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CAPITAL MARKETS
EASTERN US
CANADA
GULF COAST

GAS 1Q22 NAV COMPASS

Still Bullish

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With natural gas prices remaining near decade-highs, which producers are best positioned to prosper and return cash to investors?

KEY POINTS

- Recent market weakness has erased much of E&P equities' bull run during previous months. Since publishing our last NAV Compass reports, the median market-implied Henry Hub (HH) price for the gas group rose slightly risen from $2.81/Mcf to $2.85. We remain bullish and expect further acceleration of shareholder distributions to garner attention from investors and underscore E&P stocks' differentiated yield potential.
- At the peer-group level, we continue to favor the gas and SMID-cap oil groups over large-cap oil due to cheaper valuations and higher exposure to **shareholder distribution catalysts**.
- Each of the gas names for which we recommend long positions – [illegible], [illegible], [illegible], [illegible], [illegible] and [illegible] – is valued with a market-implied HH price below $3.00, feature improving productivity and are exposed to upside catalysts.
- On average, the group's NAVs fell 4% Q/Q, primarily due to higher well costs, operating expenses and wider basis differentials.

Positive Outlooks:

- [illegible] remains a top pick, trading at an implied HH price of $2.55 (versus a group median of $2.85), a 2022 EV/EBITDA multiple of 2.3x (versus 3.5x) and returning over 50% of its EV to shareholders via planned dividends and buybacks from 2022 through 2023 (versus 28%). The cheap valuation persists even after our NAV was pared by lower-than-expected production pro forma for the Chief acquisition, cost inflation and wider differentials in gas basins. Potential upside catalysts include a portfolio-simplifying Eagle Ford sale and Austin Chalk productivity improvements.
- [illegible] continues to screen positively on value and inventory despite increases in royalty and gathering, processing and transportation due to each expense's linkage to rising commodity prices. A strong inventory profile underpins the sustainability of an increasing shareholder distribution program.
- [illegible] and [illegible] were two of our long picks last quarter, and both equities outperformed peers. Both NAVs worsened Q/Q after incorporating higher royalties, operating expense inflation and widening basis differentials. However, we remain bullish on the firms as both feature sub-$3.00 implied HH prices, strong inventory profiles, high shareholder distribution potential and exposure to high international LNG prices.

- [redacted]'s stock outperformed the peer-group median by 12 percentage points since our last Compass report, and we still see room to run. The company's FCF/EV yield ranks near the highest in the sector this year and next. After it pays down debt to 0.5x leverage before year-end, the company can allocate over 50% of its EV to shareholder distributions over the next 24 months, according to our estimates.
- The negative impact from [redacted]'s capex budget increase was offset by improvements to the Dry Gas Utica type curve. The company's stock price screens cheap at a $2.85 implied HH. We estimate it will generate almost 40% of its EV in unallocated FCF over the next 24 months, presenting a big opportunity to capitalize on the shareholder distribution catalyst.

Neutral Outlooks:

- [redacted] and [redacted] have not announced incremental cost inflation effects on their capital budgets. We estimate both will allocate FCF to debt reduction into 2023, unlike many SMID-cap peers. We attribute modest valuation premiums ($3.25 and $3.12 implied HH, respectively) to the market's attraction to the companies' scale, low declines, inventory runway and continued productivity improvements.
- [redacted]'s NAV includes the Sundance and Sandpoint acquisitions. The acquisitions were accretive in terms of NAV and EBITDA, but we suspect steeper production declines, higher capex guidance and a more complex hydrocarbon mix tempered investors' enthusiasm. The name is cheap on NAV and offers compelling yields but lacks scale and inventory to catalyze sentiment.
- For investors looking for higher exposure to gas-price beta, we estimate [redacted] and [redacted] have the highest leverage to HH. We prefer [redacted] due to higher-quality inventory and **hedges**, but we are hesitant to recommend long positions in each because of recent production misses, Haynesville bottlenecks and focus on debt reduction. Inventory for all Haynesville operators was updated alongside the **Haynesville Play Fundamentals** report.

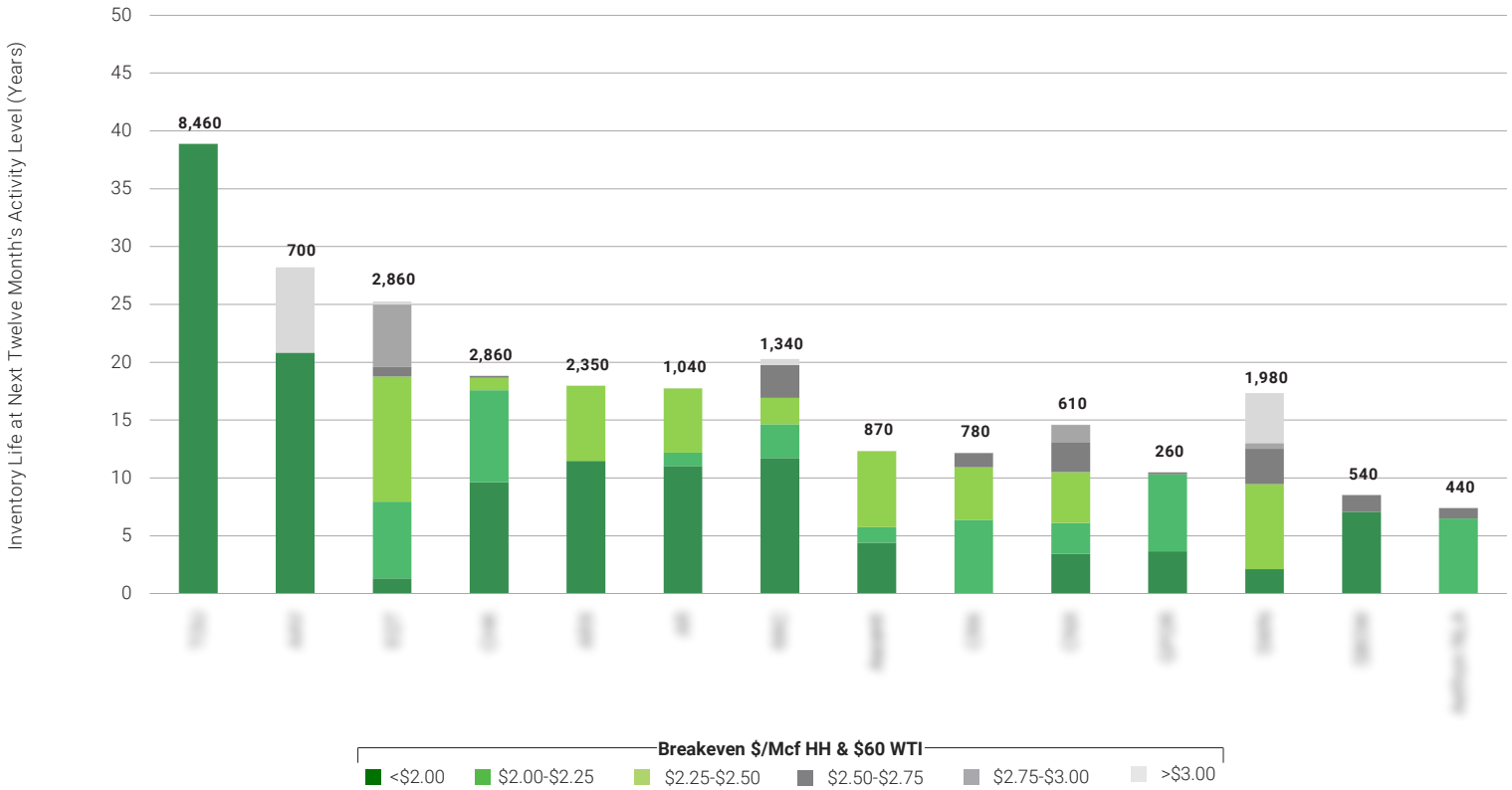
Negative Outlooks:

- We risked [redacted]'s viable acreage and inventory to better align with our conservative methodology, which reduced inventory life by seven years. Poor relative screening on NAV and inventory runway keep us bearish, especially relative to Appalachian peers. We are, however, constructive on its longer-dated basis hedges to protect against basis risk.

INVENTORY

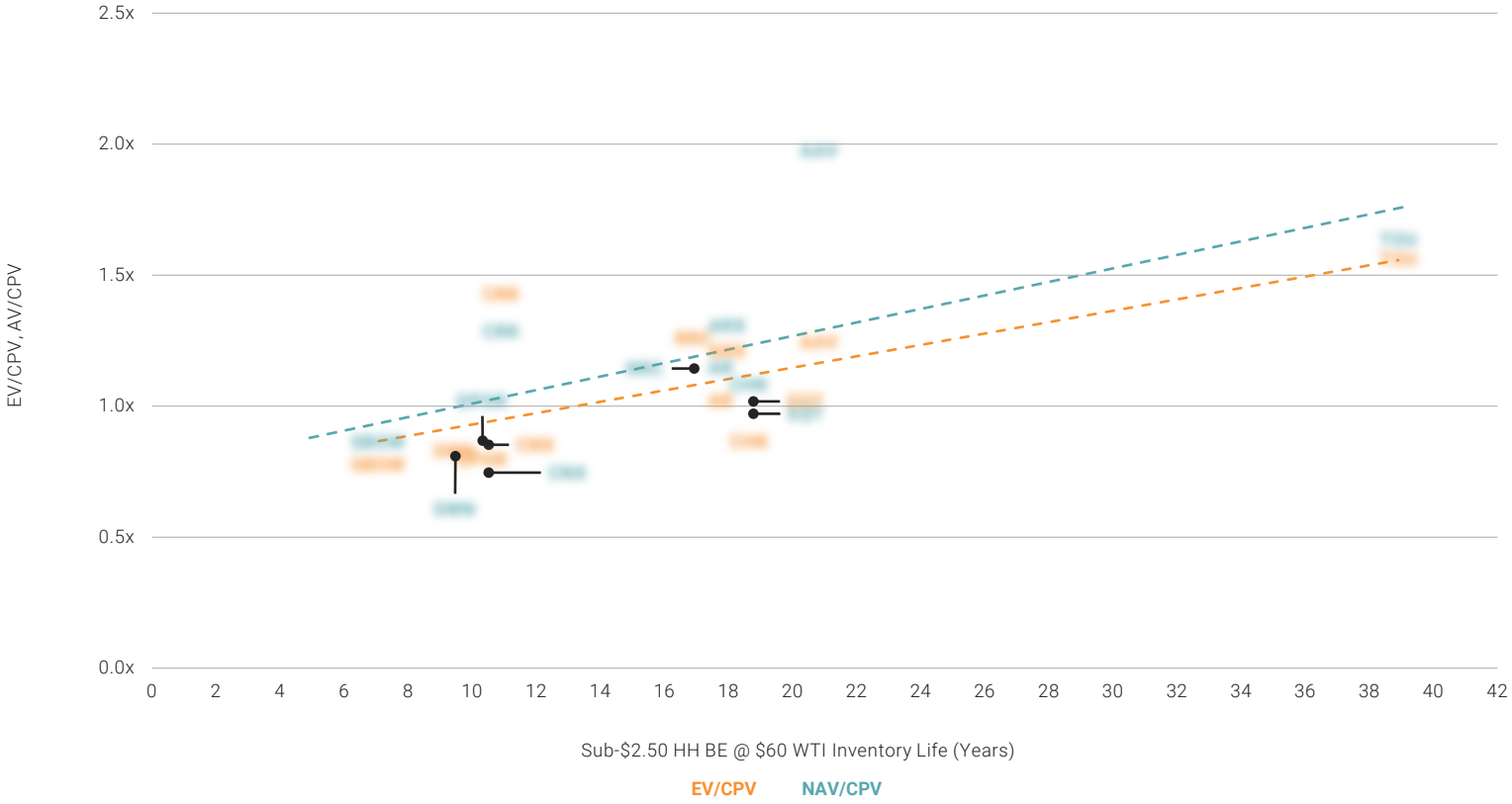
Higher commodity prices benefit companies with longer inventory lives, though the effect depends on quality. Montney players with long-dated high-quality inventory (e.g., [illegible], [illegible] and [illegible]) are in the best position to pivot to growth if conditions allow. Names with long-dated mid-quality inventory (e.g., [illegible], [illegible] and [illegible]) offer the potential for investors to ascribe value to inventory previously neglected.

FIGURE 3 | Inventory Life by Breakeven at $60 WTI, Sorted by Sub-$2.50/Mcf



Note | Ascent assumes land capital expenditures will double the company's inventory over the next 12 years. This is not the case with other operators and our standard methodology is to burden the models with land expense.
Source | Enverus Intelligence, company disclosures

FIGURE 4 | Inventory Life vs. NAV/CPV and EV/CPV, Sub-$2.50 HH $60 WTI Breakeven

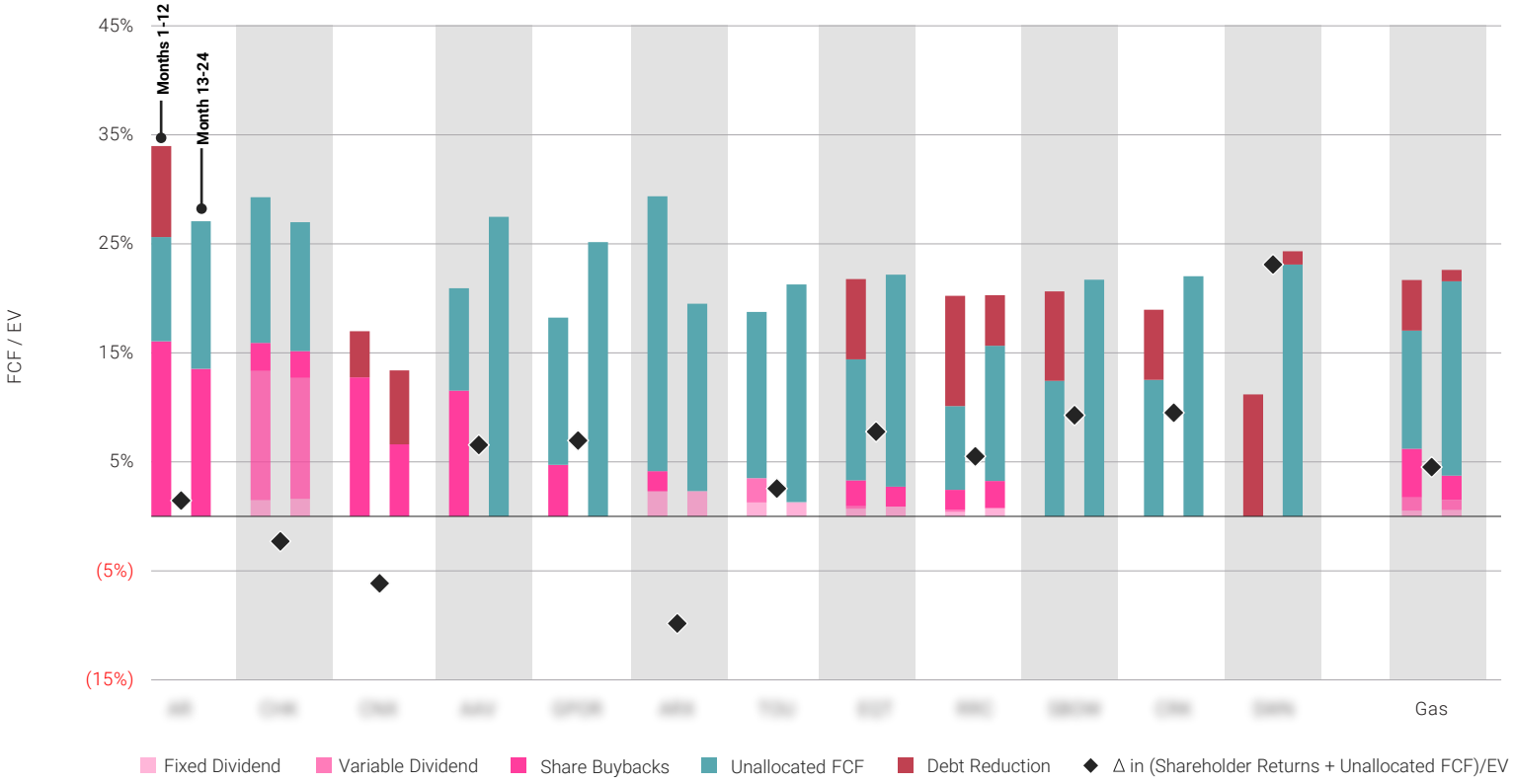


Note | Asset value = AV = (NAV + Net Debt - Minority interest), which is our estimate of E&P EV (Enterprise Value).
AV and CPV (Current Production Value) is calculated at strip for 24 months then $70 WTI and $3.00 HH.
Source | Enverus Intelligence

Shareholder Distributions

We continue to view gas E&Ps' higher potential to increase distribution programs as a significant catalyst.

FIGURE 5 | Shareholder Distributions in the Next 24 Months

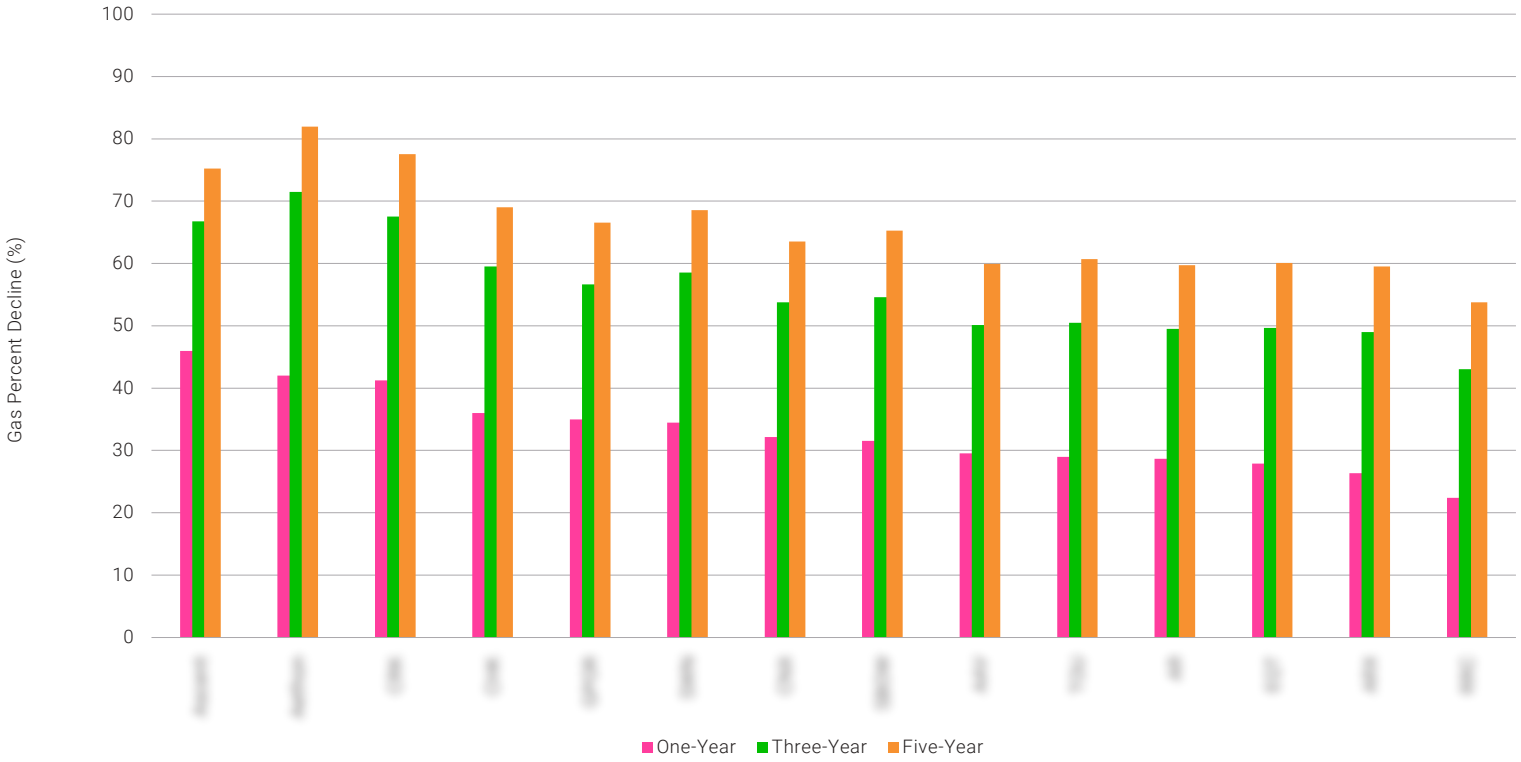


Source | Enverus Intelligence, company disclosures

Decline Rates

The median one-year decline rate across all oil-weighted names is 32%, which is one percentage point higher than last quarter.

FIGURE 6 | U.S. Onshore Gas Annual Decline Rates by Operator



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