

Energy stocks

Tips and traps for gas and oil investors **Interviewed by Paul R. Harvey**

By 2030, worldwide energy sectors will require \$16 trillion to maintain the current trend of energy usage, according to a recent World Energy Outlook report. The oil and gas industry will make up about 20 percent of that total, creating huge investment opportunities.

The oil and gas sector relies heavily on emerging technology. This technology has improved the prospects on wells drilled, helping to reduce costs and maximize production. When you add into the mix the available federal tax incentives on oil and gas investing, savvy investors can reduce risks and find good buying opportunities.

"To maintain its growth, a nation must constantly find new energy supplies," says John Barnes, chairman and CEO of B&R Energy LLC. "Energy growth is the essential engine for economic growth."

Smart Business spoke with Barnes about oil and gas investing and how regional and global events influence these markets.

What are examples of proven energy investments?

Energy is a broad spectrum. It includes power companies, gas distribution outfits, refining companies, exploration technology firms and others. A number of investment opportunities also are available in alternative energies like ethanol plants and windmills, which may have certain tax subsidies.

The U.S. government and governments around the world appear committed to the research and growth of renewable and alternative energies, but they are estimated to only provide about 1 percent of our energy in 2030.

Let's focus on upstream oil and gas investing, where companies find it, drill it and produce it. In this sector, investment opportunities are available and active, and range from master limited partnerships, producing properties, drilling and production companies, to many public companies.

What makes oil and gas investing attractive to today's investor?

First, any economic growth requires



John Barnes
Chairman and CEO
B&R Energy

an input of energy. This has been growing at a rate much faster than the availability of energy to feed that growth. As a result, we've had a significant increase in the prices of the energy needed, particularly hydrocarbon-based energies like coal, natural gas and oil. Those products have increased about 20 percent every few years for the last 10 years. This growth rate is certainly attractive for investors.

What are the tax advantages of oil and gas investing?

A tax-advantaged investment should first be a strong investment, and the tax advantage viewed as an added benefit.

There are certain tax benefits associated with oil and gas if the investments are properly structured. These may include the deductibility of intangible costs of drilling oil and gas wells — including the rig, drilling labor, consumables and other costs. These line items may be expensed in the year paid by those incurring the costs.

Other tax breaks include the possibility of taking 15 percent of the gross income as a deduction, in the form of percentage depletion.

Have previous eras, like the oil bust in the 1980s, impacted today's investor?

Every industry is subject to cycles. The oil and gas industry is no exception. The 1980s oil bust was a result of a significant surplus of oil compared to demand. OPEC did not do a good job of maintaining balance, so Saudi Arabia imposed some discipline by flooding the market with oil and gas, causing the market price to careen downward. Stock prices fell and a lot of people lost a lot of money.

Before that, there was a period when the income tax was as high as 90 percent and the deductions on oil and gas investments were thus heavily subsidized by their deductibility. A number of investments were designed without a close eye on the economics of the deal, other than the tax deductions. This trapped a lot of investors.

How has the current insurance crisis impacted oil and gas investments?

Companies drilling on land in the U.S. have not been adversely impacted by insurance rates. But for those drilling in the Gulf of Mexico, insurance has severely increased costs. Insurance rates for the Gulf have increased four times from levels before hurricanes Rita and Katrina. Insurance companies have absorbed massive losses and the rules say they have to recover them. This extreme jump in insurance rates has forced some companies to cut back on Gulf drilling, while others are selling their Gulf properties. Additionally, some traditional insurance coverage, like profit protection insurance, are no longer offered.

The bottom line is that investing in energy is likely to be strong for years to come. As in any other investment, there will always be some risk. For investors who choose their investment programs and partners wisely and well, the steady stream of demand will continue to fuel exploration and production of energy for a long time.

JOHN BARNES is chairman and CEO of B&R Energy. Reach him at (214) 445-6808 or john_barnes@BandREnergy.com.

Insights Energy is brought to you by B&R Energy LLC