

VALUE FOCUS

Exploration & Production

First Quarter 2022 // Region Focus: Eagle Ford

EXECUTIVE SUMMARY

Oil prices rose through the quarter as increased demand was met with continued producer restraint. West Texas Intermediate (WTI) front-month futures began the quarter at \$75/bbl and settled just over \$100/bbl to close the quarter, after peaking March 8th at \$124/bbl. The climbing prices come as geopolitics became front and center with Russia launching its invasion of Ukraine. Western nations enacted a series of economic sanctions against Russia. While the sanctions generally included carve-outs for energy exports, issues with financing and insurance, as well as the exit of Western oil and gas companies and oilfield service providers from Russia, have resulted in a substantial decline in Russian oil exports. Russia was the third-largest producer of petroleum and other liquids in 2020, behind the U.S. and just shy of Saudi Arabia, according to data from the U.S. Energy Information Administration (EIA). Prices swung dramatically throughout March based on the progress of peace talks, among other new developments pertaining to the conflict; the high price volatility is the direct reaction from global markets weighing the potential that much Russian oil may no longer be available.



Oil and Gas Industry Services

Mercer Capital provides business valuation and financial advisory services to companies in the energy industry.

Services Provided

- Valuation of oil & gas companies
- Transaction advisory for acquisitions and divestitures
- Valuations for purchase accounting and impairment testing
- Fairness and solvency opinions
- Litigation support for economic damages and valuation and shareholder disputes

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- Exploration & Production
- Oil Field Services
- Midstream Operations
- Alternative Energy
- Downstream
- Retail

Contact Us



Bryce Erickson, ASA, MRICS
214.468.8400
ericksonb@mercercapital.com
Dallas Office



J. David Smith, ASA, CFA
713.239.1005
smithd@mercercapital.com
Houston Office



Justin J. F. Ramirez, ASA, ABV
832.966.0307
ramirezj@mercercapital.com
Houston Office



Don Erickson, ASA
214.468.8400
ericksond@mercercapital.com
Dallas Office



Sebastian S. Elzein
214.468.8400
elzeins@mercercapital.com
Dallas Office

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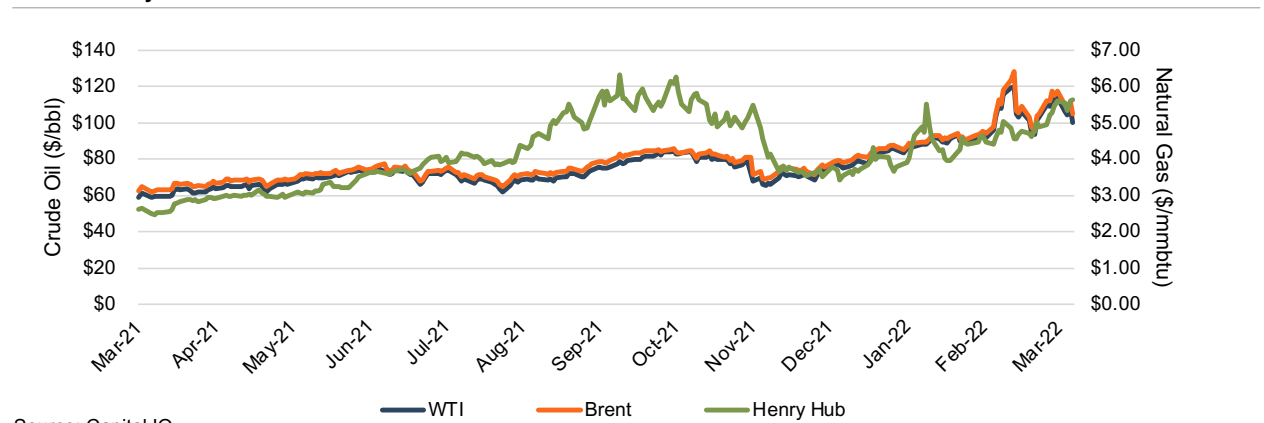
Oil and Gas Commodity Prices

Price Volatility

Oil prices rose through the quarter as increased demand was met with continued producer restraint. While the shale revolution had largely put geopolitics in the back seat as a key driver of commodity prices, geopolitics once again became front and center as Russia launched its invasion of Ukraine. In response, Western nations launched a series of economic sanctions against Russia. While the sanctions generally included **carve-outs for energy exports**, issues with financing and insurance, as well as the **exit of Western** oil and gas companies and oilfield service providers from Russia, have resulted in a **substantial decline** in oil exports from the country. Russia was the third-largest producer of petroleum and other liquids in 2020, **according to data** from the EIA, behind the U.S. and just shy of Saudi Arabia. The potential for that much oil to no longer be available for global markets has led to a high degree of volatility in oil prices. WTI front-month futures prices began the quarter at ~\$75/bbl, peaked at \$124/bbl in early March, and settled at just over \$120/bbl to end the quarter. Prices have swung dramatically based on actions in Ukraine and the **progress of peace talks**.

Natural gas prices did not exhibit the same level of volatility as oil prices, given the more localized nature of the commodity. However, natural gas is becoming more globalized as Europe grapples with how to replace Russian imports. One obvious source is the United States, as President Biden pledged to **boost LNG exports** to Europe, despite these same exports being **demonized by Democratic Senator Elizabeth Warren** just a few short months ago. Administration officials are aiming to increase European LNG exports to 50 billion cubic meters annually, up from 22 billion cubic meters exported to the EU last year.

Commodity Futures Prices



Source: Capital IQ

Macro Update

As the term “energy security” comes back into the public lexicon, the values of U.S. oil companies are rising. This comes at the delight of some and chagrin of others. Regardless, it represents a foreshadowing of a potential longer-term cycle; whereby U.S. oil production being able to meet energy demands will be increasingly important. Many believe the U.S. is now the world’s “swing” producer (although **John Hess** disagrees), and it is not due to government action (or inaction). Biden’s third SPR release in the last six months is largely symbolic and more of a political gesture than a meaningful macro-economic needle mover. Demand and supply were drifting apart before Russia’s invasion of Ukraine and this geopolitical dynamic has only widened that gap. The market participants best positioned to seize upon this unexpected gap are private U.S. operators.

The current price expectations of oil make a lot of reserves economically attractive. The rate of return on capital deployed for drilling is going to (if not already) outstrip the demand for other capital deployment options such as dividends or debt repayment. However, most U.S. public companies are not shifting their strategies.

Domestic Dynamics (Not Russia’s) Keeping Public Valuations Relatively Grounded

As we have written before, shareholders have demanded returns from oil companies for years now in forms other than production growth. Oil company valuation in its fundamental form is a function of the present value of future cash flows. Therefore, if capital available today is best served in drilling more wells tomorrow, then production growth is the most efficient path to a higher value. At historical prices from a year ago, the decision to return more capital to shareholders (as opposed to deploying it in capex) made sense. It doesn’t now. However, public companies have yet to change the courses they’ve been setting for the past several years. That’s partly why the public sector (using XOP as a proxy) only rose 65% in the past year while prices nearly doubled.

Demand is strong with the anticipated depletion of Russian oil on world markets. U.S. capital budgets would have to quadruple by the end of 2024 for shale to replace Russian oil exports to continental Europe according to Wells Fargo. In addition, break even prices in most basins for new wells are still around where they were a year ago according to the **Dallas Fed Survey**. That cost is going up and will continue to, but there is still lots of room for profitability at over \$100 per barrel. Also, as I have mentioned before as well, DUC wells **continue to shrink**. In summary, there are a lot of signals to public companies to “drill baby drill”, yet they aren’t.

Macro Update (cont.)

To be fair there are some caution signs on the horizon that should be considered and are baked into these public valuations. First, the futures curve is still backwardated, meaning that prices are anticipated to fall in the future (not rise). However, even the long-term **NYMEX** curve is still over \$70 in four years, which is still profitable for a lot of reserve inventory. Second, new wells drilled today appear to be less productive. The EIA's drilling productivity report shows that new well production per rig is going down (although they acknowledge that metric is "unstable" right now). Lastly oilfield services markets have become very tight.

Labor and equipment shortages, along with inflation in oil country tubular goods and shortages of key equipment and materials, will limit growth in our business and U.S. oil production. In particular, truck drivers are in critical shortage, perhaps due to competition from delivery services.

– Dallas Fed Survey Respondent

Private Companies Take to the Front

Enter the private oil companies. If forecasts suggest the U.S. can add between 600,000 and 800,000 barrels of oil by the end of the year (EIA says this **can be 760,000**) then the path to get there will be through the drill bits of private and private equity backed producers. According to an **Enverus Report** cited by Hart Energy, these types of operators have assumed the vast majority of new rig activity since the summer of 2020. With fewer external concerns, less ESG pressure, and lower regulatory costs, the private sector's flexibility and nimbleness allow it to surge in front in search of the growth that the fundamental economics suggest is lurking.

Macro Update (cont.)

Private Companies Take to the Front (cont.)

Merger and acquisition activity suggested that the markets signaled to potential buyers that the time was right to increase their footprint in southern Texas while conversely providing for an exit for sellers who could either capitalize on the prospect of a continued upswing in energy prices or redeploy capital elsewhere.

Whatever the exact incentives may have been that drove the M&A activity, the result was ten deals closed, mostly by private buyers or small-cap producers such as SilverBow Resources.

These implied valuation metrics suggest that there are outsized returns to be made on incremental new wells at the present time. Lots of eyes are turning to watch U.S. production, not only in the Permian, but South Texas, Oklahoma, and the Bakken as well. What they are seeing right now is public companies remaining grounded with their capital, while private companies could be leaving them behind – and quickly.

Eagle Ford

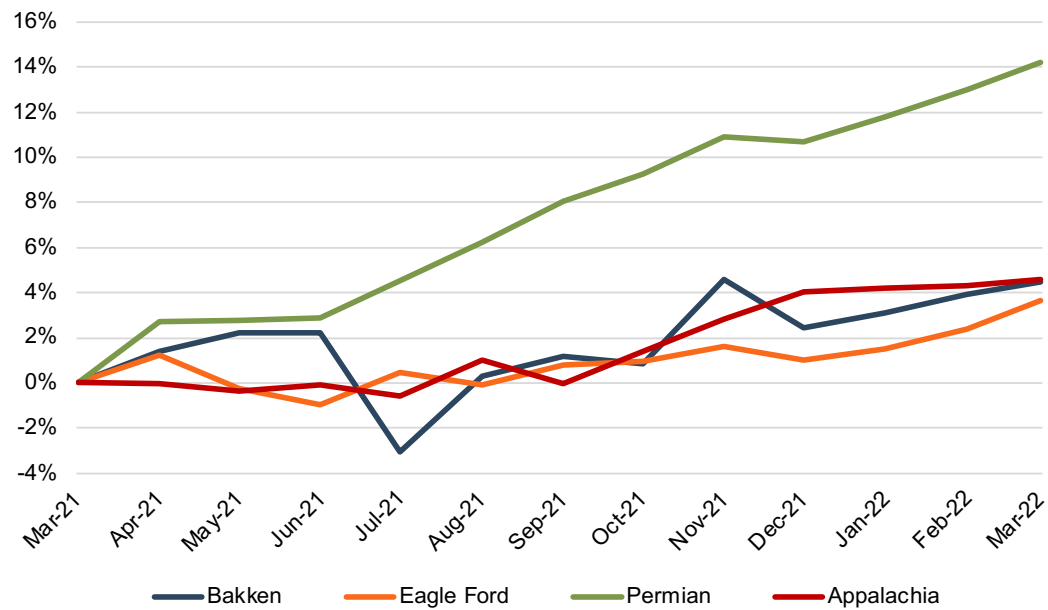
Production and Activity Levels



The economics of oil and gas production varies by region. Mercer Capital focuses on trends in the Eagle Ford, Permian, Bakken, and Appalachia plays. The cost of producing oil and gas depends on the geological makeup of the reserve, depth of reserve, and cost to transport the raw crude to market. We can observe different costs in different regions depending on these factors. This quarter we take a closer look at the Eagle Ford.

Estimated Eagle Ford production (on a barrels of oil equivalent, or “boe,” basis) increased approximately 4% year-over-year through March. This is in line with the production increases seen in the Bakken and Appalachia (4% and 5%, respectively), but lags behind the Permian, where production increased 14% year-over-year.

1-Year Change in Production



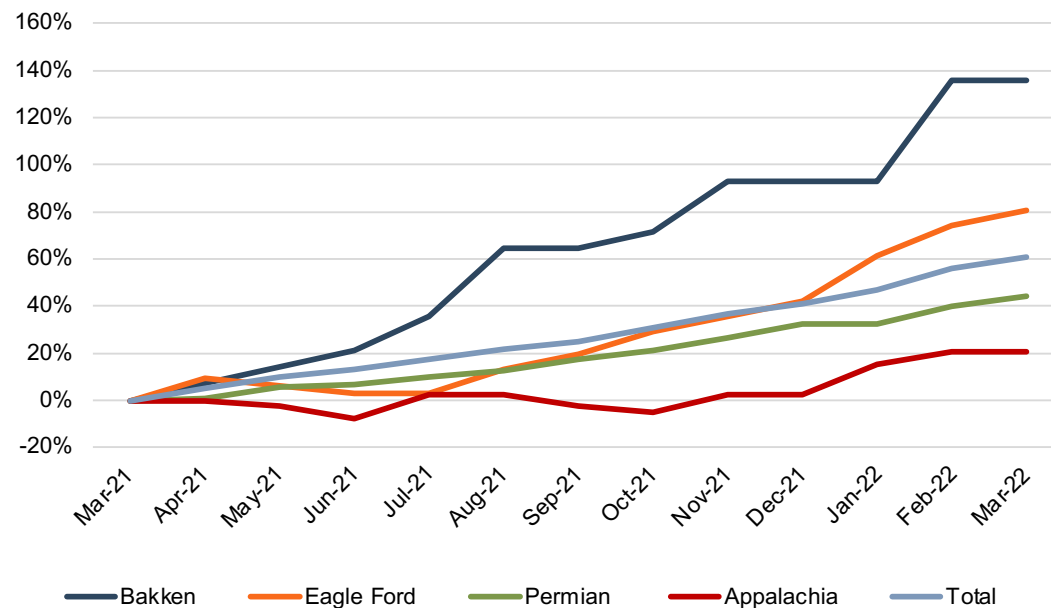
Source: EIA

Production and Activity Levels (cont.)

There were 56 rigs in the Eagle Ford as of March 31, 2022, up 81% from 31 rigs one year prior. Bakken, Permian, and Appalachia rig counts were up 136%, 44%, and 21%, respectively, over the same period.

One may wonder why the Eagle Ford has lagged the Permian in terms of production growth, despite a larger increase in rigs. The answer has to do with legacy production declines and new well production per rig. Based on data from the EIA, the Eagle Ford needs ~40-45 rigs running to offset existing production declines, and only recently (starting in January) had more rigs running than this maintenance level. The Permian has generally been operating with more than the maintenance level of rigs, so it has seen a higher level of production growth despite a smaller increase in rigs. However, with 56 rigs now running in the Eagle Ford, more production growth should be on the way.

1-Year Change in Rig Count

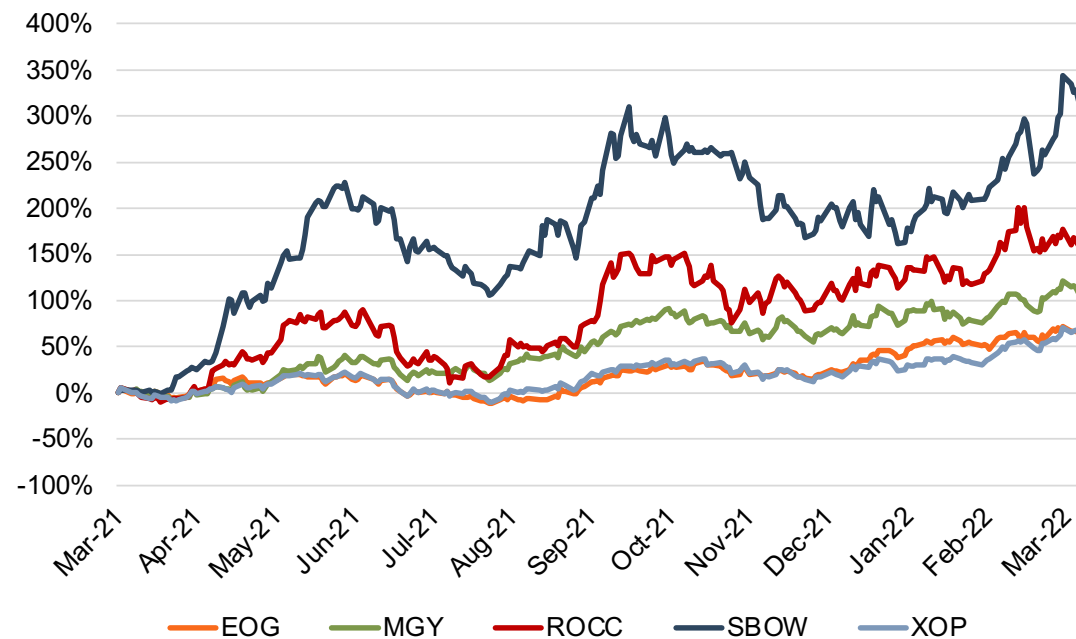


Source: Baker Hughes

Financial Performance

The Eagle Ford public comp group saw relatively strong stock price performance over the past year. The beneficial commodity price environment was a significant tailwind to smaller, more leveraged producers like SilverBow and Ranger, whose stock prices increased 311% and 158%, respectively, during the past year, outperforming the broader E&P sector (as proxied by XOP, which rose 65% during the same period). Larger, less leveraged EOG was a laggard, with its stock price rising 64%, slightly behind the broader E&P sector.

1-Year Change in Stock Price

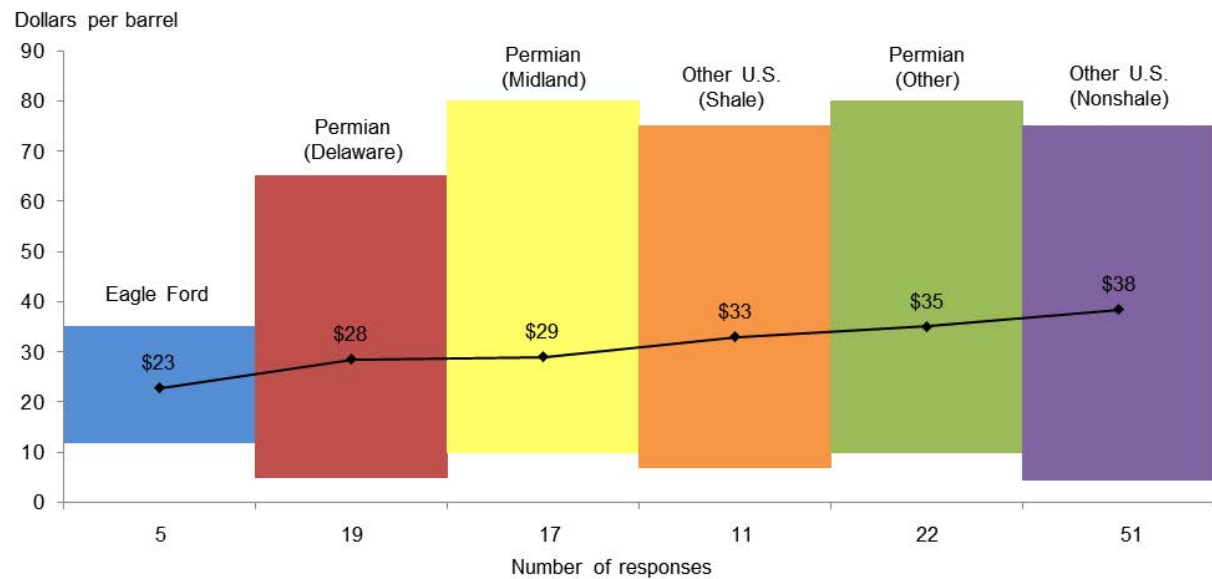


Source: S&P Capital IQ Pro

Survey Says Eagle Ford Wells Among Most Economic

According to participants of the First Quarter **2022 Dallas Fed Energy Survey**, Eagle Ford wells are among the most economic in the nation.

In the top two areas in which your firm is active: What West Texas Intermediate (WTI) oil price does your firm need to cover operating expenses for existing wells?



NOTES: Lines show the average, and bars show the range of responses. Executives from 84 exploration and production firms answered this question during the survey collection period, March 9-17, 2022.

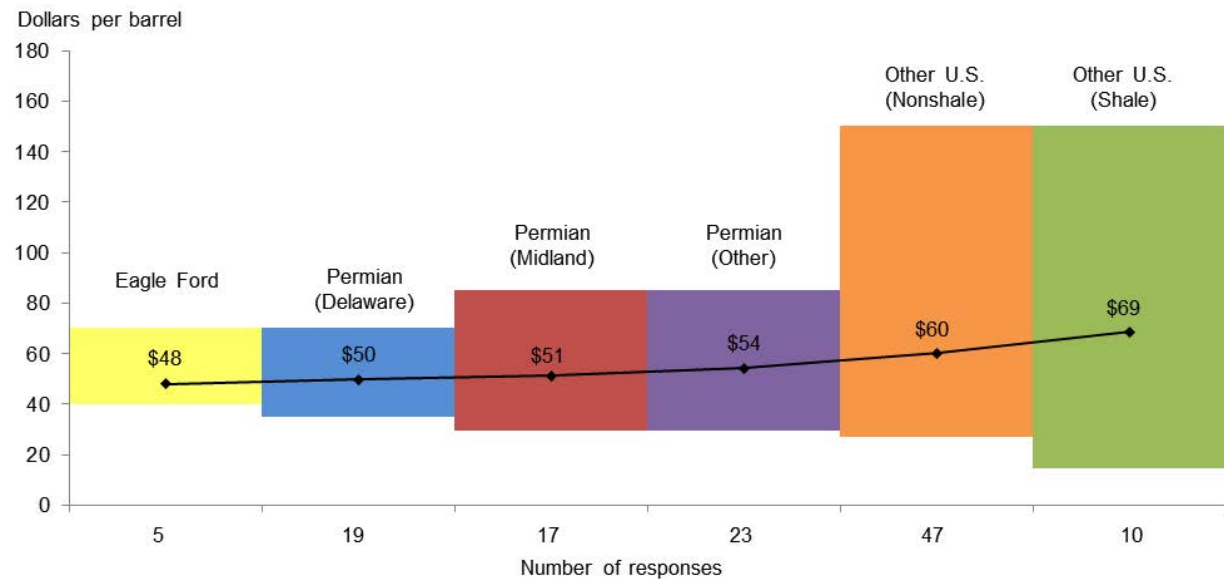
SOURCE: Federal Reserve Bank of Dallas.

Survey Says Eagle Ford Wells Among Most Economic (cont.)

Survey respondents indicated that the average WTI price needed to break even on existing Eagle Ford wells was \$23/bbl. This is below the average breakeven in the Permian (\$28-\$29) and other parts of the U.S. (\$30+). While the economic advantage diminishes somewhat with respect to drilling new wells, the Eagle Ford also had the lowest average breakeven for new development, with producers needing WTI at \$48/bbl to profitably drill new wells, besting the Permian (\$50-51) and other parts of the country (\$54-\$69).

The Eagle Ford's economic advantage comes from both its geology and geography. The basin's proximity to Gulf Coast refining and export markets gives it a leg up relative to more inland basins.

In the top two areas in which your firm is active: What WTI oil price does your firm need to profitably drill a new well?



NOTES: Lines show the average, and bars show the range of responses. Executives from 83 exploration and production firms answered this question during the survey collection period, March 9–17, 2022.

SOURCE: Federal Reserve Bank of Dallas.

Market Valuations & Transaction History

Transaction Activity Picks Over Past Four Quarters

Deal activity in the Eagle Ford increased over the past year as energy prices recovered from a tumultuous 2020. As we noted in **June of last year**, production in the Eagle Ford remained relatively flat over the prior year despite 146% growth in the regional rig count, suggesting the significant increase in drilling activity was just enough to offset the decline in already-producing wells, but not economical enough to meaningfully spur growth in production. This may also have signaled to potential buyers that the time was right to increase their footprint in southern Texas, while conversely providing an exit for sellers who could either capitalize on the prospect of continued upswing in energy prices or redeploy capital elsewhere. Whatever the exact incentives may have been that drove the M&A activity, the result was that 10 deals closed in the Eagle Ford over the past 4 quarters, up from 8 transactions closed in the 4 quarters prior to then.

A table detailing E&P transaction activity in the Eagle Ford over the last twelve months is shown below. The median deal value in the past 4 quarters (\$370 million) was approximately \$282 million higher than the **median deal value from Q2 2020 to Q1 2021**, excluding Chevron's acquisition of Noble Energy in July 2020. The average deal value over the past year (\$573 million) was more than double the average value (\$274 million) over the prior year (excluding the Chevron-Noble Energy deal). Also notable, larger positions were transacted over the past year, with a median size of 45,000 net acres as compared to 26,500 net acres in the prior year (excluding Chevron-Noble Energy), and an average deal acreage of nearly 80,000 net acres this past year which was more than double the average of 34,775 net acres in the prior year.

Announced Date	Buyer	Seller	Deal Value (\$MM)	\$ / Acre	\$ / Boe/d
3/7/2022	WildFire Energy	MD America Energy LLC	Undisclosed	nm	nm
1/12/2022	Desert Peak Minerals	Falcon Minerals	1,900	56,427	nm
11/22/2021	Paloma Partners Llc	Goodrich Petroleum Corp.	480	6,828	15,219
10/11/2021	Undisclosed Buyer	Callon Petroleum Co.	100	4,545	52,632
10/11/2021	SilverBow Resources	Undisclosed Seller	75	4,412	30,000
8/16/2021	SilverBow Resources	Undisclosed Seller	33	733	20,886
8/11/2021	Encap Investments	EP Energy Corp	1,500	5,474	18,657
7/12/2021	Penn Virginia Corp	Lonestar Resources Ltd.	370	6,981	28,462
7/9/2021	WildFire Energy	Hawkwood Energy Llc	650	4,063	43,333
6/14/2021	Earthstone Energy Inc.	Undisclosed Seller	48	nm	41,739
Median			\$370	\$5,010	\$29,231
Average			\$573	\$11,183	\$31,366

Source: Shale Experts and company filings.

Market Valuations & Transaction History (cont.)

On October 4, 2021, SilverBow Resources **announced** the closing of its purchase to acquire oil and gas assets in the Eagle Ford from an undisclosed seller in an all-stock transaction. The aggregate purchase price for these assets was \$33 million, with the transaction consisting of approximately 1.5 million shares of SilverBow's common stock. In late November 2021, SilverBow **announced** another transaction closed with its purchase of oil and gas assets from an undisclosed seller for \$75 million, including \$45 million in cash and approximately 1.35 million shares of SilverBow's common stock.

SilverBow Resources Builds Up its Eagle Ford Assets

Of this second transaction, Sean Woolverton, CEO of SilverBow, commented, "This is the third acquisition we have closed in the second half of this year. This transaction represents SilverBow's largest to date. As we look to 2022, the Company is set to grow production by double digits in part from the incremental development locations and a full year's worth of contribution from the acquired assets. With greater cash flow and liquidity, SilverBow remains well-positioned for strategic M&A and further de-levering.

Callon Petroleum Divests Non-Core Eagle Ford Assets

On October 5, 2021, Callon Petroleum – one of the upstream companies we follow regularly in our **quarterly review** of earnings call themes from E&P operators – announced it had entered into an agreement to sell non-core acreage in the Eagle Ford as part of its acquisition of leasehold interests and related oil, gas, and infrastructure assets in the Permian basin from Primexx Energy Partners. Total cash proceeds from the divestiture were approximately \$100 million. The Eagle Ford properties included approximately 22,000 net acres in northern LaSalle and Frio counties. Net daily production from the properties was approximately 1,900 Boe/d (66% oil) on average in the third quarter through month-end August. Callon noted in its press release that the sale would eliminate approximately \$50 million in capital expenditures related to continuous drilling obligations over the next two years, allowing for redeployment of capital to higher return projects.

Market Valuations & Transaction History (cont.)

Northern Oil and Gas, Inc. Acquires Non-Operated Appalachian Assets

On February 3, Northern Oil and Gas (NYSEAM:NOG) **agreed to acquire certain non-operated natural gas assets** in the Appalachian basin from Reliance Marcellus, LLC ("Reliance"), a subsidiary of Reliance Industries, Ltd., for a total consideration of \$175 million in cash and approximately 3.25 million warrants to purchase shares of NOG common stock at an exercise price of \$14.00 per share. The transaction was expected to be funded through a combination of equity and debt financings and anticipated to be leverage neutral on a trailing basis and leverage accretive on a forward basis. At the effective date of July 1, 2020, the acquired assets were producing approximately 120 MMcfe/d of natural gas equivalents, net to Northern Oil and Gas. The assets were expected to produce approximately 100,110 MMcfe/d (or approximately 19,000 Boe/d) in 2021, net to Northern Oil and Gas, and consisted of approximately 64,000 net acres containing approximately 102.2 net producing wells, 22.6 net wells in process, and 231.1 net undrilled locations in the core of the Marcellus and Utica plays.

Furthermore, an inventory of 94 gross highly-economic, work-in-progress ("WIP") wells were slated for completion over the following five years by EQT. As of the transaction announcement, approximately \$50 million of net development capital had already been deployed on the WIP wells, which was not subject to reimbursement by Northern Oil and Gas. The acquisition complemented Northern Oil and Gas's then-existing approximate 183,000 net acreage portfolio in the Williston and Permian basins. As of year-end 2020, the acquired assets held an estimated 493 Bcf of proved reserves, of which approximately 55% were comprised of PDP reserves, with PV-10 of \$269 million (at strip pricing as of January 20, 2021).

Nick O'Grady, Northern Oil and Gas's CEO, commented, "This transaction furthers our goal of becoming a national non-operated franchise with low leverage, strong free cash flow and a path towards returning capital to shareholders. With this transaction, we expect increased opportunities to efficiently allocate capital and diversify risk, our commodity mix and geographic footprint."

Appendix A

Selected Public Company Information

Mercer Capital tracks the performance of Exploration and Production companies across different mineral reserves in order to understand how the current pricing environment affects operators in each region. We created an index of seven groups to better understand performance trends across reserves and the industry. The current pricing multiples of each company in the index are summarized below.

pricing multiples of each company in the index are summarized below.

					as of 3/31/2022		
Company Name	Ticker	3/31/2022 Enterprise Value	YoY % Change in Stock Price	EBITDAX Margin	EV/ EBITDAX	Daily Production (mboe/d)	Price per Flowing Barrel*
Global Integrated							
Exxon Mobil Corp	XOM	\$402,985	47.9%	20.4%	7.1x	3,445	\$116,965
Shell PLC	SHEL	\$264,782	42.3%	20.9%	4.8x	3,067	\$86,332
Chevron Corp	CVX	\$347,190	55.4%	25.4%	8.8x	3,067	\$113,212
BP PLC	BP.	\$149,452	21.6%	19.0%	5.0x	2,820	\$52,991
Equinor ASA	EQNR	\$122,401	93.0%	49.4%	2.8x	2,104	\$58,168
Group Median			47.9%	20.9%	5.0x	3,067	\$86,332
Global E&P							
Marathon Oil Corporation	MRO	\$21,882	135.1%	67.0%	5.8x	347	\$63,056
Hess Corporation	HES	\$40,136	51.3%	54.9%	10.0x	337	\$119,038
ConocoPhillips	COP	\$143,615	88.8%	44.2%	7.0x	1,788	\$80,332
Occidental Petroleum Corporation	OXY	\$91,297	113.1%	56.2%	6.3x	1,157	\$78,875
APA Corporation	APA	\$23,381	130.9%	57.5%	5.1x	401	\$58,364
Murphy Oil Corporation	MUR	\$9,284	146.1%	60.6%	5.5x	171	\$54,435
Group Median			122.0%	56.9%	6.0x	374	\$70,965

Source: Bloomberg L.P.

- Price per Flowing Barrel is EV/daily production (\$/boe/d)
- We review 10-K's and annual reports from guideline companies to ensure companies continue to operate in the regions and groups we have identified.

Appendix A

Selected Public Company Information

as of 3/31/2022							
Company Name	Ticker	3/31/2022 Enterprise Value	YoY % Change in Stock Price	EBITDAX Margin	EV/ EBITDAX	Daily Production (mboe/d)	Price per Flowing Barrel*
Bakken							
Continental Resources, Inc.	CLR	\$29,254	137.1%	82.9%	6.5x	392	\$74,586
Whiting Petroleum Corporation	WLL	\$3,177	129.93%	37.4%	5.5x	93	\$33,987
Oasis Petroleum Inc.	OAS	\$3,263	146.34%	9.3%	23.5x	95	\$34,226
Group Median			137.1%	37.41%	6.5x	95	\$34,226
Appalachia							
Range Resources Corporation	RRC	\$10,719	194.1%	30.5%	9.7x	359	\$29,842
EQT Corporation	EQT	\$18,395	85.2%	11.6%	23.6x	925	\$19,892
Coterra Energy Inc	CTRA	\$9,598	43.6%	65.1%	10.2x	639	\$15,019
Antero Resources Corporation	AR	\$15,463	199.3%	39.3%	6.0x	533	\$29,018
Southwestern Energy Company	SWN	\$13,553	54.2%	13.6%	15.0x	761	\$17,804
Group Median			85.2%	30.5%	10.2x	639	\$19,892
Permian Basin							
Diamondback Energy, Inc.	FANG	\$31,528	86.5%	68.2%	7.2x	374	\$84,238
Centennial Resource Development, Inc.	CDEV	\$3,052	92.1%	53.9%	5.5x	65	\$47,079
Callon Petroleum Company	CPE	\$6,359	53.3%	44.0%	7.1x	105	\$60,580
Laredo Petroleum, Inc.	LPI	\$2,724	163.3%	36.5%	5.3x	83	\$32,902
Pioneer Natural Resources Company	PXD	\$64,523	57.4%	39.4%	9.2x	640	\$100,826
Group Median			86.5%	44.0%	7.1x	105	\$60,580
Eagle Ford							

Source: Bloomberg L.P.

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We review 10-K's and annual reports from guideline companies to ensure companies continue to operate in the regions and groups we have identified.

Appendix A

Selected Public Company Information

					as of 3/31/2022		
Company Name	Ticker	3/31/2022 Enterprise Value	YoY % Change in Stock Price	EBITDAX Margin	EV/ EBITDAX	Daily Production (mboe/d)	Price per Flowing Barrel*
EOG Resources, Inc.	EOG	\$70,494	64.4%	55.4%	6.4x	901	\$78,268
Magnolia Oil & Gas Corporation	MGY	\$4,719	106.0%	76.8%	5.7x	72	\$65,785
SilverBow Resources, Inc.	SBOW	\$920	311.3%	48.9%	4.6x	41	\$22,227
Ranger Oil Corporation	ROCC	\$1,660	157.7%	60.0%	5.0x	40	\$41,318
Group Median			131.8%	57.7%	5.4x	57	\$53,551
OVERALL MEDIAN			92.6%	46.6%	6.3x	396	\$58,266

Source: Bloomberg L.P.

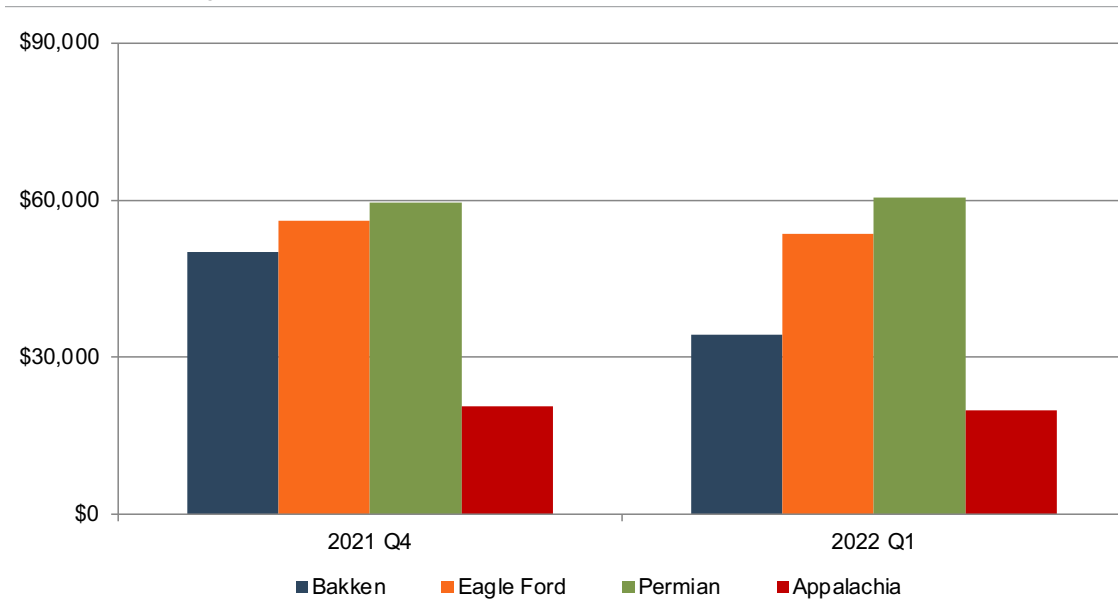
- Price per Flowing Barrel is EV/daily production (\$/boe/d)
- We review 10-K's and annual reports from guideline companies to ensure companies continue to operate in the regions and groups we have identified.

Appendix A

Selected Public Company Information

The following graph depicts the median of EV/production multiples, also known as price per flowing barrel, for Q1 2022, as compared to the median multiples for Q4 2021.

Price per Flowing Barrel



Source: Bloomberg

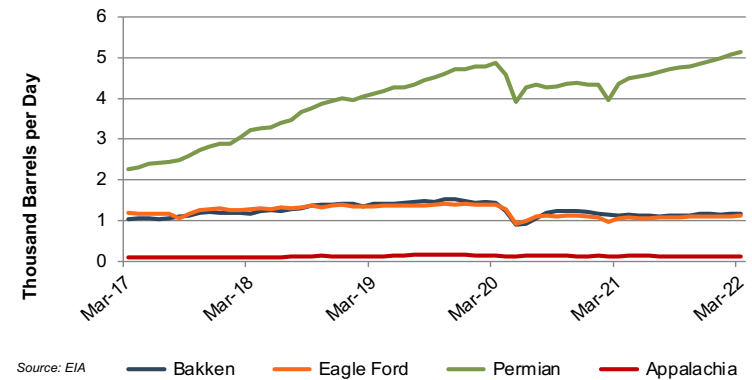
- Price per Flowing Barrel is EV/ daily production (\$/boe/d)
- This is simply a graphic depiction of median figures of our selected public companies for each region. This should be interpreted solely in the context of relative valuation between the various basins over time. Bloomberg aggregates this raw data, and Mercer Capital does not represent or warrant these figures as indicative of valuation multiples attributable to E&P companies or other interests.

Appendix B

Production

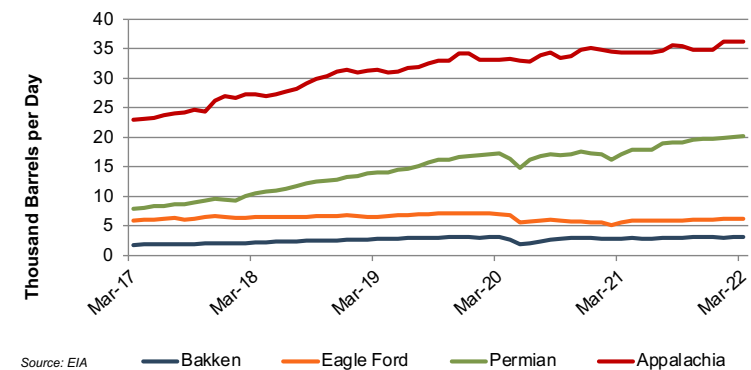
Daily Production of Crude Oil

Oil production in the Bakken, Eagle Ford, and Permian increased over the last year by 3.9%, 7.1%, and 17.7%, respectively. Appalachia, however, experienced a production decline of 11.0% year-over-year.



Daily Production of Natural Gas

Natural gas production in the Bakken, Eagle Ford, Permian, and Appalachia all increased over the last year 10.5%, 13.0%, 17.5%, and 5.8% respectively.



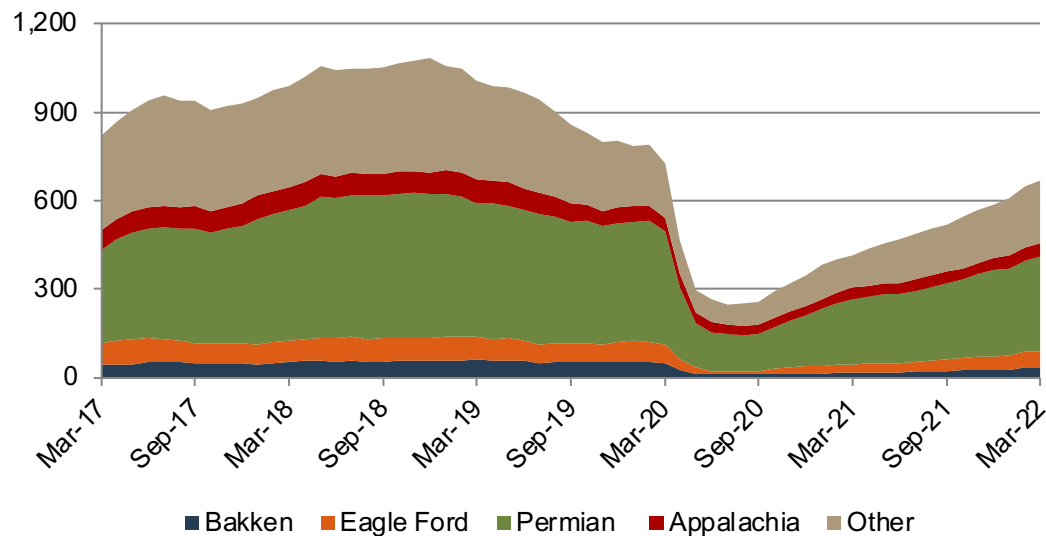
Appendix C

Rig Count

Baker Hughes collects and publishes information regarding active drilling rigs in the United States and internationally. The number of active rigs is a key indicator of demand for oilfield services & equipment. Factors influencing rig counts include energy prices, investment climate, technological changes, regulatory activity, weather, and seasonality.

The number of active rigs in the U.S. as of March 31, 2022 stood at 668, nearly 61% higher than the 416 count as of March 31, 2021, and 14.0% greater than the count in December 2021. The rig count in the Bakken increased more than twofold, from 14 to 33 rigs over the last year as energy prices increased.

Rig Count by Region

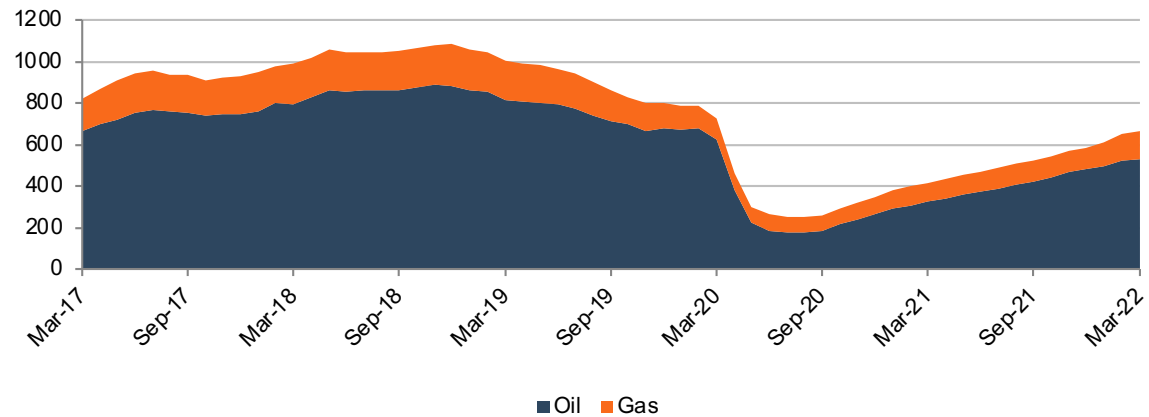


Source: Baker Hughes

Appendix C

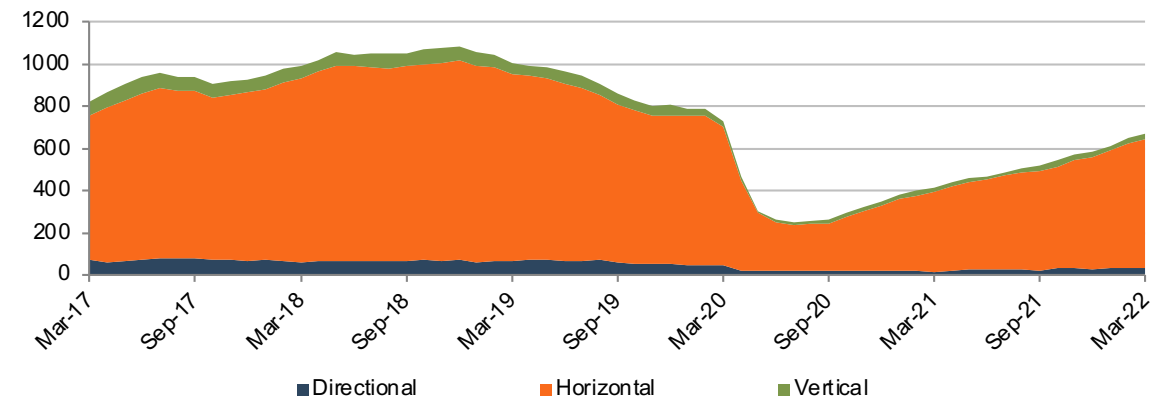
Rig Count

U.S. Rig Count by Oil vs. Natural Gas



Source: Baker Hughes

U.S. Rig Count by Trajectory



Source: Baker Hughes



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