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A portrait of James Sigmon, a middle-aged man with glasses and a goatee, wearing a dark suit, white shirt, and a red patterned tie. He is smiling slightly and looking directly at the camera.

James Sigmon, chairman, president,
and CEO, TXCO Resources Inc.

**TXCO Resources:
new name, new partner
in Maverick basin**

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AN INTERVIEW WITH TXCO RESOURCES' JIM SIGMON



Don Stowers
Editor, OGEJ

TXCO Resources growing, becoming more diversified

EDITOR'S NOTE: TXCO Resources has seen major changes during the last two years. Its acquisition of privately held Output Exploration LLC in early 2007 doubled proved reserves, significantly increased oil and gas production, and opened new drilling opportunities outside TXCO's core Maverick basin operating area. In late 2005, TXCO and EnCana announced an agreement that brought one of North America's premier independents into the Maverick basin. James E. (Jim) Sigmon, TXCO's chairman, president and CEO, recently took time to talk to OGFJ about how the company has changed and its prospects for the future.

OIL & GAS FINANCIAL JOURNAL: After 25 years, your shareholders voted to change the company name to TXCO Resources from The Exploration Company at your annual meeting back in May. Can you explain why you did this?

JIM SIGMON: Our new name better reflects the broader growth opportunities we have. TXCO now has a diversified exploration, exploitation, and development inventory, which was not reflected in the name that had served us for so long. We have become a larger and more diverse organization with even greater growth potential. We have thousands of identified drilling locations and we believe our prospects are tremendous. We remain committed to the Maverick basin but we now have opportunities to use the expertise we've gained there in other and very attractive areas. We think TXCO offers investors a winning equation that we summarize in our new name: Technology, times capital, plus opportunity, equals growth. TXCO equals growth.

OGFJ: As you say, TXCO Resources' main focus is the Maverick basin of Southwest Texas. I believe TXCO is the main player there with something like 600,000 net acres leased. Can you tell us why this relatively small basin has captured your company's attention?

SIGMON: You're correct, we're the largest leaseholder there. TXCO has a large acreage position for a firm of our comparatively small size. We came to the Maverick basin in the late 1980s primarily because of the initial success other operators had with the Pearsall gas play. However, their early successes turned into hit-or-miss propositions due to the limited technology of the time. We decided to stay because we found the basin to be a layer cake of multiple, hydrocarbon-bearing formations.

There are many attractive targets in addition to the Pearsall and they have kept us busy. TXCO was able to lease a large acreage position over time as we continued to expand our operations and as we proved to be a good partner with the surface owners. We've had success with some of the other zones while we waited for the right time to drill the Pearsall. We feel that time has come.

OGFJ: The geology is very complex, isn't it? Is this why the Maverick basin, here in 2007, is still under explored and under developed?

SIGMON: Yes, the Maverick has experienced a lot of tectonic activity. Americans sometimes forget it's not that far from where we are, along the Texas side of the Rio Grande, over to the Sierra Madre over in Mexico, which is an extension of the Rockies. The Maverick basin is far different geology than the Wilcox and the other plays around the Gulf Coast.

OGFJ: Were there pipelines, gathering systems, and other infrastructure in place before TXCO entered the Maverick basin, or did you have to build it from scratch?

SIGMON: There is some infrastructure in place since there has been some production for many years. We acquired an existing gas pipeline in 2002 that gathers gas from our wells and other operators. It has four delivery points to both the US market and Mexico and we're also able to sell into the Houston Ship Channel. It's a far different situation than say in the Rockies, where operators have limited outlets for their gas. If Pearsall gas production increases as we expect it will, this could be an important asset for us.

OGFJ: Oil & Gas Journal's Alan Petzet wrote a story in August in which he noted that more and more operators are eyeing the basin's potential. Can you provide an overview as to who is operating in the basin, whether they are producing oil or gas, and some of the new participants?

SIGMON: Alan did a good job summarizing all of the activity going on in the Maverick basin. There's plenty to keep all the operators busy. The Pearsall has created the most interest. EnCana came into the basin in late 2005 through the asset sale agreement with us, which allowed our two firms to join forces and start drilling the Pearsall.

EnCana has some great people. They have been a good partner and they have valuable expertise in shale gas plays from their activity in the Fort Worth basin. EnCana has since shifted its North American drilling focus and we recently modified our Maverick basin agreement, which benefits both companies. I believe we will have a long relationship that will benefit the shareholders of both companies.

Anadarko has leased 330,000 acres to the south of our acreage and has drilled five vertical Pearsall wells and has announced plans for one horizontal Pearsall well. Cornerstone E&P has acquired an interest in 190,000 acres and they are looking at the Pearsall and the deeper Jurassic. We're working with Pearl Exploration & Production out of Calgary on our tar sand



Jim Sigmon (left), TXCO's chairman, president, and CEO, points to a drilling site in the Maverick basin in Southwest Texas. At right is Mark Stark, vice president, treasurer, and CFO. *Photo courtesy of TXCO Resources*

project. They have great expertise from Canada's tar sands that has been a real help. Recent acquisitions also have brought St. Mary Land & Exploration and Swift Energy into the southern part of the basin. And we certainly can't forget ConocoPhillips, which is the one major that has stayed in the basin. It operates the Sautosa, an oil field discovered back in the 1950s that's now in waterflood.

OGFJ: You have said that the Pearsall shale has great potential. Can you elaborate?

SIGMON: The Pearsall is a blanket, high-pressure shale gas resource play. It's similar to the Barnett and Woodford shales in the Fort Worth and Arkoma basins except it is overpressured. It has attracted a lot of interest because there are estimates by EnCana and Anadarko of 100 to 300 bcf of gas in place per section. There have been more than 50 conventional, vertical wells drilled to the Pearsall over the years. In the past, if an operator happened to hit a fracture, these wells could have astounding production rates but overall, the wells averaged around 0.4 bcf.

Technology can be the difference. Through horizontal and underbalanced drilling, and advanced fracturing

techniques, we have the potential to turn the Pearsall from a hit-or-miss proposition into a predictable resource play.

OGFJ: How important is technology (3D seismic, advances in horizontal drilling and fracturing techniques) in development of the basin?

SIGMON: It's huge. I think we forget sometimes just how far the technology of this industry has come just in the last 10 or 15 years. Technology is fundamental to TXCO's growth.

Our success in achieving a higher return on investment has come by applying new technology to overlooked opportunities. Production in the Maverick basin dates back to the late 1920s but operators could not repeat a success. They would drill one good well, then move over to the next section and drill a dry hole. Advances in seismic and drilling technology have changed things dramatically. Now we can image underground features, then use advanced drilling and completion techniques. We have proprietary 3D seismic data coverage of most of our Maverick basin acreage, which is invaluable.

OGFJ: What's your best example to date of advanced technology at work?

SIGMON: Probably the Glen Rose Porosity. This has been a great oil play for us since the 2002 discovery. The oil is contained in highly porous traps created through dissolution as water upwelled from below through tectonic activity. You get nothing if you miss a trap so we have to be able to site a well exactly. We identify these traps with 3D, then we use horizontal drilling to connect two or more traps and complete very good wells. They pay out quickly so it has provided excellent cash flow.

We simply could not have had the success we've had without advanced technology. Now, we have Schlumberger doing a study on how to best develop this play. It is a geologically unusual feature but has great potential so we want to be sure we develop it in the best possible way. We have more than 300 Porosity drilling locations in our inventory so we'll be busy for years to come.

OGFJ: What are you doing in the San Miguel oil sands play, which covers about 170,000 acres in the northeastern part of the Maverick basin and has been described as analogous to Alberta's Athabasca oil sands? I understand you are conducting pilot tests of separate tar sand and heavy oil deposits there.

SIGMON: The San Miguel oil sands may be the most exciting Maverick basin prospect we have. This is another resource play. TXCO estimates 7 billion to 10 billion barrels of 0° API gravity in place and we have approximately half of that under lease. We estimate there are 2 to 3 billion barrels in place net to TXCO. But that value is not

reflected now in our share price. Similar, non-producing Canadian tar sand deposits have sold recently at around \$1 per recoverable barrel, which would represent additional value to our shareholders. We think our shareholders will see a significant appreciation as we move forward.

It has been demonstrated already that this oil is recoverable. Conoco did two pilots here in the early 1980s and recovered more than 50% of the oil in place. But with available technology and oil prices at the time, the project did not prove economic.

We believe it could be profitable now. We have had a cyclic-steam pilot operating for several months with positive results. We're planning to expand that pilot and drill wells for a second commercial pilot that we will begin steaming in early 2008. We've had preliminary pricing around \$15 per barrel below WTI, in line with what we projected. It's just a very exciting project.

There's also a separate deposit of 10-14° API gravity heavy oil in the San Miguel. This is very shallow, 100 to 300 feet, and we've drilled additional wells for a pilot there. We're installing an exothermic hydrogen peroxide steaming system that could cut the steam-oil ratio by half. There's an estimated 100 million barrels in place and TXCO holds 100% of that.

OGFJ: Where else does TXCO have operations now? Can you provide a brief overview?

SIGMON: Our acquisition of Output added 31,000 net acres to TXCO's leasehold. We gained important new prospects around the Gulf Coast and the Midcontinent region of Oklahoma. The Fort Trinidad Field in East Texas is the most promising acreage we acquired. Before



Gas-fired steam generator and tank battery at TXCO Resources-Pearl E&P two-well tar sand pilot project in Maverick County. Photo courtesy of TXCO Resources

the Output acquisition, we acquired 140,000 acres in the Marfa basin of West Texas.

OGFJ: Talk a little bit about Fort Trinidad. Why did it interest you?

SIGMON: Some people wondered why we moved into East Texas when we have so much in the Maverick basin. But this is another example of how we're applying new technology to overlooked opportunities. The geologic sections of the Maverick basin and Fort Trinidad are nearly identical, particularly the Glen Rose formation, which we know a lot about. We can easily apply our Maverick basin expertise, so Fort Trinidad represents a bolt-on to what we're already doing.

We have successfully drilled Glen Rose shoals in the Maverick basin for years and Fort Trinidad has stacked Glen Rose shoals. We're using our 3D seismic and horizontal drilling expertise to go in and drill one zone that has seen very little production. We've identified approximately 40 locations that are offsets to producing wells. We just recently spudded our first horizontal well and we're optimistic that what worked for us in the Maverick will work in East Texas.

OGFJ: The Marfa basin is another area we don't hear much about. Why did you move into that area?

SIGMON: Once again, TXCO is applying technology in an overlooked area. The Marfa has seen little drilling but it lies along the Ouachita overthrust and is prospective for the Barnett and Woodford shales. Major companies went to the basin years ago seeking the deep Ellenberger. On their way down, they encountered gas shows going through the Barnett and Woodford, which appeared to be up to 1,200 feet thick. We re-entered one of these wells drilled back in the 1970s and confirmed gas is present in the Barnett and Woodford. TXCO recently performed a frac on the Barnett and we hope to have results shortly. We're very early in the process but we're excited about the potential there.

OGFJ: Your CFO, Mark Stark, wrote a Capital Perspectives column for Oil & Gas Financial Journal back in 2004. He recited the challenges that a publicly-held company like yours has in raising capital for an extensive inventory of drilling targets. Do you

consider the company solidly capitalized today and able to execute its business plan?

SIGMON: TXCO is like many emerging independents in that we have more projects than capital. It's a continuing challenge for us to fund our drilling program without diluting shareholder value. We'll continue to rely on a mix of funding alternatives as we grow. Although our debt is higher now than I like, we have historically kept debt low because all of us in TXCO's management have been in this business long enough to see what happens to companies that take on heavy debt loads when prices fall. Although I believe the industry will have strong oil and gas prices in the foreseeable future, we want to be prudent with debt in case things change. TXCO has strong cashflow and we have been blessed with strong oil production at the same time oil prices have set records.

Our 2007 capital program is fully funded and our largest ever. We set a CAPEX target of \$85-90 million for 90-100 wells. Half of that will go to the Glen Rose, primarily the Porosity, but also for shoal wells in the Maverick basin and Fort Trinidad.

"Although I believe the industry will have strong oil and gas prices in the foreseeable future, we want to be prudent with debt in case things change. TXCO has strong cashflow and we have been blessed with strong oil production at the same time oil prices have set records."

OGFJ: I've noticed that TXCO Resources makes financial presentations at frequent investor events, including EnerCom's Oil & Gas Conference, the various IPAA OGIS events, and that you're scheduled to present at OGFJ's Houston Energy

Financial Forum in November. Can you explain what benefit the company derives from these conferences?

SIGMON: We have a great story to tell about TXCO's growth potential. We have a record of continuing reserve and production growth and our greatest opportunities for growth lie in the future. It's easy for smaller companies to be overlooked by investors so we work hard to get our message out.

OGFJ: You seem to have a lot going on. What do you expect going forward?

SIGMON: TXCO is blessed with multiple, and very attractive, prospects. In 2006, we set records in revenues, cash flow, proved reserves, and production. We're accelerating and believe 2007 and 2008 will build on that success. Our goal continues to be increasing value for our shareholders. I believe the best is yet to come.

Thank you for taking the time to talk with us. OGFJ