

Johnson Rice & Company L.L.C.

Exploration and Production

Top picks on how to play the natural gas recovery.

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Cabot Oil & Gas (COG, \$35.75, OW)

- Operational leverage to gas is high with 97% of production being natural gas. Looking ahead to 2010, only 20% of natural gas production is hedged, giving COG significant leverage to improving gas market fundamentals.
- Near-term growth comes from the prolific Marcellus Shale where drilling results Susquehanna County have been very strong with the most recent well testing horizontal well IP's at 10.8 mmcf/d and is still producing 11.1 mmcf/d.
- With 160,000 net acres in Susquehanna County alone, assuming 100-acre spacing, COG has net reserve potential of more than 3 Tcfe assuming 75% of the acreage is prospective and average EUR's of 4.5 Bcfe (gross).
- East Texas remains an area with significant upside potential in a number of different plays, including the Haynesville Shale. Recent industry well results around the County Line acreage are de-risking COG's position, bringing the play to them.
- Balance sheet remains strong with debt-to-book cap at 30% at June 30, 2009 and available liquidity of more than \$350 million under the bank credit facility and free cash flow of roughly \$50 in 2009, COG is well positioned to accelerate activity when gas prices justify increased spending.

Carrizo Oil and Gas (CRZO, \$24.49, OW)

- Carrizo has maintained a deep inventory of Barnett shale wells that have been drilled but not yet completed, with its current backlog representing about 70+ mmcfe/d of production. The Company estimates this backlog of wells could be completed within 3-4 months, once natural gas prices improve. In addition, the Company has shut-in about 11 mmcfe/d in response to low gas prices; however, this production can be re-started on short notice.
- With its vertical drilling program in the Marcellus getting underway in central Pennsylvania and West Virginia, Carrizo is beginning the evaluation of its acreage, which totals 103,000 net acres. It remains possible its initial horizontal well could be spud in Susquehanna County by year-end, as industry activity in that area has de-risked its acreage in that area.
- With Carrizo planning to sell its gathering system in the Barnett and at least a portion of its North Sea assets, we believe one of the biggest investor concerns, the risk of a pending equity offering, is minimized. With the gathering sale expected to generate \$30-40 million of proceeds and the sale of just the Forties formation in the North Sea capable of generating \$75-\$100 million of potential proceeds, the Company's balance sheet can be improved significantly with the sale of any booked reserves or current production.
- With almost \$100 million of availability under its revolver and its cash flows funding the capital program, Carrizo's balance sheet provides flexibility.

Chesapeake Energy (CHK, \$28.40, OW)

- CHK has premier positions in all the major shale plays, providing low cost reserve and production opportunities for years to come. Holdings in the Big Four shale plays alone offer risked reserve potential of more than 40 Tcfe versus year-end 2008 proved reserves of 12.5 Tcfe.
- Leverage is both operational and financial with natural gas representing more than 90% of reserves and production.
- A combination of extensive hedging and Joint Venture drilling carries are driving a reduced but still very active drilling program in 2009. With the current program, CHK will show production growth of +8% in 2009 (ex. asset sales) and +9% in 2010.
- Swaps and collars cover 23% of 2010 gas production, leaving substantial upside in terms of volumes exposed to improving pricing.
- Between the Haynesville JV amendment (\$1.1 billion already received) and the recently announced midstream sale, CHK is delivering on its promise to bring in significant cash to reduce debt outstanding. Additional asset sales are awaited including a JV on the company's Barnett Shale acreage.

Comstock Resources (CRK, \$40.08, OW)

- With Comstock focusing its activities in its Logansport and Toledo Bend North fields in DeSoto Parish, which has resulted in initial production rates of 10-20 mmcf/d on its recent wells, we would expect the Company to continue to report strong well results.
- Comstock has increased its Haynesville activity level through the year, and currently has five rigs drilling in the play. Looking ahead to next year, the Company will likely utilize up to seven rigs, though that number could be increased if gas prices are higher than expected.
- With natural gas representing more than 90% of its total production and no production currently hedged in 2010, Comstock provides the most leverage to increased natural gas prices.
- With a strong balance sheet (23% debt-to-capitalization), Comstock possesses the financial flexibility to fully execute its drilling program.

Petrohawk Energy (HK, \$24.21, FL)

- Petrohawk possesses dominant positions in two of the more attractive shale domestic plays, the Haynesville and Eagle Ford. The Company has reported some of the strongest well results in each of these plays to-date. With its rig count in both areas expected to continue to increase through year-end 2010, we would expect continued newsflow and potential upward revisions to its production estimates.
- While Petrohawk has achieved better than expected production results in each of the areas, the Company continues to refine its drilling and completion techniques to further reduce drilling costs and improve well results.
- With its \$950 million borrowing base fully undrawn and an estimated cash position of \$750+ million following the sale of its Permian assets, Petrohawk can fund its drilling/leasing plans. In addition, the Company continues to explore the potential sale of a portion of its midstream assets, which could generate \$300+ million of proceeds.

Petroleum Development Corp. (PETD, \$18.66, OW)

- PETD has 50% of proved reserves and 53% of 3P reserves in the Piceance Basin, which needs \$5.75-6.25/Mcf to justify a drilling program. If the strip can maintain above those levels PETD's largest property should provide solid returns and the stock should receive an implied value significantly higher than the \$0.87/Mcfe it is currently given by the market
- PETD is 47% hedged in 2010, allowing the company to capture a significant portion of any upward move in natural gas pricing
- Our original thesis that PETD's liquids heavy Wattenberg program and Marcellus exposure provides more value than the market is giving the company with P/CF of 2.0x and a EV/EBITDA of 2.9x still holds. Catalysts include continued results from the company's vertical Marcellus program (five well results remaining this year), as well as the results from the company's first horizontal in 1Q:10. Additional acreage adds in the Wattenberg and Marcellus would also be a positive and would not surprise us

PetroQuest Energy (PQ, \$6.49, OW)

- While PetroQuest stopped its drilling activity in the Woodford shale in late 2008, the Company has continued to be impressed with well performance in the play. With the expected EURs having steadily crept up to about 4.6 Bcfe per well, the play should begin to capture increased investor attention. With well costs now expected to average about \$4.0-\$4.5 million per well, PetroQuest recently contracted a rig to re-start its Woodford drilling activities.
- In addition to continuing its recompletion program in the Gulf Coast, PetroQuest has also re-started its drilling program in the area. The Whistling Straits prospect (24% w.i.; 93 Bcfe gross unrisks potential) is currently drilling and the Syrah prospect (25% w.i.; 127 Bcfe gross unrisks potential) should spud by year-end.
- Given the resumption of drilling/recompletion activity in the Woodford and the Gulf Coast, PetroQuest is set to begin showing sequential growth once again in the fourth quarter.
- With its borrowing base reduction to \$100 million (down from \$130 million) announced, any headline risk associated with that event should be eliminated. With over \$80 million of cash on its balance sheet, the Company had anticipated the reduction and took steps (limited capex and equity offering) to address the reduction.

Rosetta Resources (ROSE, \$14.69, OW)

- With 95% of production being gas and only 11% of 2010 production hedged Rosetta is in the position to take advantage of a rebound in natural gas pricing
- Rosetta has a significant position in the DJ Basin which needs ~\$5.00/Mcf pricing to justify additional drilling; with 350 Bcf of potential in the DJ maintaining a \$5.00-6.00/Mcf strip should unlock significant value for ROSE
- Our original thesis that ROSE provides excellent exposure to the Eagle Ford shale at below group multiples continues to hold. The company should benefit from a flow of both ROSE and 3rd party Eagle Ford drilling results. Additional catalysts will include results from the company's Alberta Bakken exploration program (coring now) and continued results from their highly successful Sacramento Basin recompletion program

SandRidge Energy (SD, \$12.96, FL)

- 85% of 2009 natural gas production is hedged at \$8.42/mcf, financing a drilling program aimed at providing production into the Century Plant, where Phase 1, due on-line in 2Q10, will provide SD with an incremental 100 mmcf/d of production, driving growth of more than 20% next year.
- Phase 2 of the Century Plant will be on-line mid-2011, adding another 100 mmcf/d (net) of natural gas production, driving growth of more than 25%.
- The Piñon Field alone offers unbooked reserve potential more than 5 Tcfe (versus YE08 proved reserves of 2.16 Tcfe) at a finding cost of less than \$1/mcf at current service cost levels.
- A leveraged balance sheet has weighed on SD shares in the recent difficult macro environment but that leverage will result in outperformance as the gas macro situation improves heading into 2010.
- Liquidity issues have been resolved in 2009 with a series of transaction including asset sales and the issuance of equity. With more than \$960 million available under the credit facility, SD has plenty of liquidity to fund the drilling program in 2010 and 2011.
- Assuming a \$6 gas price going forward, SD will be cash flow neutral in 2012.

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