

USA – Offshore Drillers | June 21, 2010

CAUTIOUS VIEW

HIGH RISK

TRADE BRIEF

## The wealth of the states! Tax profits = +\$1trillion...!

- Over the years, higher commodity prices have generated strong EBITDA, earnings, cash flow for oil & gas companies, as well as strong dividend pay-outs for investors. **However, often ignored in the profit gain and dividend paid-out are the corollary facts that the ensuing tax revenues** collected by the federal government, state and local municipalities from the oil & gas companies are at **near historical highs**.
- According to our data, compiled from a small sample of oil & gas companies and data provided by the Department of Energy Information Administration (DEIA), the reported estimated profit (earnings) from our sample in 2009 was \$84 billion compared to tax revenues of \$91 billion.
- As illustrated in Exhibit 1, from 1977 through 1997, the average reported earnings from the oil industry was \$20.3 billion, compared to the average tax profits of \$44.3 billion, equating to a tax rate of 68.6%. In 1998, the good time came to an end when oil & gas earnings fell to \$12.8 billion; nonetheless, tax revenues were up by \$1.2 billion. From 1999, earnings were rising, ranging from \$24.8 billion to a high of \$125.2 billion in 2006 – this as a result of higher commodity prices accompanied by increased global demand.
- **The wealth of the states: We note that since 1977, governments collected more than \$1.78 trillion, in tax revenues.** This is \$517.0 billion more than the amount of profits earned by major U.S. oil & gas companies during the same period. No other industry is capable of generating such tax revenues for the federal government. Further, our analysis excludes gasoline tax revenues that average approximately \$0.477 cents per gallon nationwide, which is significant on its own.
- Presently, with the moratorium in place, we estimate that the federal government, state and local municipalities are losing approximately \$6.5-7 billion per month in tax revenues. Given the staggering loss of tax revenues, we are confident that the moratorium will be lifted before six months.
- This being the case, it is safe to conclude that the most recent barrage of media and political strife will slowly diminish; further, we believe that investors' concerns about the imminent crisis are likely overstated and the overhang appears to have been slowly removed. **Go long the drillers.**

OSX: 183.63

S&P 500: 1,117.51

NASDAQ: 2,309.80

DOW: 10,450.64

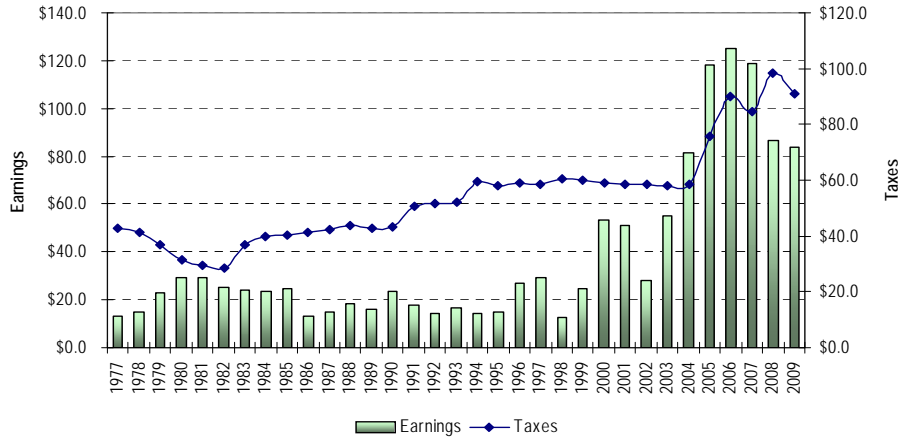
Please refer to the disclaimer of this research at the end of document.

Senior Equity Analyst  
Zephyrin Group  
info@zephyringroup.com



### Exhibit 1. Oil & Gas Companies Earnings and Taxes 1977 – 2009E

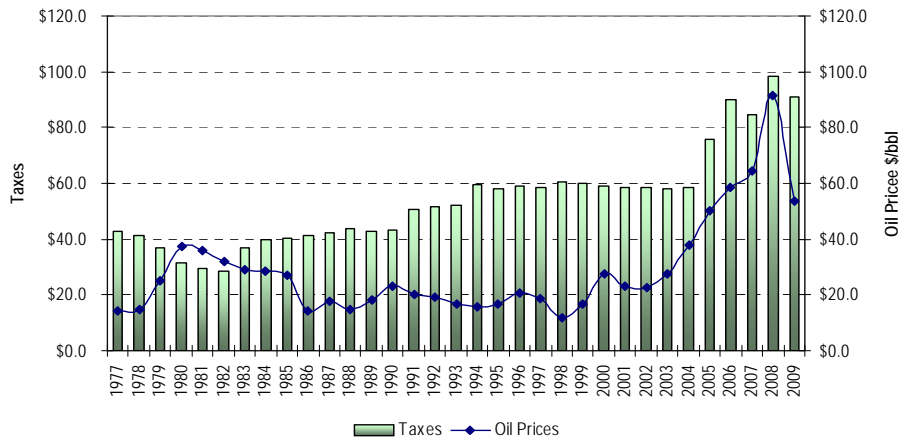
Only from 2004-2007, oil & gas companies earnings were higher than tax revenues.



Source: \$ in Billion. Company data, DEIA and Zephyrin Group, Inc. (ZGI) research estimates

### Exhibit 2. Oil & Gas Companies Taxes vs. Oil Prices 1977 – 2009E

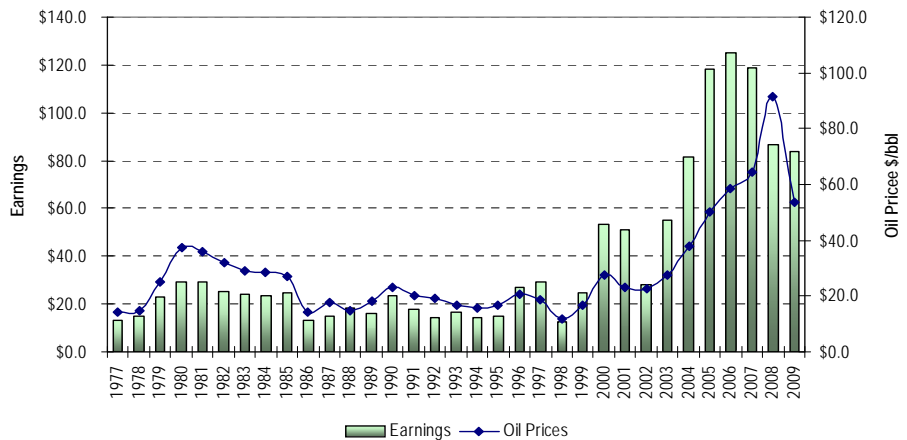
Tax revenues surged despite low oil prices.



Source: \$ in Billion. Company data, DEIA and Zephyrin Group, Inc. (ZGI) research estimates

### Exhibit 3. Oil & Gas Companies Earnings vs. Oil Prices 1977 – 2009E

Oil & gas earnings are not stable. Earnings will rise as a result of higher commodity prices and demand.



Source: \$ in Billion. Company data, DEIA and Zephyrin Group, Inc. (ZGI) research estimates



## Companies mentioned \*As of June 18, 2010

Name	Ticker	Price*	Objective	Rating
Basic Energy Services	BAS	\$8.78	N/A	Not Rated
Diamond Offshore	DO	63.87	-	Buy Speculative Risk
ENSCO	ESV	40.82	-	Buy Medium Risk
Hercules Offshore	HERO	3.06	-	Buy Speculative Risk
Noble Corp.	NE	31.56	-	Buy High Risk
Pride International	PDE	25.05	-	Buy High Risk
Rowan Cos.	RDC	25.26	-	Buy Medium Risk
Seadrill Ltd.	SDRL	20.70	-	Sell High Risk
Seahawk Drilling	HAWK	11.53	-	Not Rated
Transocean Inc.	RIG	54.61	-	Buy High Risk

N/A = Not Applicable

### IMPORTANT DISCLOSURE:

**Rating System:** BUY — The stock, securities or shares are expected to achieve a total return of 15% or more over the next 12-18 months, or are expected to outperform its industry peers and the S&P 500. HOLD — The stock, securities or shares are expected to achieve a total return of 10% or less, or are expected to perform in-line with its industry peers and the S&P 500 over the next 12-18 months. UNDERPERFORM/SELL — The stock, securities or shares are expected to underperform its industry peers and the S&P 500 over the next 12-18 months.

**Risk Rating:** LOW RISK (LR) — Return of 0-10%; MEDIUM RISK (MR) — Return of 0-20%; HIGH RISK (HR) — Return of 0-30% and SPECULATIVE RISK (SR) — Return of 0-50%. **Distribution of Rating:** Buy = 7 (87.5%); Hold = 0 (0%); Underperform/Sell = 1 (12.5%)

All of the recommendation and views about the securities and companies in this report accurately reflect the personal views of the research analyst named on the cover of this report.

The Zephirin Group, Inc. ("ZGI") is an independent e-research company that is incorporated in the State of Delaware on November 2003. The above material has been prepared by ZGI for informational purposes only and should not be construed as an offer to sell or solicitation of an offer to purchase or subscribe for any investment. The information and opinions contained in this document have been compiled or arrived at by ZGI in good faith from sources believed to be reliable, but no representation or warranty, express or implied, is made as to its accuracy, completeness or correctness. All opinions and estimates contained in this document constitute ZGI's judgment as of the date of this document and are subject to change without notice. ZGI makes no guarantee, representation or warranty and accepts no responsibility or liability as to its accuracy or completeness. Expressions of opinion are those of ZGI only and are subject to change without notice. ZGI does not provide an analysis of a company's financial position; financial position and all information should be verified with the "mentioned company" investor relations department. Information about publicly listed companies and other investor resources can be found at the Securities & Exchange Commission website [www.sec.gov](http://www.sec.gov). We are not registered investment advisors, or broker/dealers or members of any financial regulatory bodies. The information contained herein is not to be regarded as advice to make any particular investment. In receiving this material, each recipient represents, warrants and acknowledges that it has taken, or will take, appropriate steps to: obtain such independent legal, tax, accounting and other professional advice as may be appropriate prior to taking any action in relation to any companies mentioned; form its own independent judgment regarding the risks and rewards associated with any action or inaction relating to any companies mentioned. The information contained herein contains forward-looking statements and information within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934 and as defined in the Private Securities Litigation of 1995, including statements regarding expected continual growth of featured company. Any statements that express or involve discussions with respect to predictions, expectations, beliefs, plans, projections, objectives, goals, assumptions or future events or performance may be forward looking statements. Forward looking statement are based on expectations, estimates, and projections at the time the statements are made that involve a number of risks and uncertainties which could cause actual results or events to differ materially from those presently anticipated.

©Copyright 2004-2010 The Zephirin Group, Inc. ("ZGI"). All rights reserved. The Zephirin Group, Inc. Website: [www.zephiringroup.com](http://www.zephiringroup.com) - Email: [info@zephiringroup.com](mailto:info@zephiringroup.com)

This document may not be reproduced, distributed or published in electronic, paper or other form for any purpose without the prior written consent of ZGI. No Group Company accepts any liability whatsoever for any direct, indirect or consequential loss arising from any inaccuracy herein or from any use of this document or its contents. Any unauthorized use, duplication, redistribution or disclosure is prohibited by law and will result in prosecution. ZGI accepts no liability whatsoever for the actions of third parties. ZGI makes no representations or warranties whatsoever as to the data and information provided in any third party referenced website and shall have no liability or responsibility arising out of, or in connection with, any such referenced website. This publication is made available through Thomson One Analytics [www.thomsononeim.com](http://www.thomsononeim.com) First Call research direct portal. This publication is available through Thomson Research Investext <http://research.thomsonib.com> an Institutional research portal. This publication is made available through FactSet Research Systems Inc. [www.factset.com](http://www.factset.com) a research portal provider. This publication is also made available in the U.K. through Independent Research Ltd. [www.inderec.com](http://www.inderec.com) a research portal provider.

ZGI adheres to the CFA Institute (formerly Association for Investment Management & Research) Research Objective Standards guideline.

This document is intended solely for distribution to the professional investment community. ZGI or any officers, directors does not hold any equity positions in any company or companies mentioned in this report.