12, 2006

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- **Growth strategies of independent oil companies**
 - **Acquire and exploit**
 - **International**
 - **Unconventional**
- **Challenges facing the oil and gas industry**
 - **Resource constraints**
 - **Price volatility**
 - **Geopolitical risks**

What is an Independent Oil Company



- **Independent oil company is primarily in the exploration and production side of the industry (i.e., little refining and marketing)**
- **Total of about 5,000 companies**
- **Drill 90% of the wells in the U.S.**
- **Produce 68% of U.S. oil**
 - **23% from public and 45% from private companies**
- **Produce 82% of U.S. natural gas**
 - **32% from public and 50% from private companies**

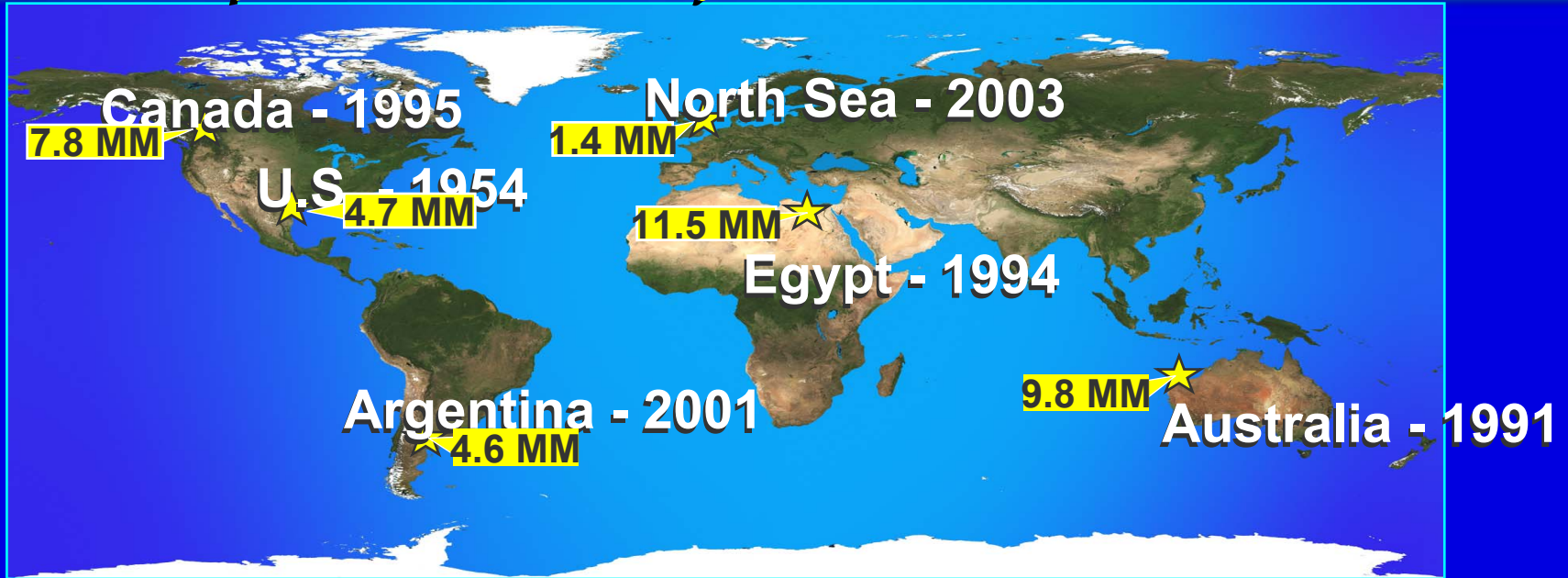
Source: IPAA

Oil Companies are Consolidating

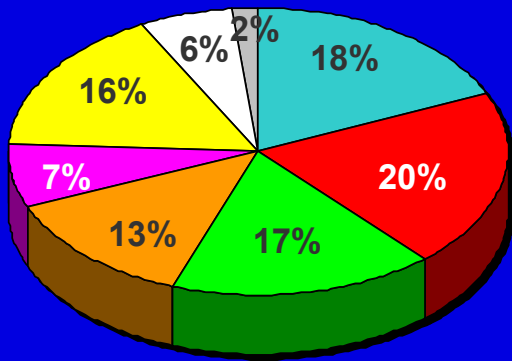


- **Oil & Gas Journal 400 – 300 – 200 – 100?**
 - **Tracks the largest U.S. based public companies**
 - **400 companies in 1983**
 - **300 companies in 1991**
 - **200 companies in 1995**
 - **138 companies in 2005**
 - **ExxonMobil 1st in revenue - \$ 370.7 billion**
 - **Apache 10th in revenue - \$7.6 billion**
 - **Smallest company had revenue of \$469,000**

Apache Corporation's Portfolio

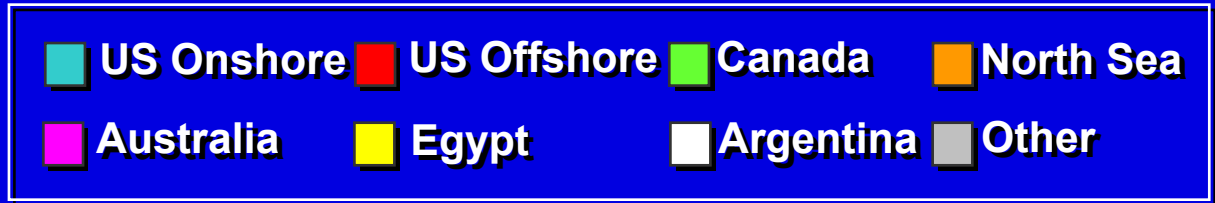


40 MM acres worldwide in 6 countries

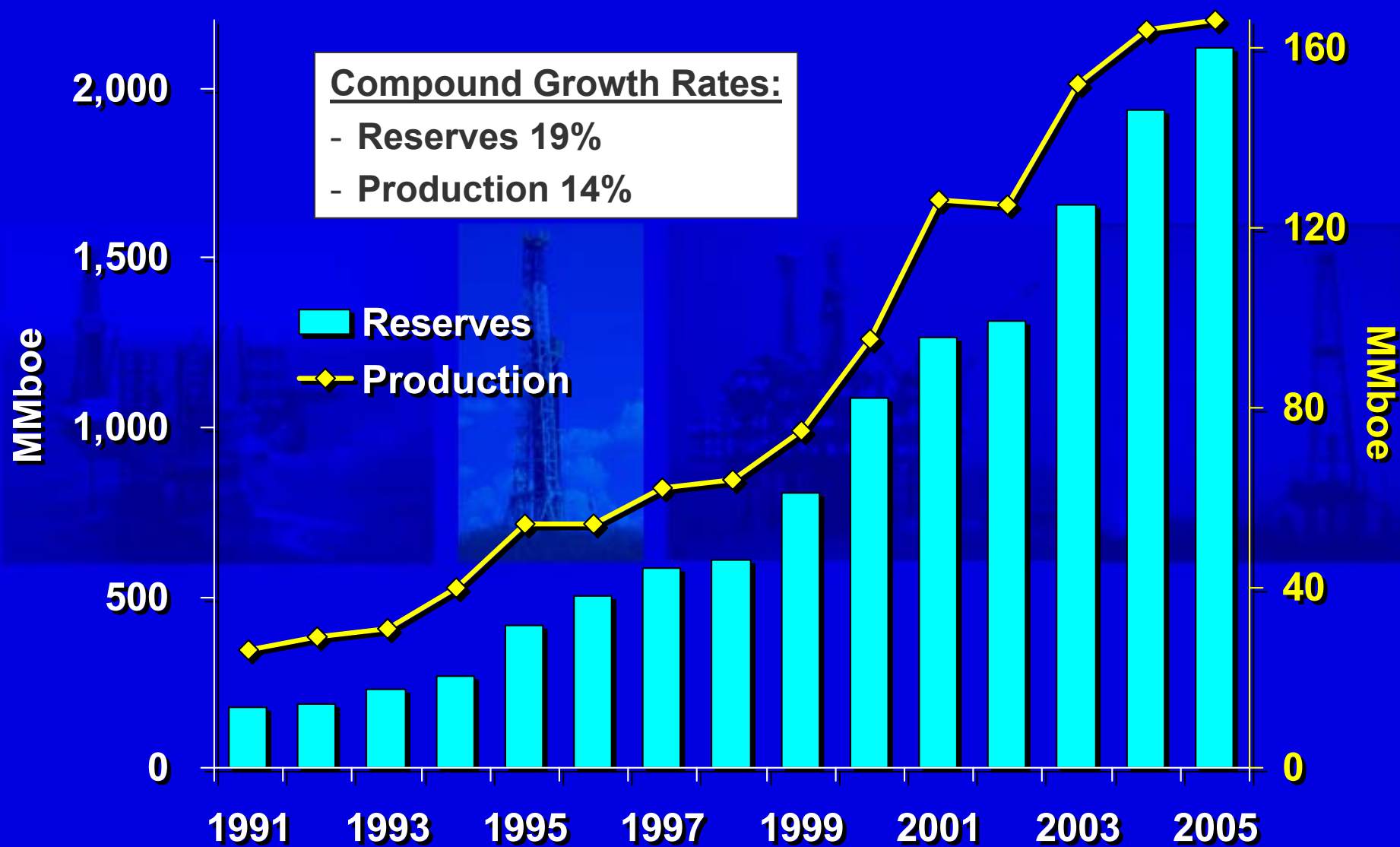


2nd Quarter 2006 Production:

500,888 BOE/Day – 52% Gas & 48% Oil



Driven to Grow



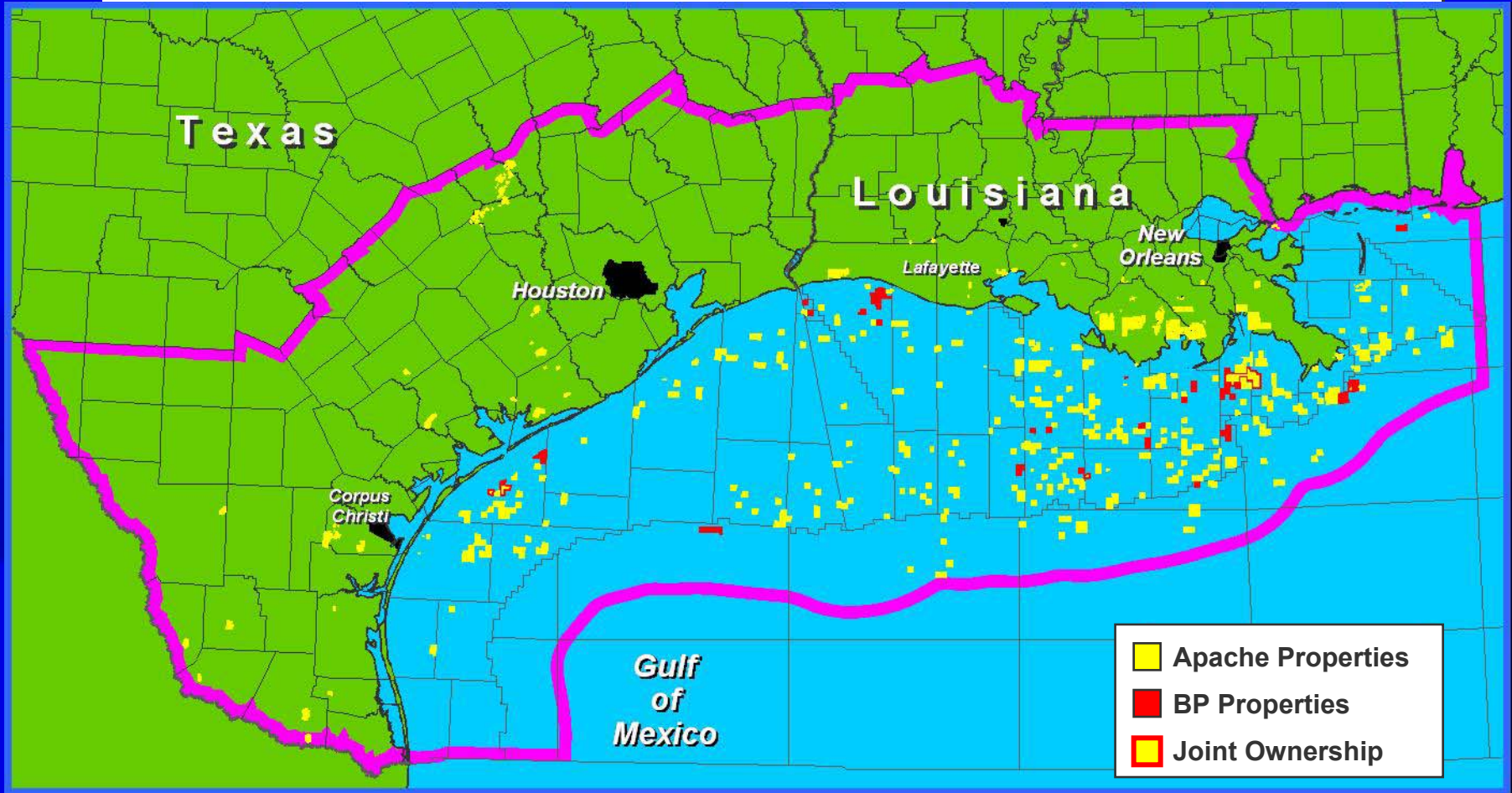
Acquire and Exploit

- **Independents acquired assets that were no longer of strategic significance to major oil companies**
 - **Assets typically manpower intensive and provided lower rates of return than mega-projects available to majors**
 - **Assets divested by major oil companies were significant additions to the portfolios of independents**
 - **Typically, assets had a large inventory of projects and a large land position**
 - **Projects provided a high rate-of-return**
 - **Independents are low cost producers and can squeeze more oil and gas out of assets**

Gulf of Mexico Highlights

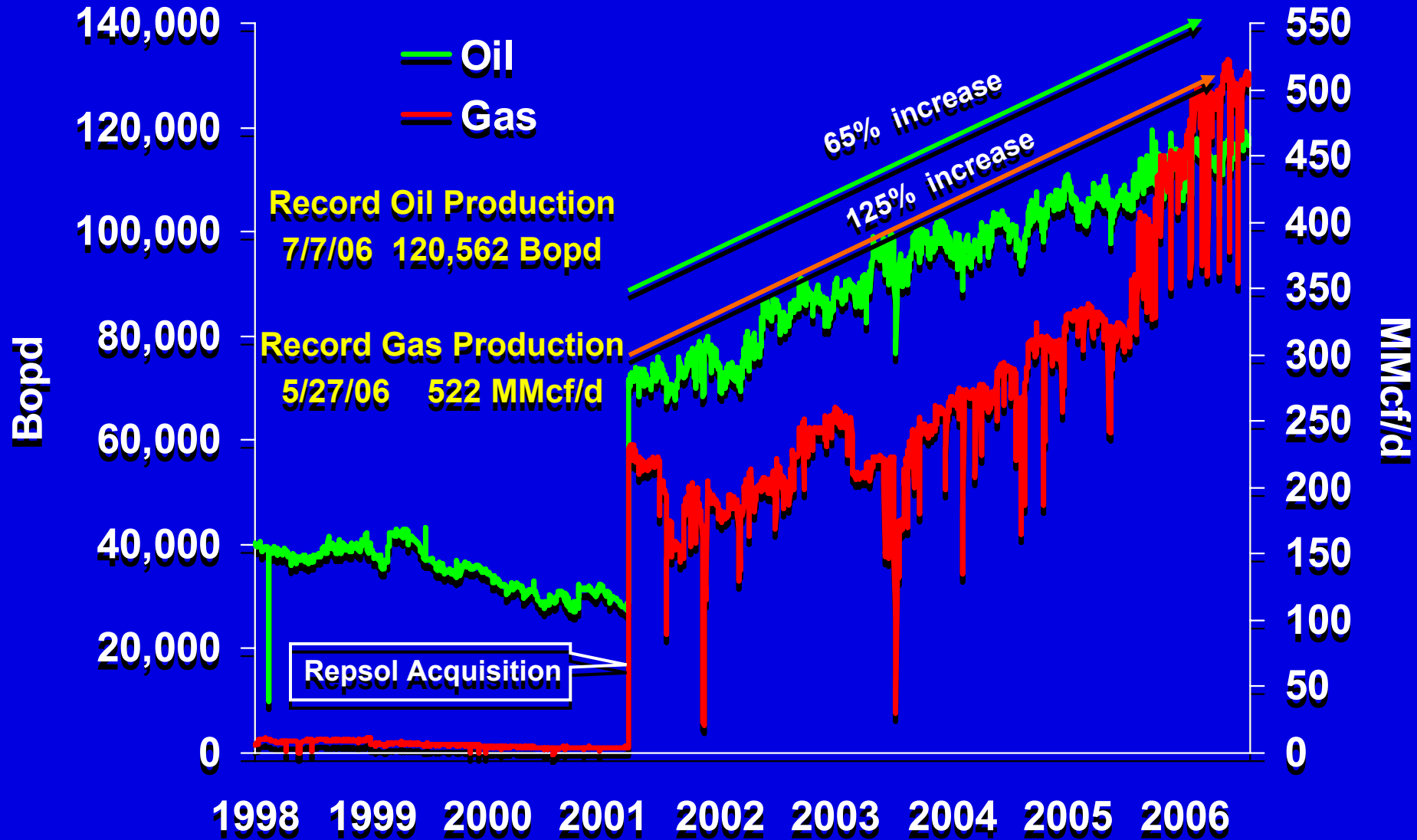


Apache is the largest HBP leaseholder and 2nd largest producer on the Shelf.

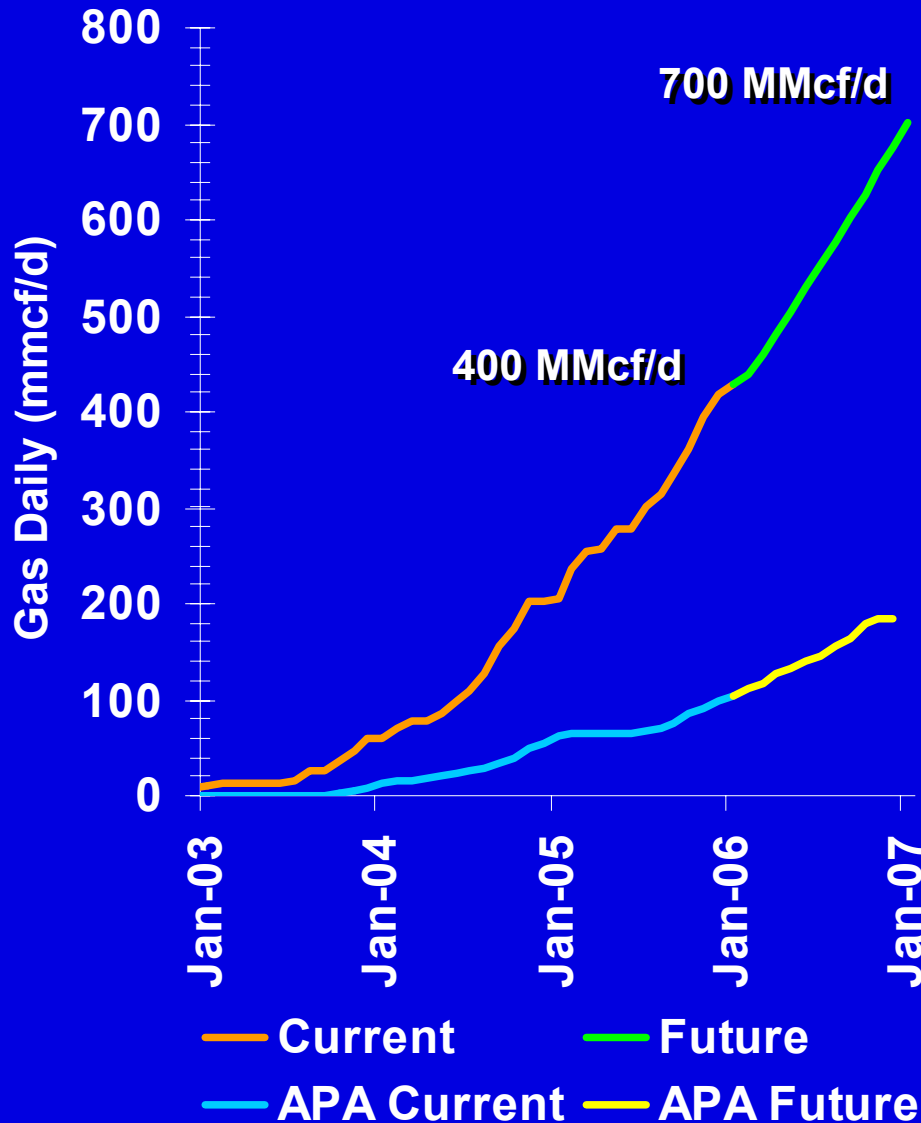


Through 2005, 136% of the net investments in the Gulf of Mexico have been returned and 64% of the original reserves remain.

Apache Egypt – Gross Operated Production



CBM Activity Growing in Alberta



WCSB CBM

- More than 6,000 CBM wells - most since '03
- 3,000+ wells drilled in '05
- 3,500 planned in '06
- More than \$2 billion invested \$1.5 billion planned for '06
- Current production is ~450 MMcf/d (projected 700+ MMcf/d by '07)

...Apache currently produces about 25% of basin total

- **International**
 - **National oil companies control 90% of the world's reserves**

- **U.S. Offshore**
 - **11% of the Lower 48 OCS is open to drilling**

- **U.S. Onshore**
 - **ANWR**
 - **Rockies**

Resource Constraints - People

- **Downsizing in the 80s and 90 shrank the workforce**
 - **Employment shrank from 1.1 million to 270,000**

- **Average age of a petroleum engineer – 48**
 - **Half of the engineers could retire within 10 years**
 - **Demographics for most technical positions are the same**

- **Lack of skilled labor**
 - **Not enough people to man rigs**
 - **Failure rate for drug testing extremely high**

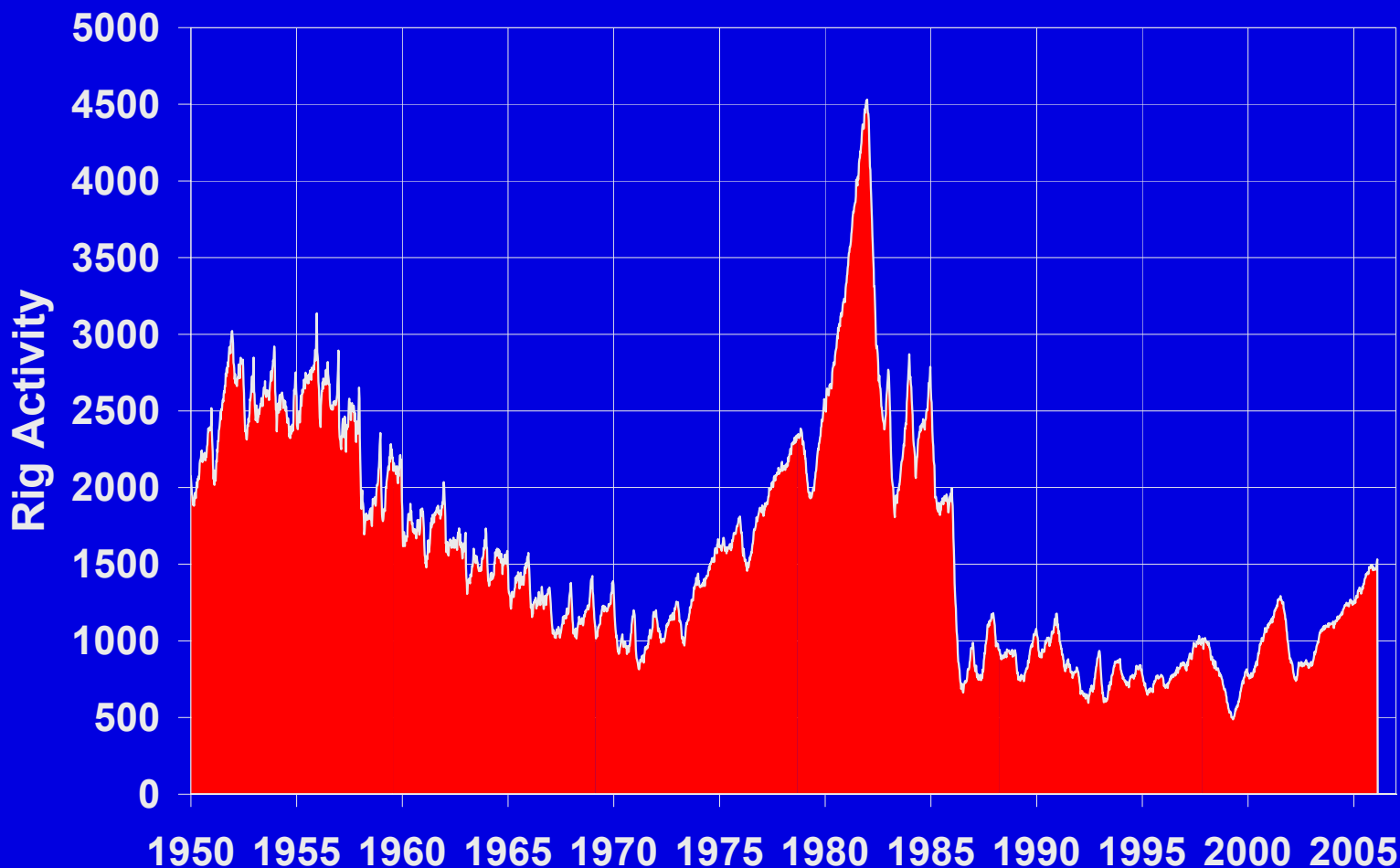
- **Demand for rigs exceeded supply**
 - **Rigs moving overseas from Gulf of Mexico**
 - **Rigs imported from China**
 - **Suppliers gained pricing power**

- **Availability of steel for pipe has been constrained**

- **Compressors delayed up to a year**

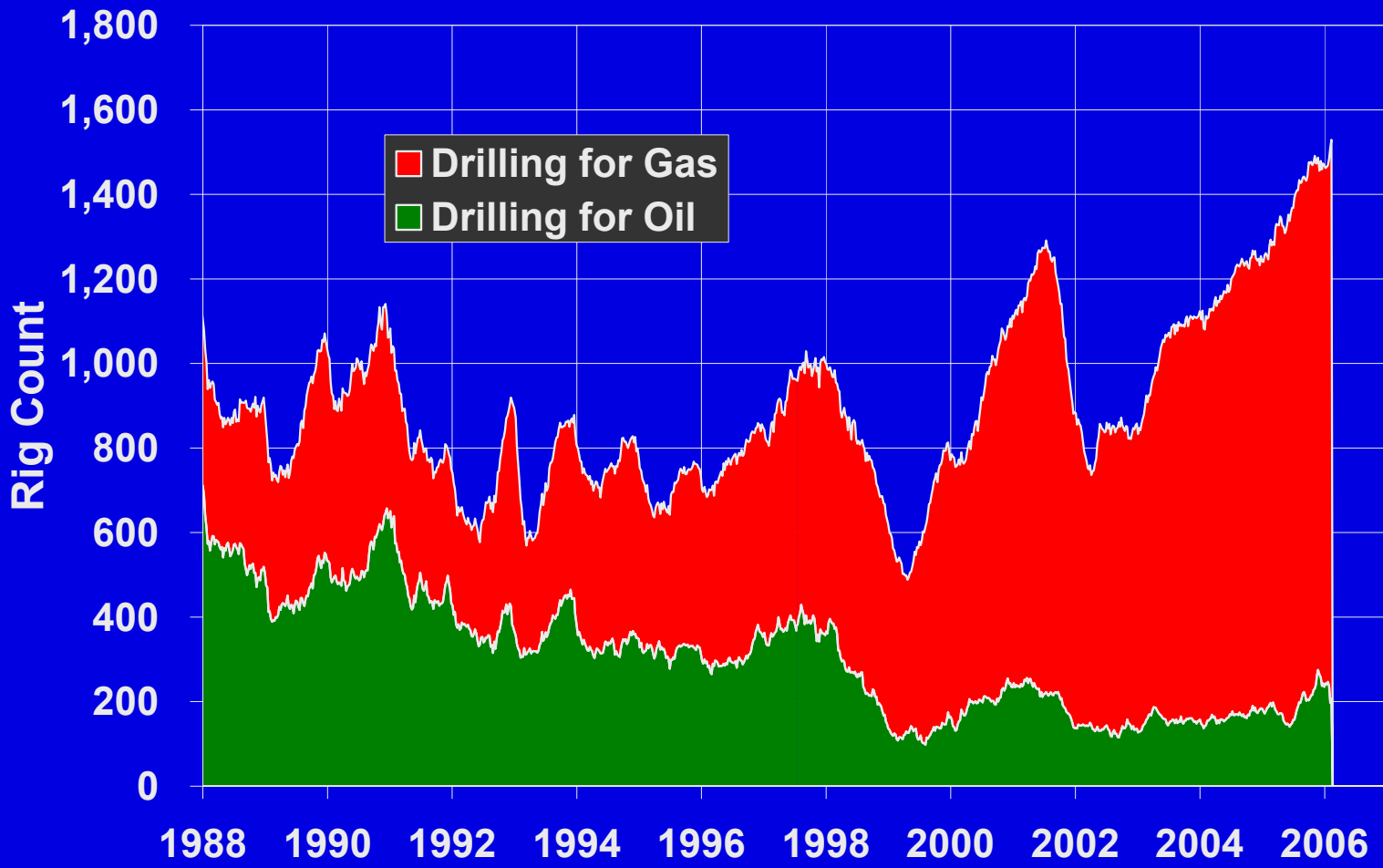
- **Demand for CO₂ for enhanced oil recovery exceeds supply**

Historical U.S. Rig Activity



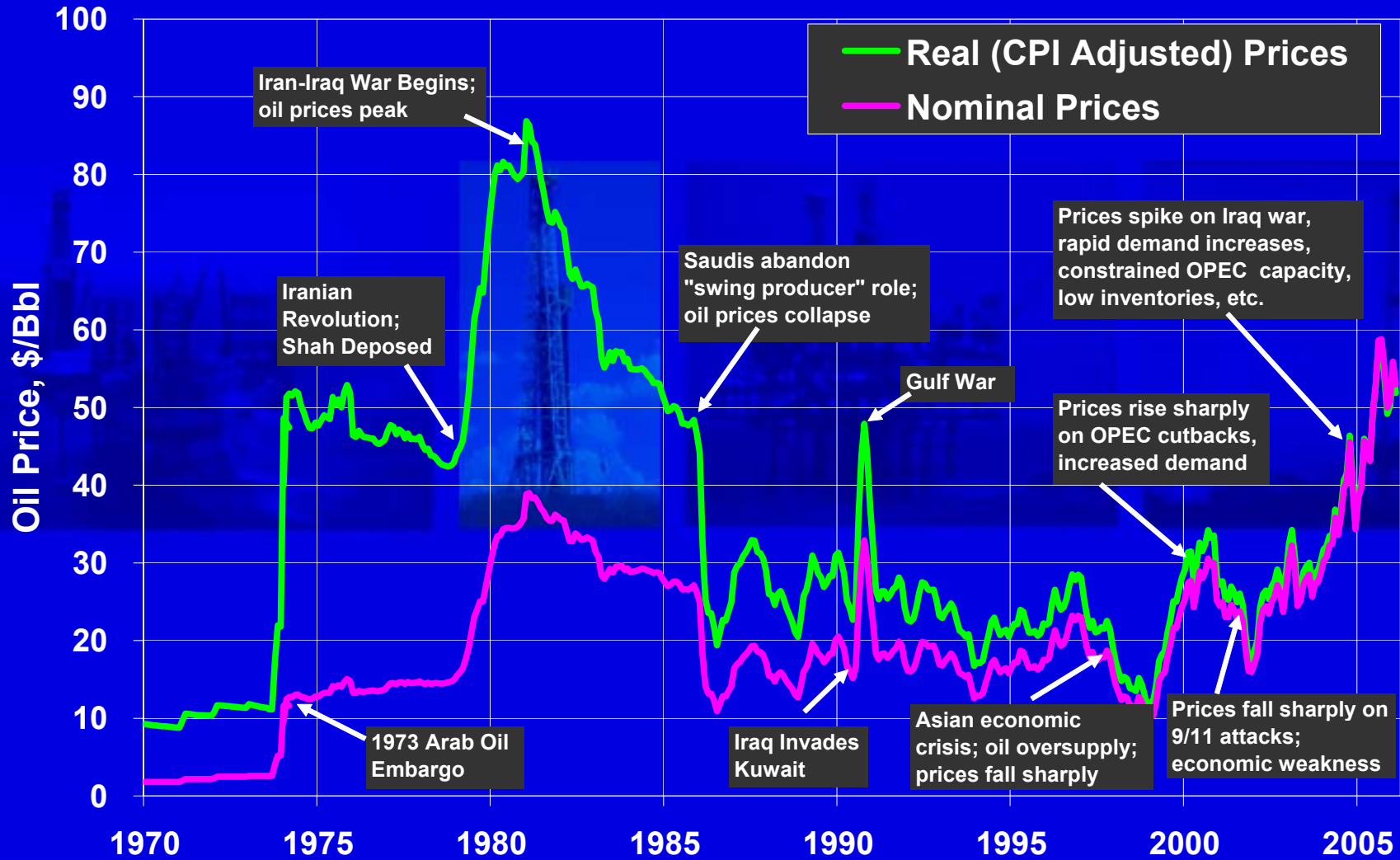
Source: Baker Hughes

U.S. Oil & Gas Rig Activity

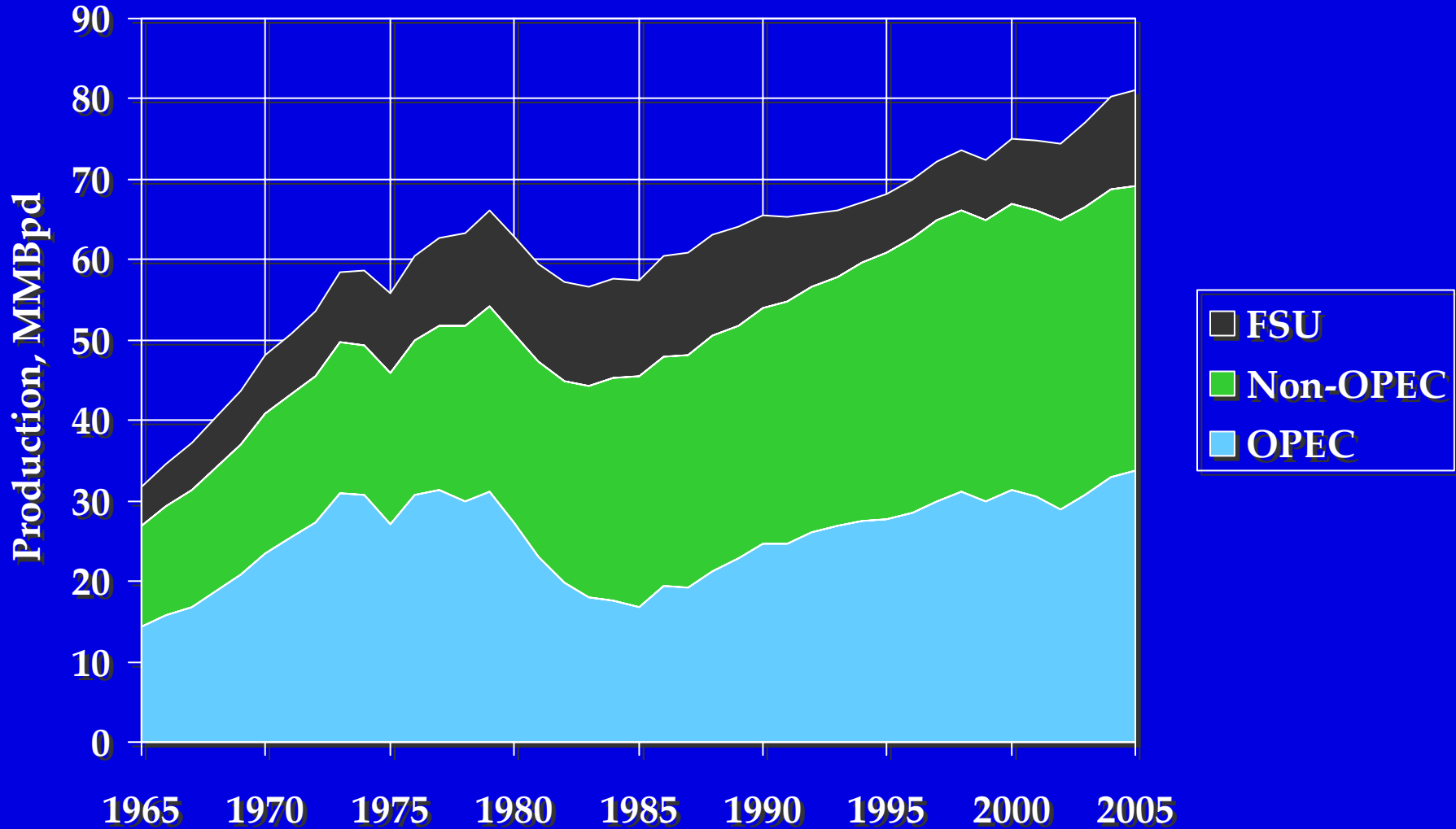


Source: Baker Hughes

Nominal and Real Oil Prices

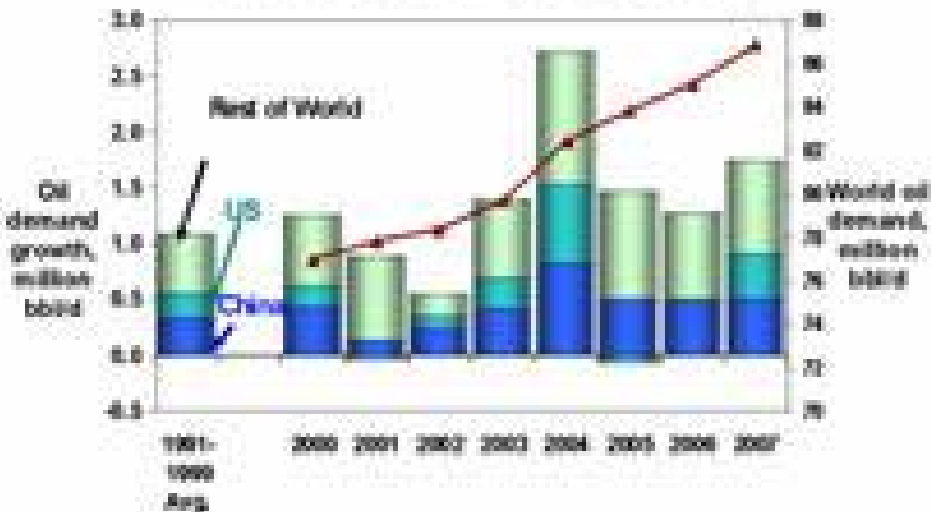


Global Oil Supply

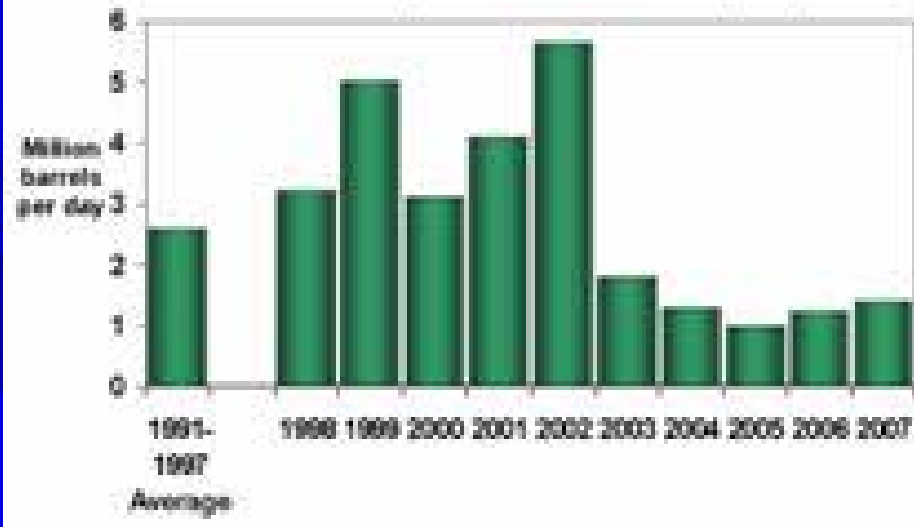


Source: BP Statistical Review

World Oil Consumption Growth



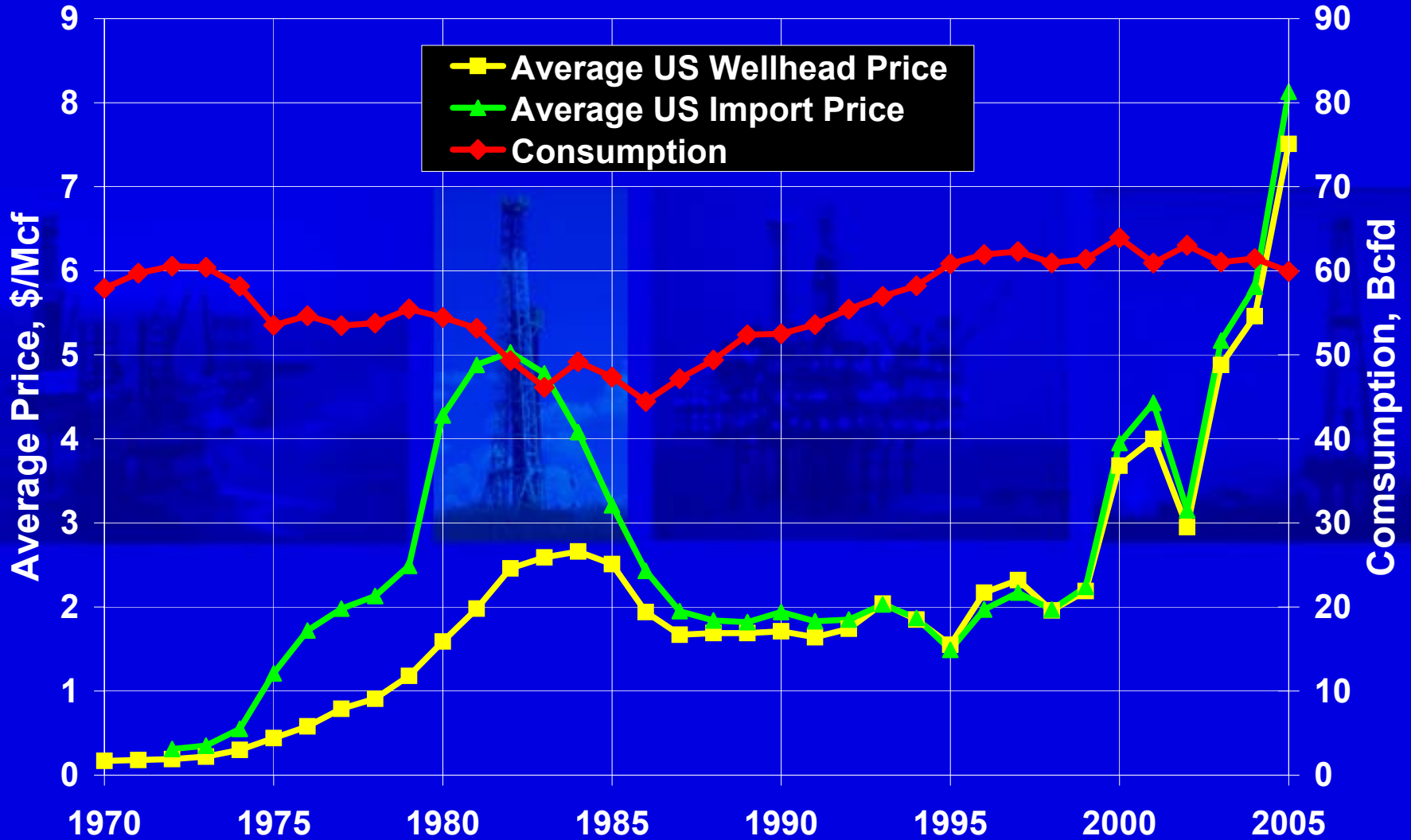
World Oil Surplus Production Capacity



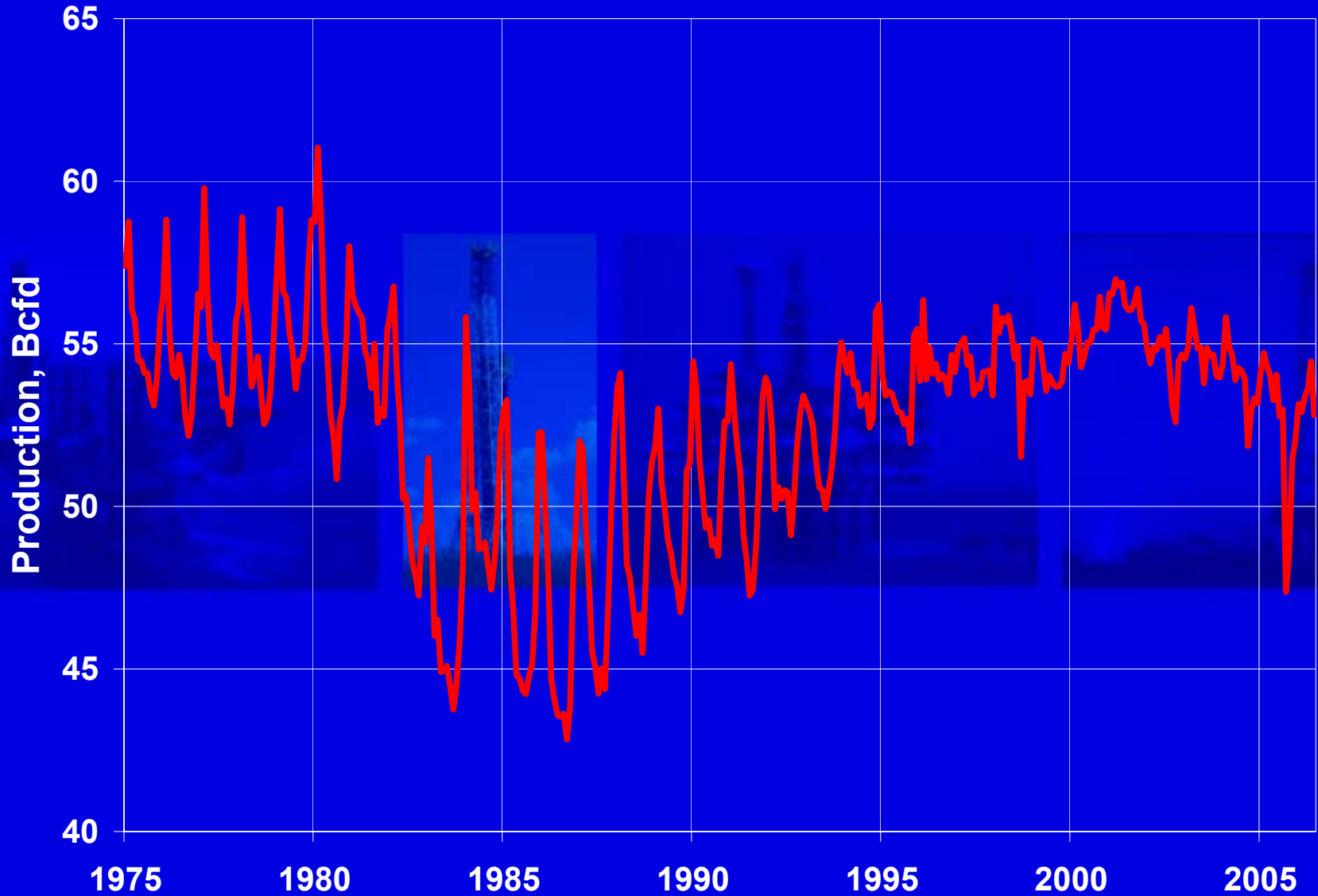
Source: EIA

Historical Natural Gas Prices

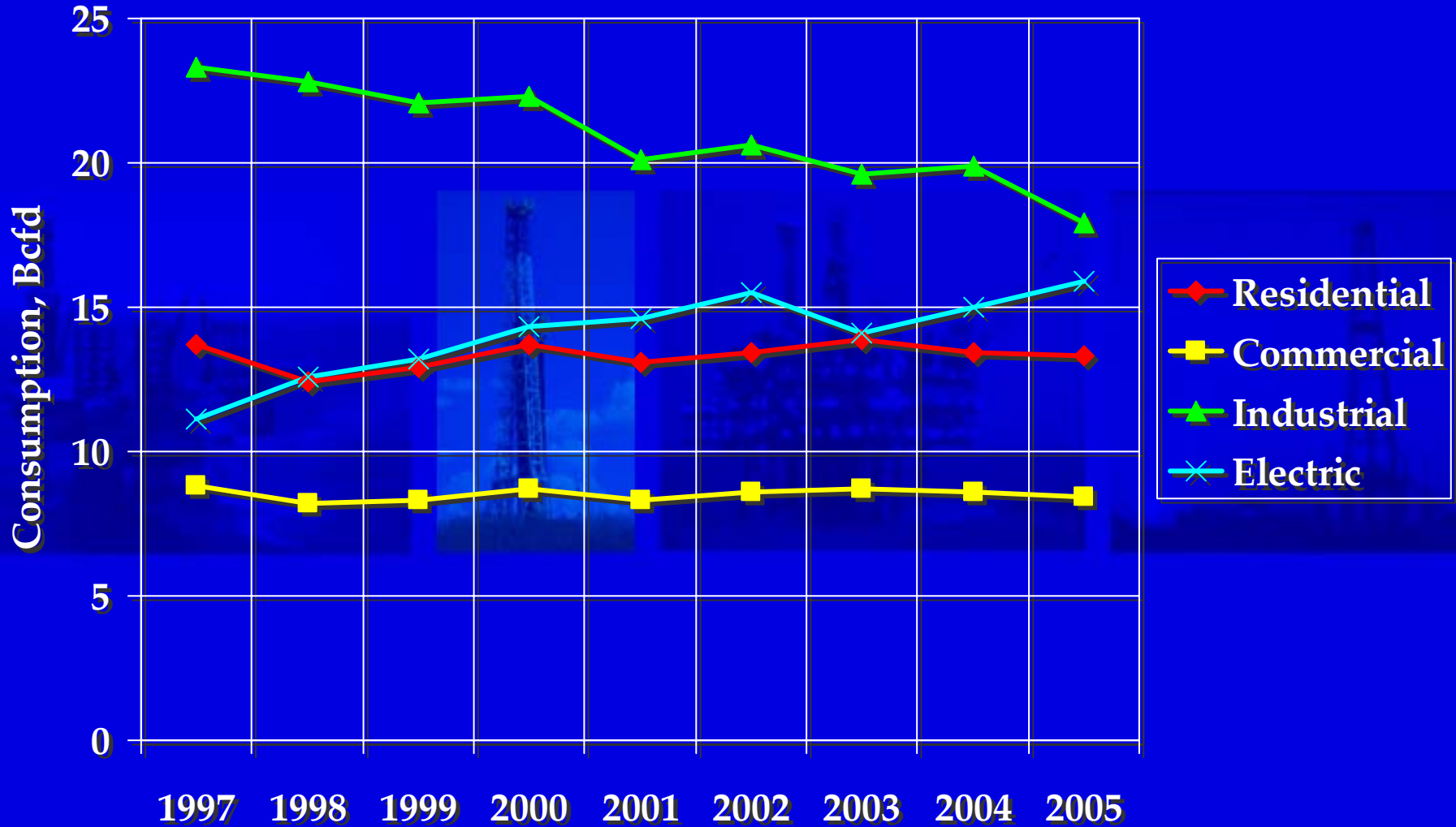
US Average Natural Gas Consumption & Prices



U.S. Excess Production Capacity is Gone

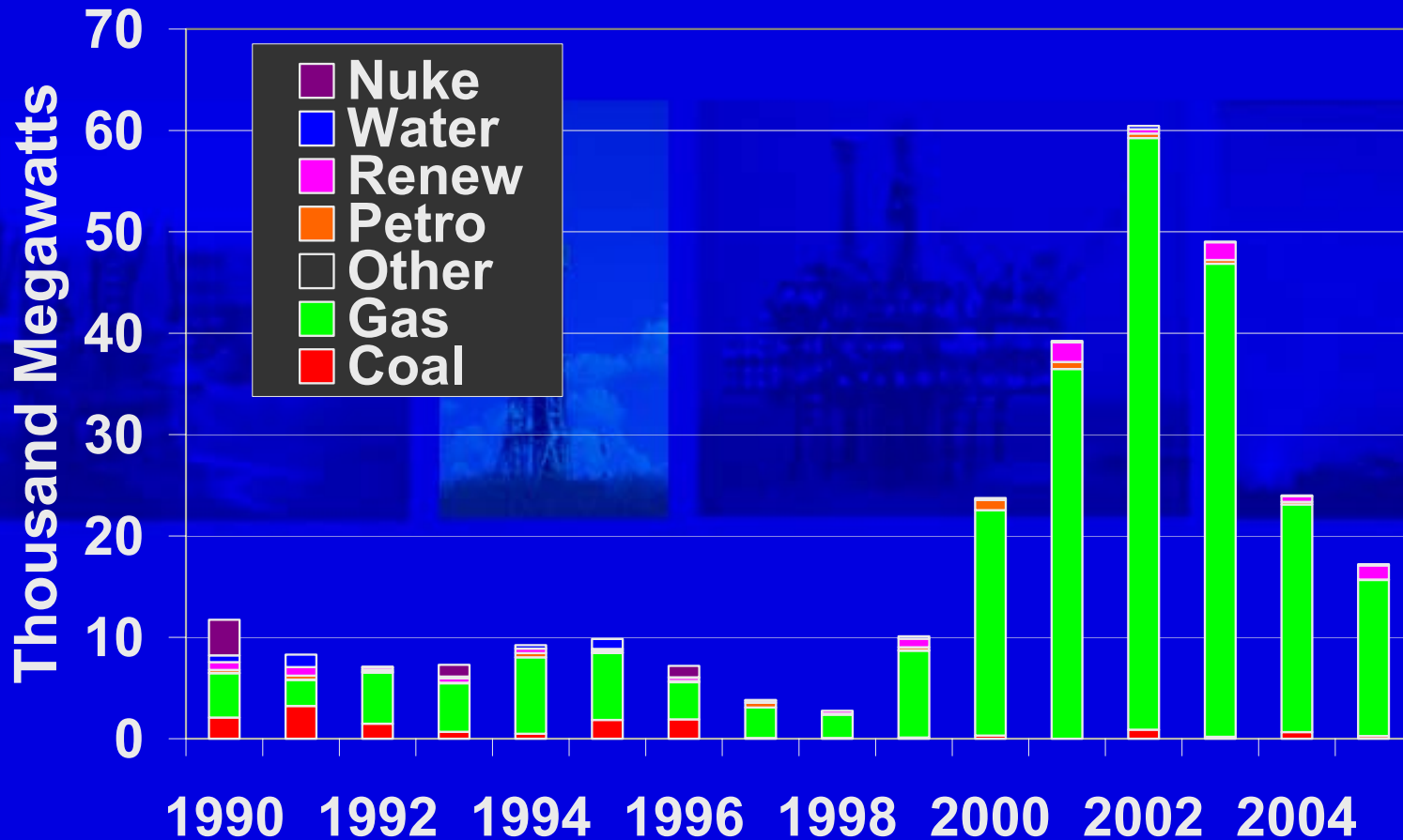


Natural Gas Demand by Sector



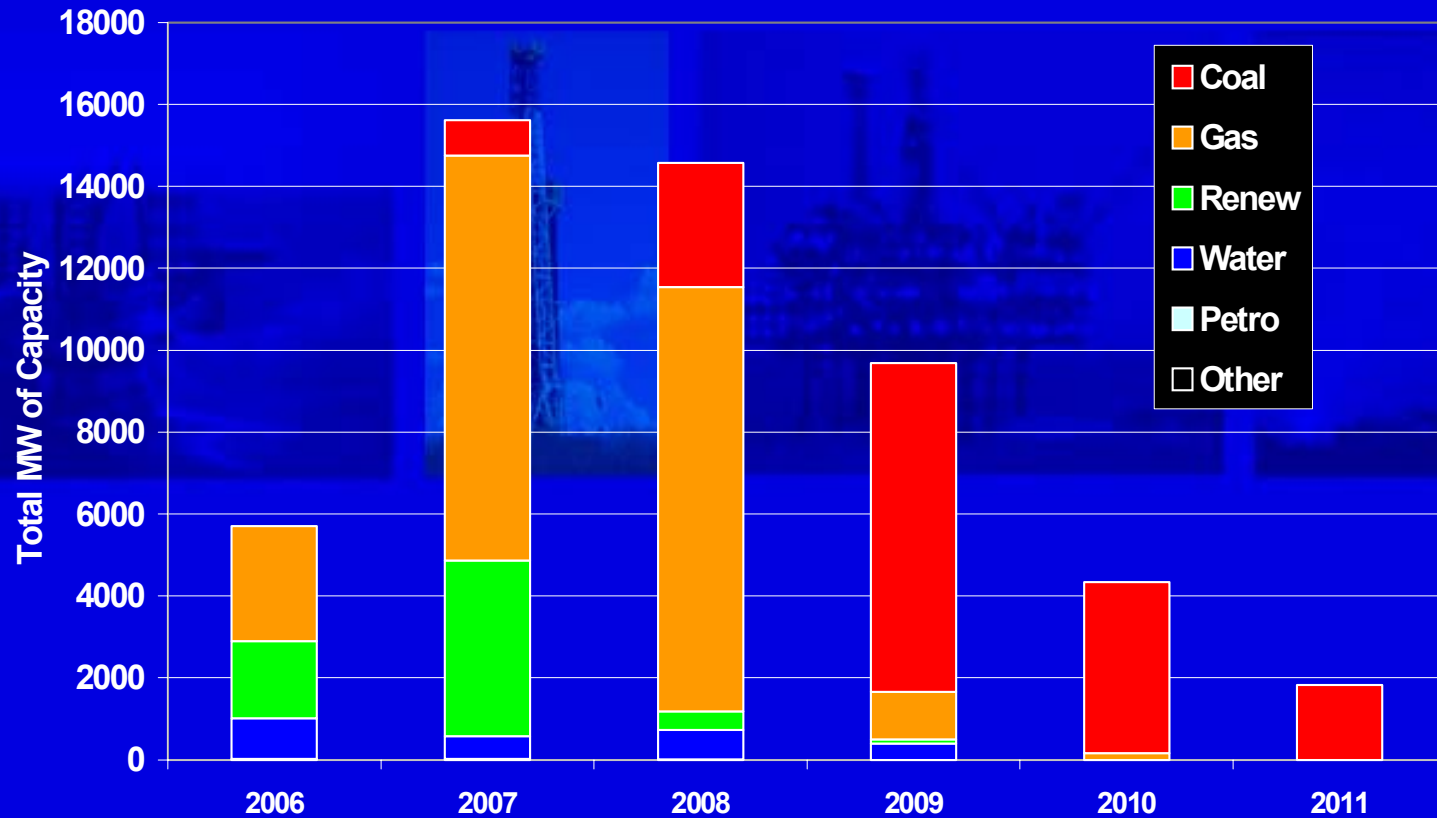
Impact of Power Generation on Demand

New Generation Capacity by Fuel 1990-2005

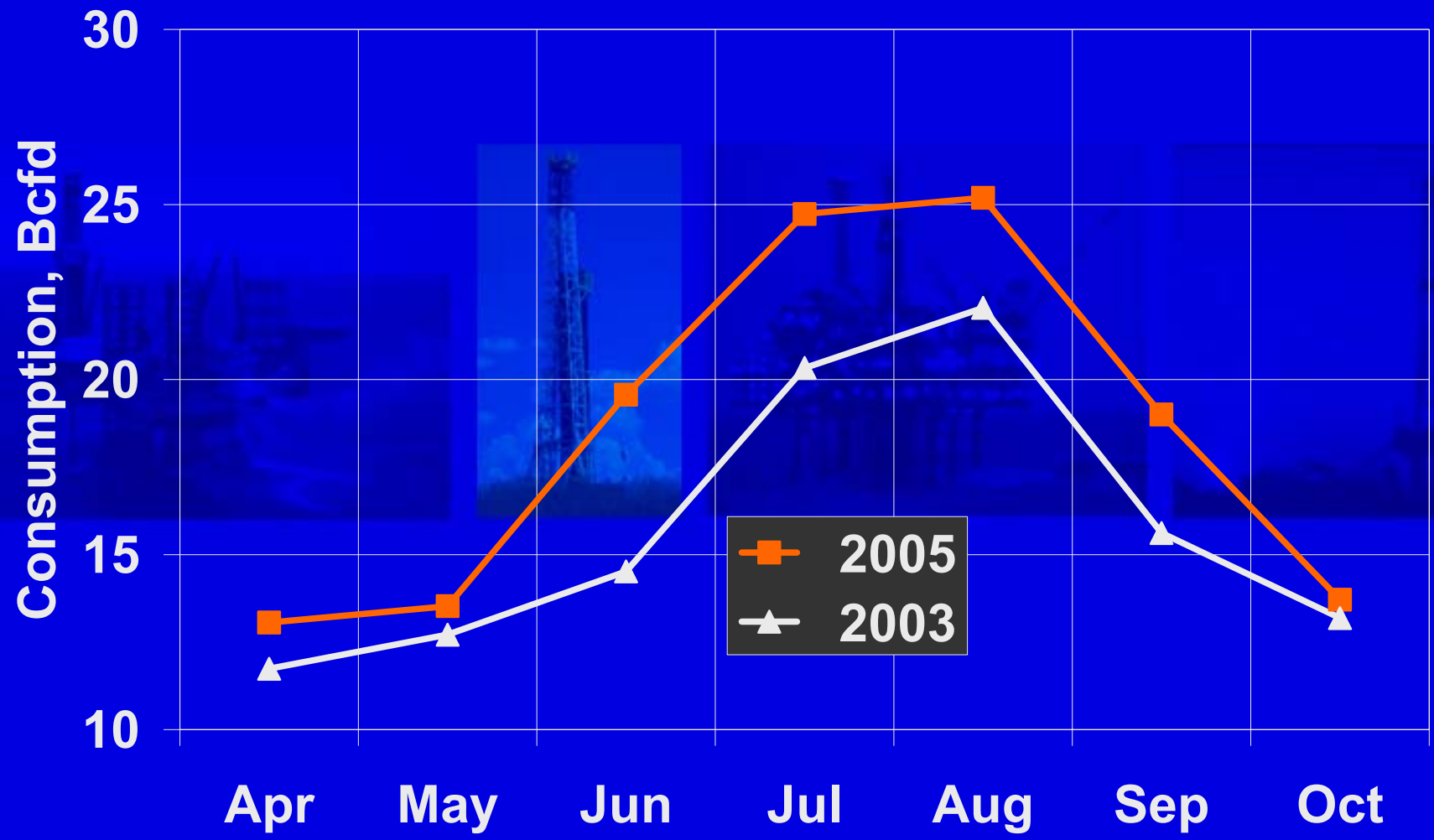


Fuel for Future Generation will Change

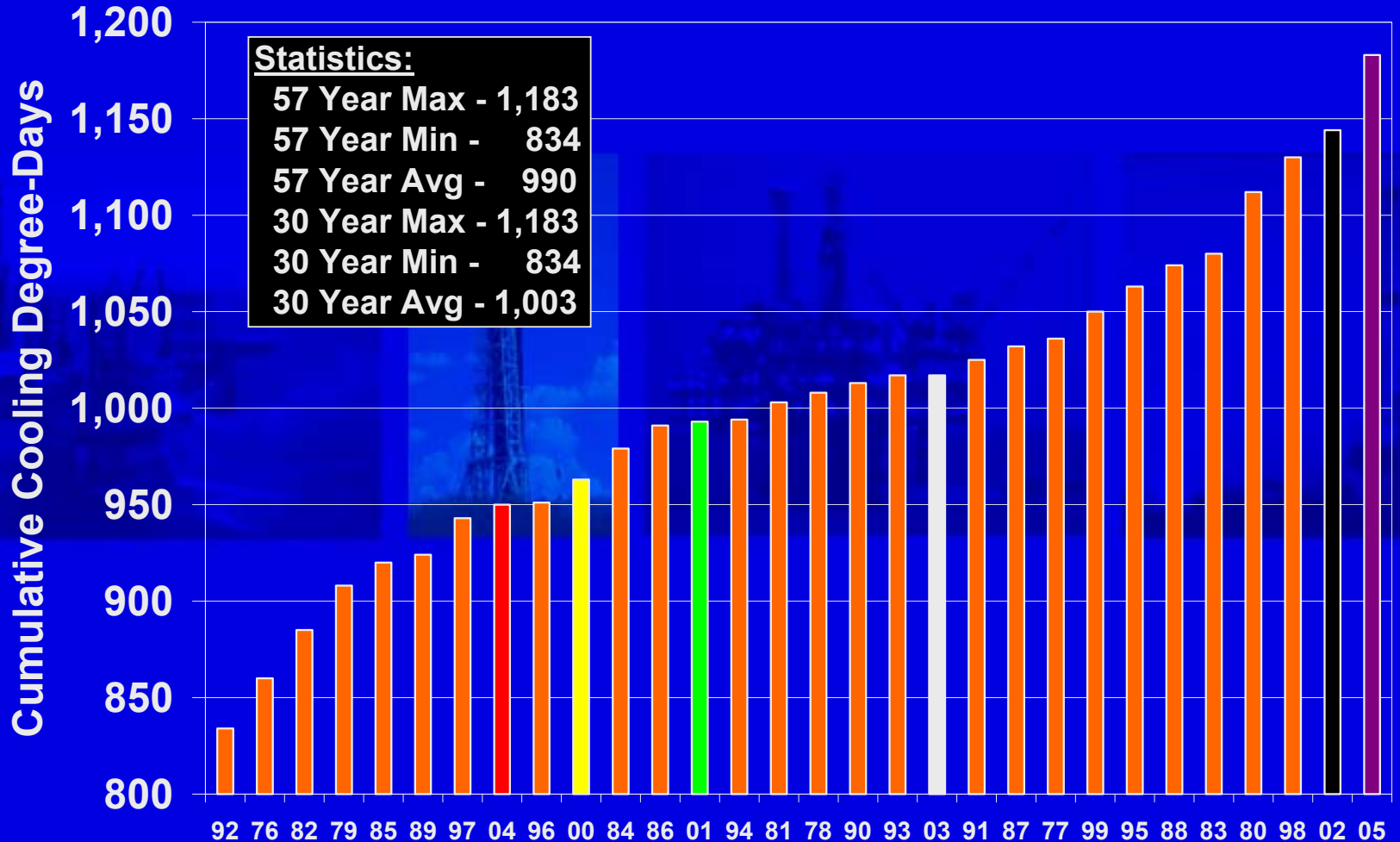
Power Generation Capacity Under Construction or Permitted



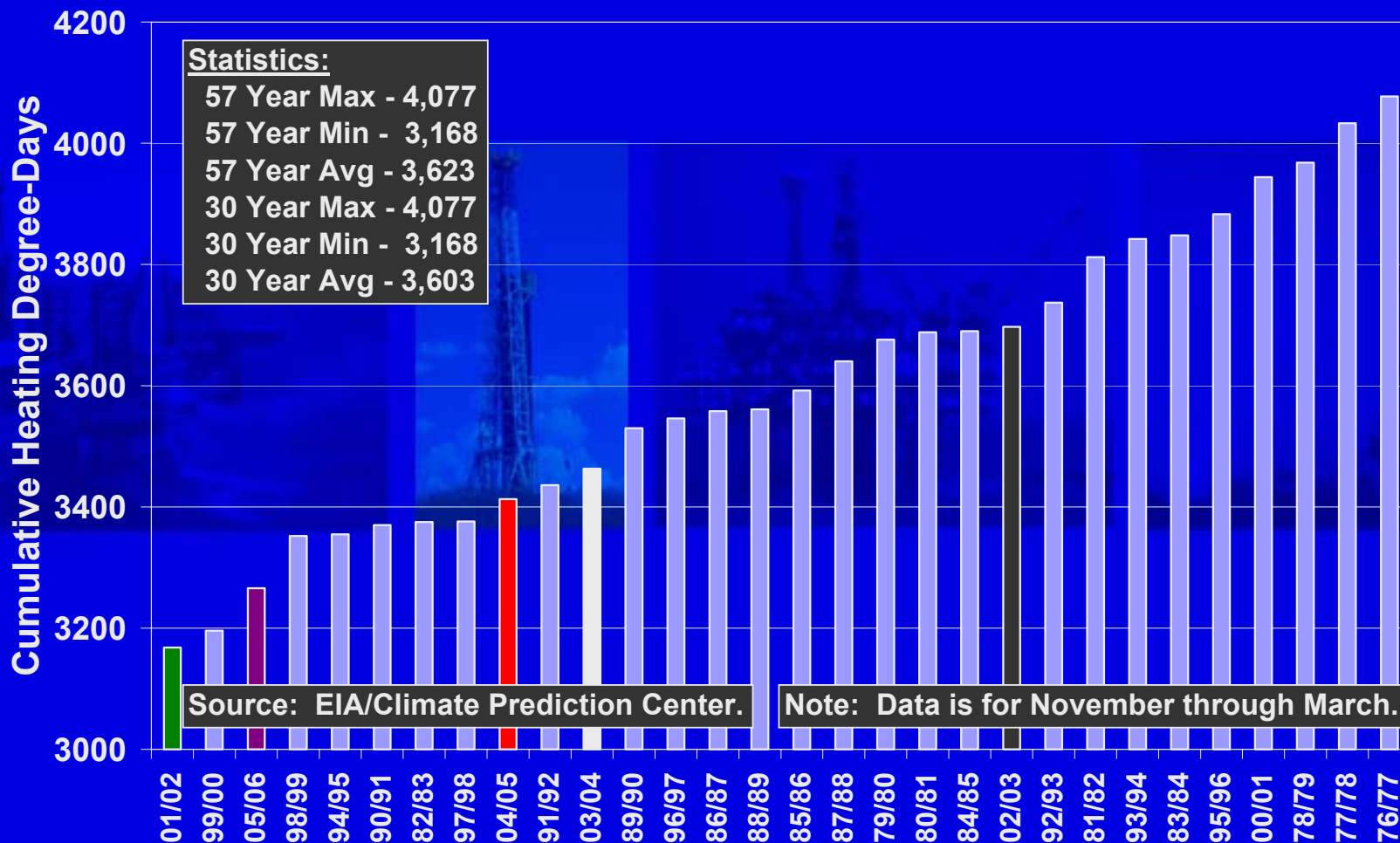
Natural Gas Consumption - Electricity Sector



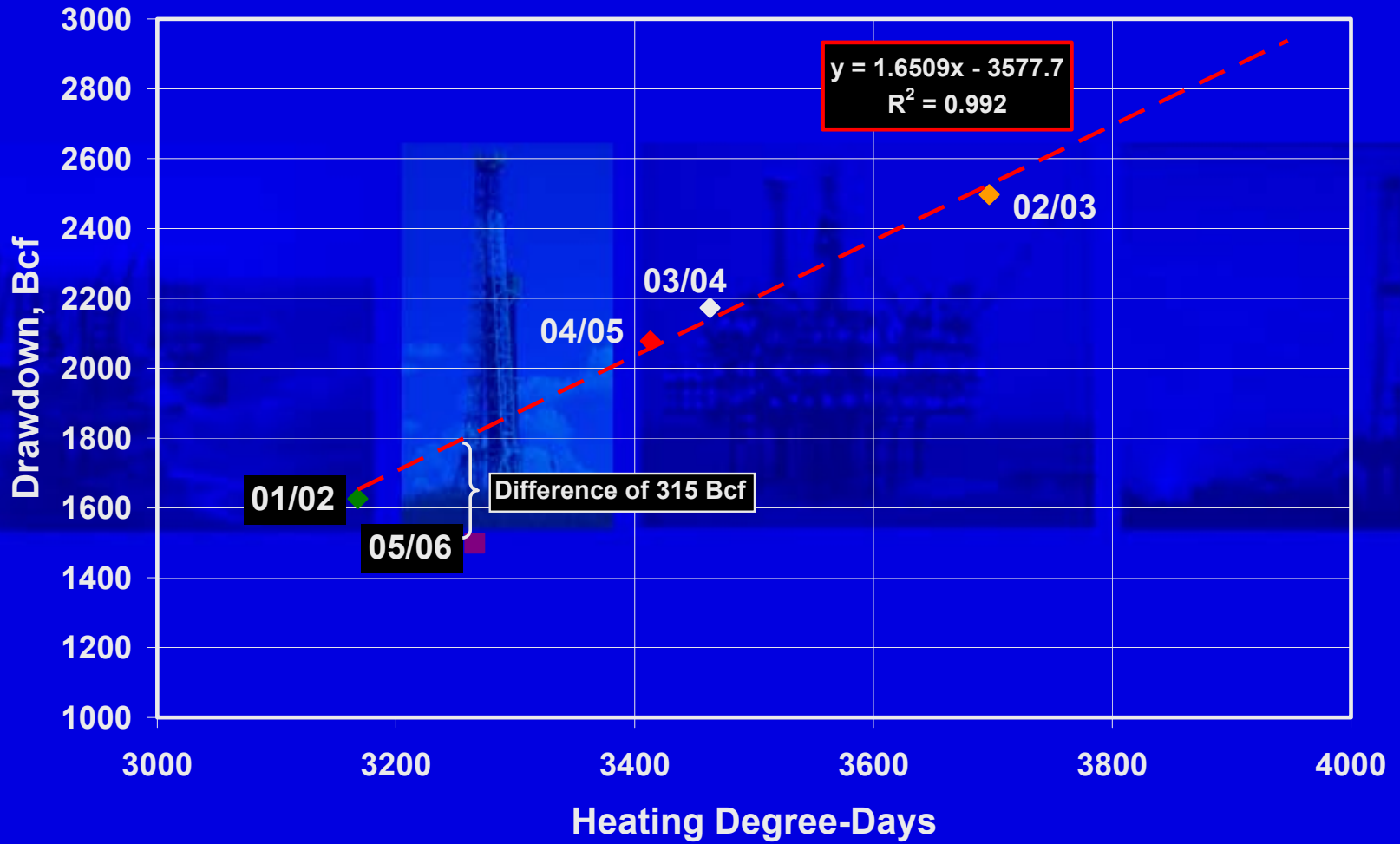
June through Sept. Cooling Degree-Days - Past 30 Years



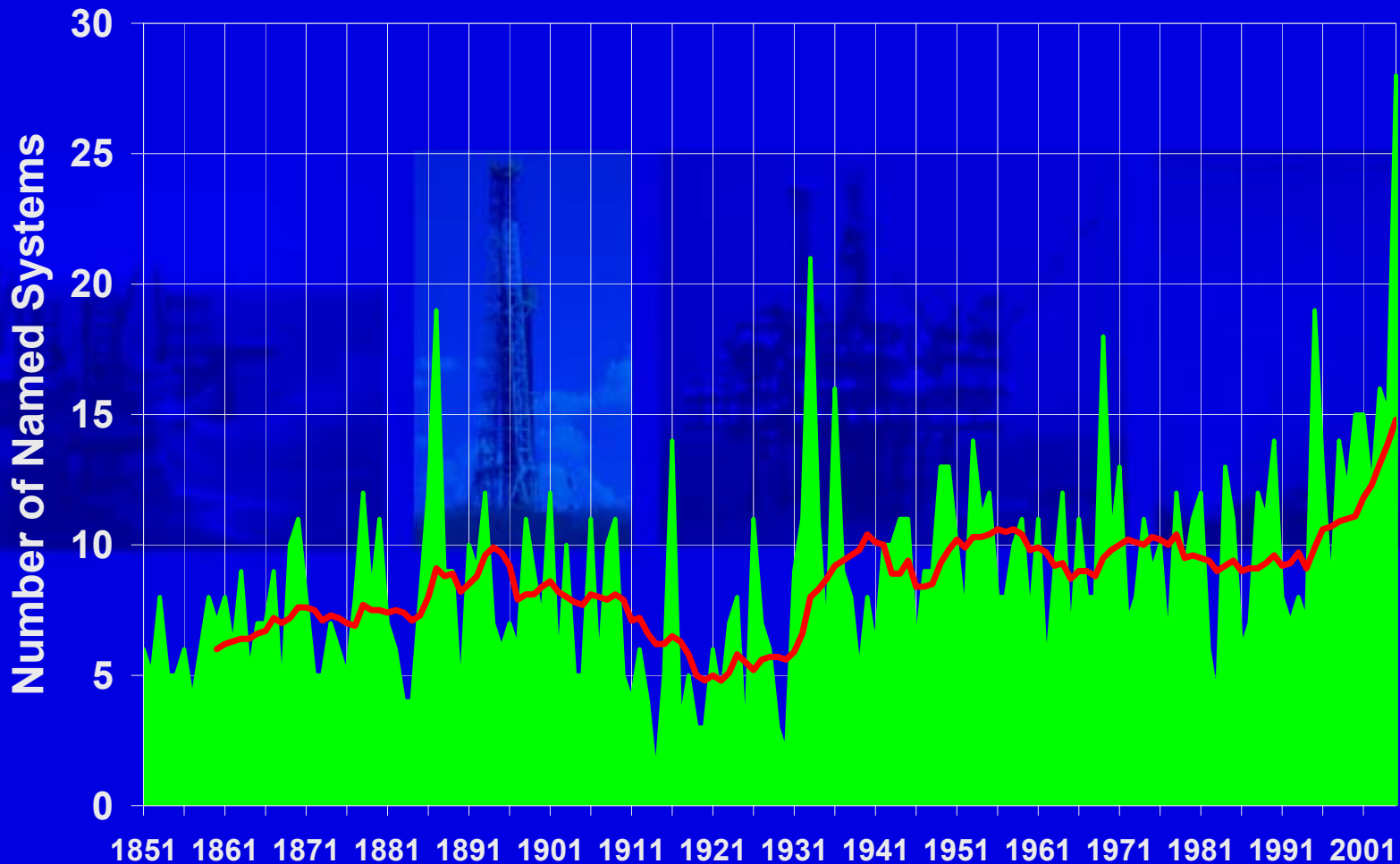
Winter Heating Degree-Days - Past 30 Years



Storage Drawdown vs. Heating Degree-Days



Tropical Activity in the Atlantic Ocean

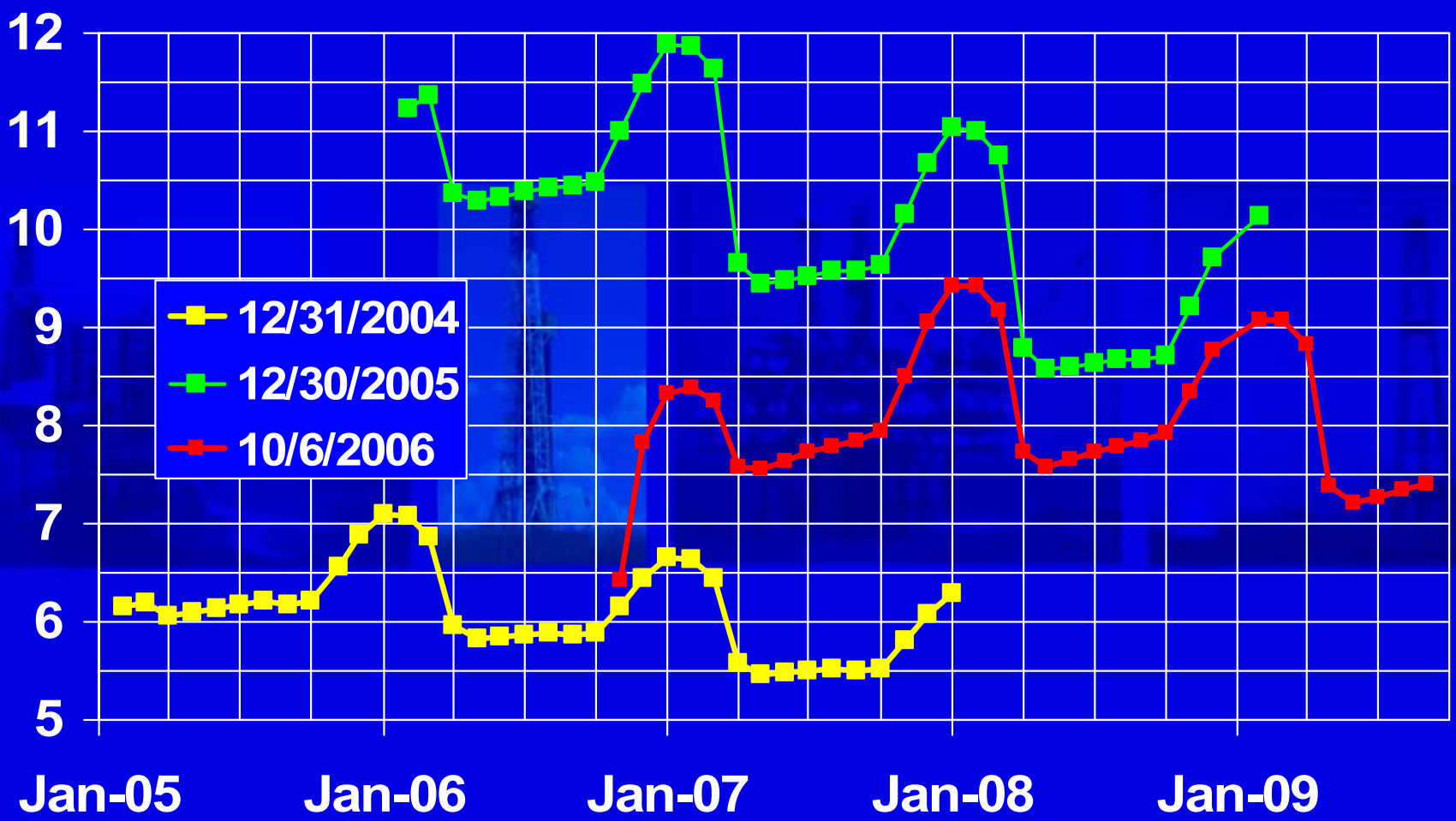


Hurricane Impact on Natural Gas Prices

NYMEX 12 Month Strip Price



NYMEX Futures Contract – Poor Price Predictor



- **Nationalization of oil and gas industry**
- **Making resources off-limits to foreign oil companies**
- **Assessment of back taxes**
- **Assessment of windfall profits tax**
- **Unilateral modification of contracts**
- **Imposition of higher royalty rates**
- **Higher export taxes**
- **Assignment of preferential bidding rights**
- **Attacks by militants**

- **Discourages investment in countries that have nationalized their reserves**
 - **Massive external financing needed or countries will have to reinvest more of their energy income into the industry**

- **Promotes inefficient national oil companies and less technology transfer**

- **Less investment and a lack of new technology will lead to slower production growth or production losses**

Emergence of National Oil Companies

- **National Oil Companies (NOC)**
 - **Strategic advantage within country**
 - **Instruments of foreign policy – alliances with producing countries**
 - **Competing globally with IOC's for scarce resources**
- **Impact on International Oil Companies (IOC)**
 - **Fewer resources available for development**
 - **Greater competition for assets that are available**
- **Impact on global production**
 - **Lower growth from countries with greatest resources**
 - **Less capital available & lack of IOC expertise**
 - **Greater concentration of reserves in the future**

- **Iran – Nuclear stand-off threatens 25% of world's oil supply transiting through the Strait of Hormuz**
- **Nigeria – More violence as April 07 election approaches**
- **Iraq – Threat of civil war and conflict over oil contracts in Kurdistan region**
- **Venezuela – More nationalization and possible embargo of U.S.**
- **Russia – More nationalization and threat of natural gas supply disruptions to Europe**
- **China/Japan – New field in disputed waters**
- **Mexico – Potential steep decline in production from the Cantarell field**

- **Low prices and inadequate investments in the 80s and 90s set up the current period of growth for the oil and gas industry**
- **Resource constraints, price volatility and geopolitical events create a challenging environment for production growth**
- **The industry will continue to consolidate because of limited investment opportunities**
- **High energy prices and new technologies will provide incentives and methods to find and produce more oil and gas**