



The New Dune

World Energy interviews Dune Energy's Chairman of the Board of Directors, Alan Gaines, and President and Chief Executive Officer, James Watt.

World Energy: Tell us a little about yourselves, the company and how it got its start.

Alan Gaines: My background is in energy mergers and acquisitions (M&A) banking. I was cofounder of Gaines, Berland, Inc., a firm specializing in global energy markets with an emphasis on small to mid-capitalization exploration and production, midstream, pipeline and oil services companies. After selling Gaines, Berland in 1998 I engaged in merchant banking within the energy sector. In mid-2003 I formed Dune Energy, Inc., with personal capital and personal guarantees. Dune initially acquired an interest in two South Texas properties in 2004, and we followed that up with an acquisition of a working interest in Bayou Couba in South Louisiana and acreage on the fairway of the Barnett Shale. At year-end 2006, Dune Energy reported 29.4 billion cubic feet equivalent of proved reserves with a present value at 10 percent of \$35.2 million.

James Watt: I began my career as a geophysicist with Amoco in 1971. Over the last 36 years I have held technical and management positions with several independent oil and gas companies, including nine years as CEO of Remington Oil and Gas Corporation. I took my current position here at Dune this past spring.

World Energy: James, can you tell us more about what you did at Remington? How big was it when you started and when you left nine years later?

Watt: Remington was a small, family-controlled oil and gas company with about 60 bcfce of reserves. It had about \$55 million in high-yield debt, \$70 million of contingent liabilities involving major litigation and a market capitalization of approximately \$100 million. The company was recapitalized, bringing in one major shareholder, J.R. Simplot, and removing the family from control. When Remington was sold for approximately \$1.4 billion in June 2006 to Helix Energy Solutions, it had no debt and a compound annual growth rate of more than 20 percent in both reserves and production.

World Energy: Why come back into the business when you could easily and comfortably have called it quits?

Watt: I thoroughly enjoy the technical challenges of the oil and gas industry and building value through applied technology and cost containment.

World Energy: Alan, tell us a bit about Dune's early years and how the company has evolved.

Gaines: I formed Dune to own properties and to take advantage of what I believed were rising commodity energy prices. At the same time, there was an unusual arbitrage between the valuations of public and private companies. Our main concentration was South Texas, and our early proved producing reserves were largely natural gas. Of course, our recent acquisition of Goldking Energy Corporation, coupled with our Barnett Shale position of approximately 8,000 high-quality acres, have helped to increase our profile as a public company.

World Energy: The vision for the company has extended beyond the one that initiated its genesis. What was needed to go to the next level?

Watt: Dune required both strong financial and operating teams and a creative financial acquisition team working in concert with each other. The recent Goldking acquisition, in May 2007, and the new management provided the catalyst to carry us to the next level.

World Energy: What makes the management structure of Dune unique?

Watt: A number of things make Dune's management structure unique. First and foremost is the combination of Alan and me in one company. With my technical background and expertise in management coupled with Alan's M&A background, we are extremely complementary. We have set up a defined division of tasks: I run the day-to-day business and act as the principal executive officer for SEC reporting, and Alan spends most of his time in New York concentrating on M&A opportunities while interacting with investment banks and analysts. We both have excellent deal flow and knowledge about many companies. If Alan can find an acquisition that makes sense, Dune can act quickly. The Goldking acquisition is a prime example of how we work together. The transaction was extremely well received by investors, and Dune was able to raise substantially more capital than anticipated.

World Energy: Sharing control after being the chairman and CEO must be different. How are you adapting?

Gaines: My focus is on building value for our shareholders. I feel our shared authority will result in the best results for our shareholders. Our long-term compensation and that of all our employees is tied to increased shareholder value.



Watt: Alan and Dr. Amiel David, Dune's senior advisor to the Board of Directors, focus on creative acquisition opportunities, which frequently are assets officially not for sale. Alan and I communicate daily, and if I feel our team can effectively manage an asset, Alan will follow through to structure a deal.

World Energy: How do you make decisions together? Does either of you have sole operating authority?

Watt: Our focus revolves around how to build value. If something looks good financially but does not fit Dune's culture, strengths and operations, we would not take it on.

Gaines: I rely on Jim's 36 years of experience, and Jim relies on my financial and M&A experience. It's a team effort, and that mindset is among the greatest assets of Dune's corporate culture.

World Energy: Your company has changed a lot in a short time. What is the culture of the new Dune?

Gaines: Under Jim's leadership we have successfully integrated the Goldking organization into Dune. All employees participate in a bonus program focused on production growth, reserve additions and the control of finding and development costs. All employees have been provided stock grants. Everyone's compensation is focused on adding incremental shareholder value, and all participate directly in that added value.

Watt: Our senior management group is highly experienced in E&P; each member has over 20 years of experience, particularly along the Gulf Coast. Our management team is very operations-focused. The financial group, led by Frank Smith, has significant experience, especially with Gulf Coast companies and in the public realm. All of our people are hands-on people with strong technical disciplines.

World Energy: What are Dune's greatest strengths?

Watt: Our strengths lie in three primary areas. First are our employees—you must have a strong, hands-on, experienced and dedicated team of people. Second is our property base, which features our recent acquisitions, which were old-legacy fields of majors that for the last decade were undercapitalized and generally had not experienced modern technology. Third is our ability to raise the capital that can allow us to develop those fields and exploit their potential. The basic idea is to know how to make sense of the big picture, to have a team of knowledgeable people who are good at what they do and to have the capital to leverage both employees and technology.

World Energy: Regarding building and maintaining a great team, how do you intend to keep such a great team in place, especially as the experienced members of the industry reach retirement age and eventually move on?

Watt: That is a really good question, and one that keeps me awake at night. Our senior management team is highly incentivized with a stock base. If they do well for the shareholders, they will also do well for themselves. The industry personnel is getting "long in the tooth," and in the last 20 years it has not had an increase of new blood and interest because of the lack of "pizzazz" that other industries, such as the dot-coms, have had. We do have good people though, and by believing in them, financially rewarding them for success and establishing a good succession plan for the management team, we will be able to withstand the changes as the current group of experienced team members heads toward retirement. We will be looking at this issue really hard over the coming years so that staffing changes can be made.

World Energy: Dune emphasizes its asset diversity. How did you create such a varied group, and why did you structure the asset base the way you have?

Watt: Gulf Coast assets today are largely out of favor and thus are lower priced than many other assets. However, the returns for properly managed Gulf Coast properties are excellent either on an internal rate of return (IRR) basis or a return on assets (ROA) basis. Our geographic diversity consists of almost 30 separate fields spread across the Gulf Coast plus our Barnett Shale assets. This diversity helps insulate us against both hurricane-related risks and the risk of concentration in value in an individual field or well.

World Energy: If Gulf Coast assets are out of favor and Barnett Shale production has a quick decline rate, how do you attract and keep investors?

Watt: Basically through taking measures for appropriate risk mitigation. If you manage all of those risks well, you still get a good turnaround for projects, and if you have a good use of assets and technologies you will be able to combat those risk issues. We are already looking for more rigs and projects in order to expand operations.

Gaines: Gulf Coast assets presently are out of favor due to the 2005 hurricane season and the residual effects of hurricanes Katrina and Rita. While 2005 was a difficult year for many offshore companies, we were not nearly as impacted because we operate onshore. That is not to suggest that we are entirely immune to such risk. Were a similar situation to occur, approximately 33 percent of total production would be impacted for

some period of time. However, the probability of such a one-two punch is very low. In our production projections we do take prospective downtime into account.

World Energy: Some of the assets that Dune gravitates toward are financial entities previously held by other companies. What is the attraction?

Watt: We seek assets with significant upside. The financial entities that have owned our major properties were, on the whole, risk averse. Deeper pool tests and field extensions that were not booked were frequently considered too risky to drill. We recognize the risk of these opportunities but also recognize the upside potential and returns of new reserves.

World Energy: How do you intend to bring more value from those assets from deeper pool tests and field extensions that others considered too risky to drill?

Watt: Mainly through applied technology of 3-D seismic, time and depth migration and directional drilling, coupled with dedicating the capital resources to drill new wells, upgrade facilities and enhance production efficiencies.

World Energy: That's a fairly unusual perspective for a small, independent E&P company. How do your abilities to accept risk differ from those of your competitors?

Watt: We believe that good technology coupled with knowledgeable people can significantly reduce the risk profile of drilling operations. In most of the properties we currently operate we have a 100 percent working interest. The wells for the remainder of 2007 are mostly proved undeveloped (PUD) locations or relatively low-risk field extensions with a per-well cost not exceeding \$5 million. As we look to higher-risk, higher-potential projects, we will bring in partners to share the investment risk.

World Energy: Not every company employs this kind of strategy with regard to risk. Why is Dune able to act where others don't?

Watt: The 3-D seismic and directional drilling technology we are using is proven. Our staff understands all the risks associated with our operations. No one project or single investment will dominate our program. We manage a portfolio of opportunities of varied risk to achieve the best results for our shareholders.

World Energy: What makes Dune more adept at managing risk?

Watt: We build our production forecast yearly and take the fields that have the highest potential for hurricane risk out of the equation for a time during the months of June through October

(hurricane season). Risk management and risk expectation must be balanced.

World Energy: In the past, rig availability was a challenge for Dune. How does it affect the company now?

Watt: Gulf Coast rig availability and services are very good right now, and while day rates have not dropped as much as one would like to see, it is not difficult in today's market to get the right sized rig on a timely basis. In the Barnett Shale, we have a two-year evergreen contract for a dedicated rig. We are finalizing a contract for a second and will maintain a third rig as needed.

World Energy: Where will Dune go from here?

Watt: We must continue to execute our program of PUD and low-risk drilling for 2007 and expand our horizons to deeper pool tests in 2008 and beyond. While accomplishing this, we also must add new opportunities through acquisition efforts.

World Energy: What are some of these new opportunities?

Watt: This is a business that is totally opportunistic. It's hard to say that we are going to make "x, y, z acquisitions next year," whether those are companies or properties. We continue to look for assets that may not have had the capital or proper technology applied and where we see longer-term upside. Timing, a sense of feasibility with the right property set, our capital and most importantly employees will drive those new opportunities.

World Energy: On a broader topic, how do you see the issues of domestic production and the future of the industry?

Watt: For oil and gas companies, the biggest challenges will be people. If we get the right people and technology and capture the funds, we will still get things done. Globally, the industry isn't liked by the political world, but hopefully it will reach a juncture that makes economic, political and environmental sense and still allow the industry to provide the oil and gas needed to meet the demand.

Dune Energy, Inc. is an independent exploration and development company, with operations focused along the Louisiana/Texas Gulf Coast and the North Texas Fort Worth Basin Barnett Shale. Dune will continue to exploit its existing asset base, seek accretive acquisitions, and enter into additional joint venture drilling programs.