MERCER CAPITAL

BUSINESS VALUATION &
FINANCIAL ADVISORY SERVICES

VALUE FOCUS

Exploration & Production

Third Quarter 2021 // Region Focus: Bakken

EXECUTIVE SUMMARY

Oil prices were relatively stable in Q3 2021 following a significant run-up in the first two quarters. Front-month futures prices for West Texas Intermediate (WTI) generally oscillated between $65/bbl and $75/bbl. Demand for crude oil was tempered due to the rise in Delta variant COVID-19 cases, which decreased travel activity. While there are signs that the E&P industry may be emerging from the relatively high volatility of the past year and a half, the trajectory of production growth is less clear. Henry Hub natural gas front-month futures prices began the quarter at approximately $3.63/mmbtu but broke above $5.00/mmbtu in September. Various factors may account for the run-up in natural gas prices in Q3, including increased demand for U.S. LNG exports, leading to some concern regarding further increases in gas prices as we approach winter.

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

Industry Segments

Mercer Capital serves the following industry segments:

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

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In This Issue

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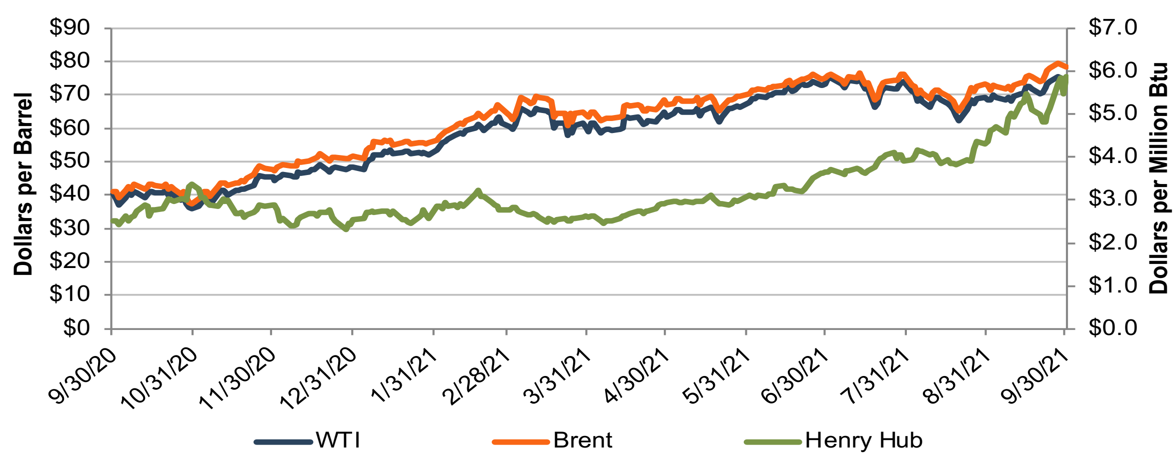
Oil and Gas Commodity Prices

After a significant run-up in the first two quarters of the year, oil prices were largely rangebound during the third quarter of 2021, with front-month futures prices for West Texas Intermediate (WTI) generally oscillating between $65/bbl and $75/bbl. Rising COVID-19 cases in the U.S. caused by the Delta variant put a damper on travel activity and associated fuel consumption. However, producers seem to be maintaining their **capital discipline** even in light of higher prices, which is limiting production growth. Henry Hub natural gas front-month futures prices began the quarter at approximately $3.63/mmbtu but broke above $5.00/mmbtu in September. The current run-up in natural gas prices has **some concerned** about what the winter may hold, when prices generally increase due to heating demand. In Europe, declining coal capacity and less-than-expected wind generation from North Sea wind turbines have contributed to **surging natural gas prices**, and the situation is beginning to impact industrial production.

However, the current commodity price environment may be short-lived. Commodity futures prices are in backwardation (meaning that current prices are higher than future prices), implying some near-term tightness that is expected to subside. This sentiment is echoed by the U.S. Energy Information Administration ("EIA"), which stated in their **September 2021 Short-term Energy Outlook** that "growth in production from OPEC+, U.S. tight oil, and other non-OPEC countries will outpace slowing growth in global oil consumption" and would likely lead to lower oil prices.

Crude Oil and Natural Gas Prices



Source: Bloomberg

Macro Update

Several themes came up in our review of **E&P operator Q3 earnings calls**, suggesting bluer skies for the industry, including increased demand for U.S. LNG exports to European and Asian (primarily Chinese) markets. Most E&P operators appear to have stabilized fairly well over the past several quarters to the point that management teams have returned to touting differentiated value prospects for their companies, in contrast to prior quarterly calls where capital discipline, deleveraging, and returning capital to shareholders were nearly universal mantras. For some operators, the value proposition translates to easing the austerity measures of the past year and a half by deploying more capital moving forward. Others are not as quick to restart an acquisition program or increase production on the property they hold but, rather, continue to convey their value by returning free cash flow back to shareholders. Reading the tea leaves, though, net oil and gas production growth among the public operators may be tepid. However, commentary from the management teams of the public companies in the past several quarterly earnings calls has indicated that private companies may be leaning heavily into the rising commodity price environment. It remains to be seen just how the current economic situation–including commodity price backwardation–may affect total U.S. oil and gas production.

As commodity prices have risen and profitability has returned, so have accusations of price gouging by oil and gas companies. Senator Warren recently said as much on MSNBC. She is wrong on this point, but certainly not alone by any means. Politicians have made oil companies a proverbial punching bag on numerous fronts. This is not news. They have been rhetorical targets for decades.

However, it is true that U.S. upstream producers (both oil and gas) have yet to momentously hasten new production and aggressive drilling plans. It would make sense if they did, as it speaks to the core incentives of commodity-based businesses like oil and gas. Yet the U.S. industry remains tentative and reticent. In the meantime, the market remains in backwardation marked by continuing inventory draws and increasing prices. Why? The answer is found somewhere among supply and demand dynamics, rising costs, and capital headwinds.

Macro Update
(cont.)

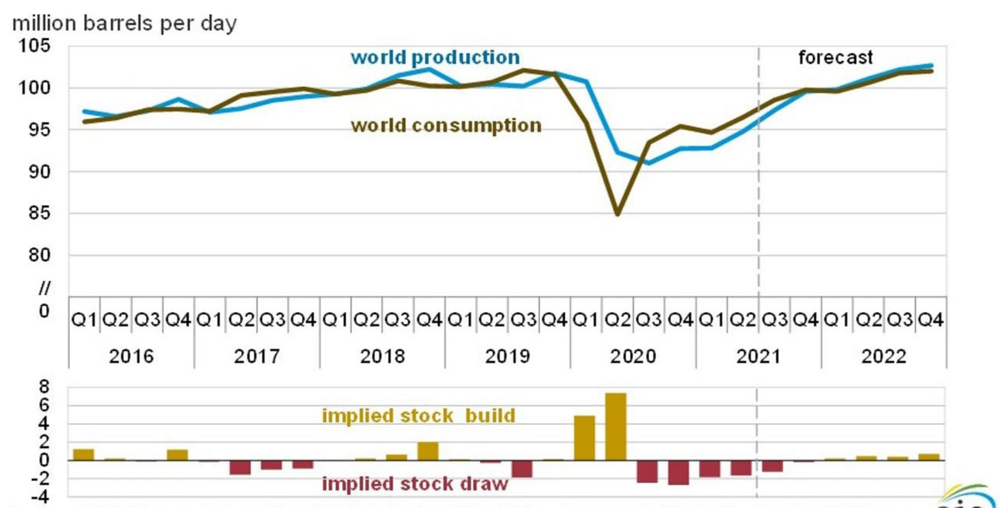
Supply & Demand Issues

"We are encouraged by the restraint shown by U.S. upstream operators. By restricting capital expenditure, we are healing historic overproduction of both oil and natural gas. We believe investors will be attracted back into the E&P space if, as an industry, we continue on this path for at least a year or two more to deleverage balance sheets and return capital to investors." – **Fed Survey** Respondent

It was a rough 2020, but producers have turned a corner on drilling discipline, and have restrained on the drill bit compared to years past. They also deleveraged balance sheets, and where possible, returned capital to shareholders. During 2021 traffic patterns have normalized, and apart from jet fuel, demand growth has bounced back to pre-pandemic levels. It is also creeping into winter and natural gas will be in season. That's good news.

Energy consumption is a bellwether for economic activity. However, that production discipline in both the U.S. and OPEC+ nations has resulted in crude oil inventories being 6% below the five-year average (2016-2020) overall, as consumption has exceeded production. This imbalance (with respect to liquid fuels) started in Q3 2020 and has continued since, and is helping to keep prices high, though perhaps not for too long. The **EIA** projects this to come back into balance around year-end 2021 to early 2022.

World Liquid Fuels Production and Consumption Balance



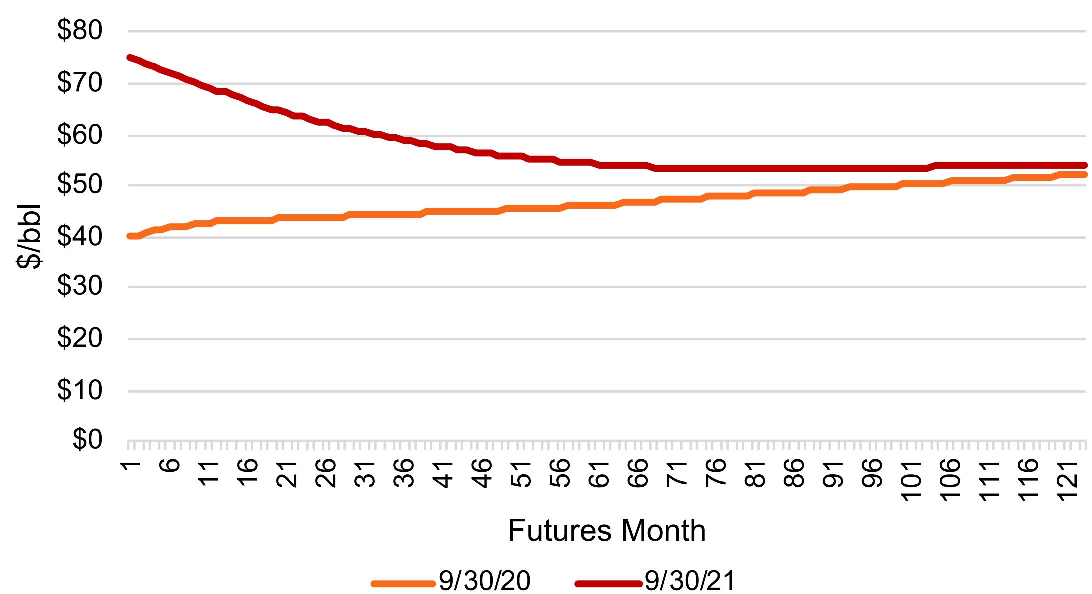
Source: U.S. Energy Information Administration, Short-Term Energy Outlook, September 2021

Macro Update (cont.)

Supply & Demand Issues

OPEC+ is slowly, but steadily adding production to the markets, while U.S. shale producers, although increasing activity, have been lagging this year. Futures markets suggest a similar outcome and prices are expected to steady according to NYMEX and EIA. As the futures curves tail out, the 60 month premium from a year ago is higher, but the near term spread is even wider, thus giving firms pause before diving in headlong with massive new production initiatives.

WTI Futures Prices



Source: S&P Capital IQ Pro

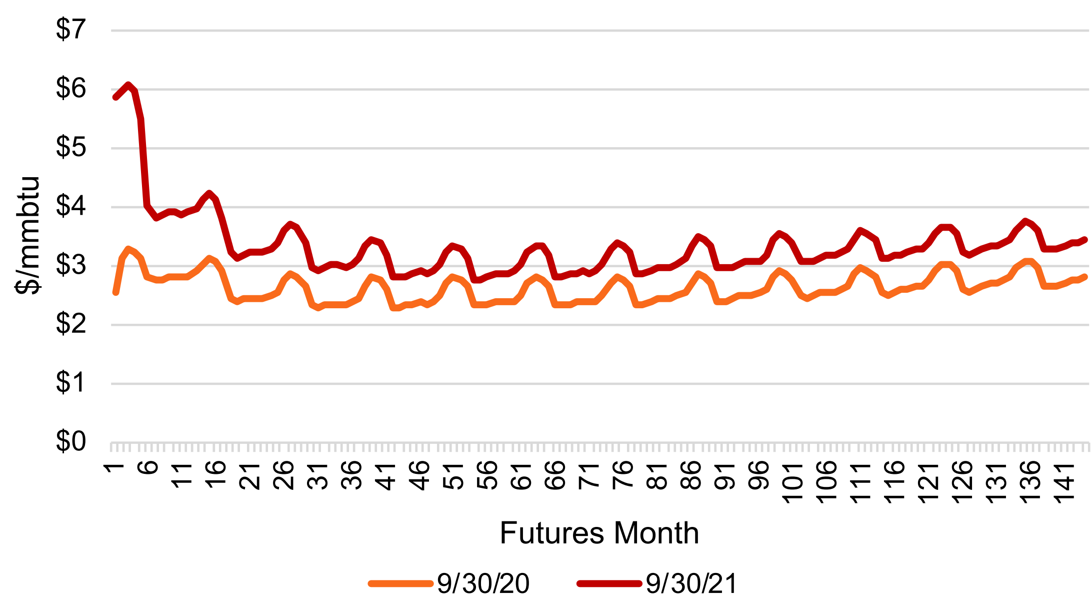
Macro Update (cont.)

Supply & Demand Issues

(Not all share this outlook – Bank of America sees oil at $120 by June 2022). Still, producers went through a lot to discipline themselves, and expectations by investors have been clear for years now: less drills more bills.

One other commodity that's in demand which should impact oil and gas supply as well is the U.S. dollar. The currency is strengthening, and this brings downward pressure on prices too.

Henry Hub Futures Prices



Source: Capital IQ

Macro Update (cont.)

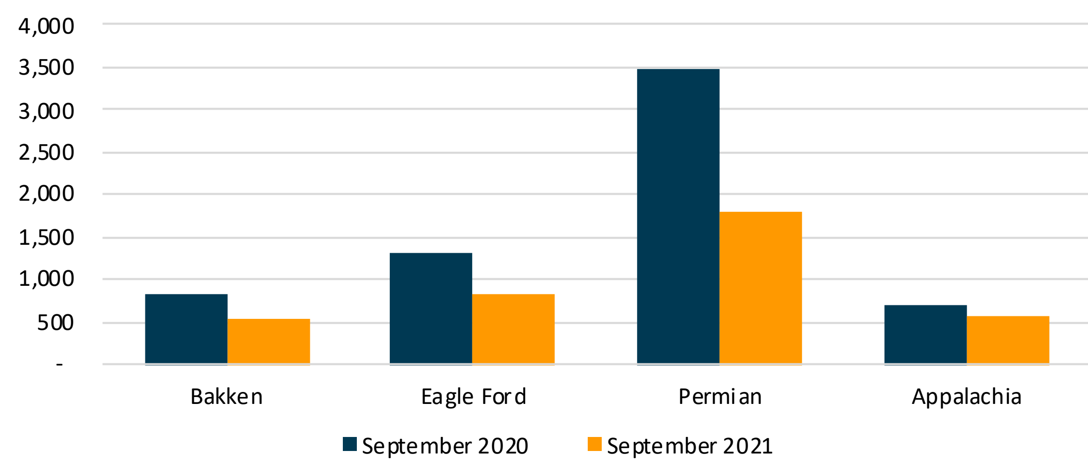
Costs

"Labor is causing major problems in staffing for the increase in activity. Wages are up 20 percent, and companies are poaching employees from competitors. We are finding it difficult to increase prices to match our increase in costs." – Fed Survey Respondent

As oil and gas prices are going up, inflationary pressures are impacting the industry's operations concurrently. The cost of oilfield services is rising quickly. Lease operating expenses are increasing. Delays are a problem as well, as 70% of the respondents to the latest **Dallas Fed survey** said they experienced delays of some sort in the last quarter. This is partially a result of tight labor markets and it's dampening enthusiasm somewhat.

Costs of development are going up **as drilled but uncompleted (DUC) well inventories shrink**. They have continued their downward march and are at the lowest levels in seven years (November 2014).

Drilled but Uncompleted Wells (DUCs)



Source: Energy Information Administration

Macro Update (cont.)

Investment Headwinds

This leads to another less heralded point as well. U.S. shale oil fields have been active for around a decade now. Many of the best drilling locations have been developed. Although there are a lot remaining, they haven't been drilled yet for a reason. Productivity per rig metrics have fallen slightly this year and it may have more to do with geology rather than technology making production growth more expensive and squeezing margins.

> *"Oil, natural gas and natural gas liquids prices are greatly improved and appear to be sustainable for the coming months. The greatest headwind is skilled labor supply and access to expanding credit on our reserve base loan. Initial conversations with regional energy banks show increasing interest in advancing incremental credit. The money center banks continue to seek to reduce their commitments to oil and gas borrowers."*
> – Fed Survey Respondent

Although economics have shifted quickly for producers this year, though investment sentiment not so much. Capital providers are not only cautious, but fewer in number. The multi-year souring on the oil and gas sector from several investment segments has not changed recently, leaving upstream producers with fewer options.

On the debt side, some regional banks have shown a willingness to lend, but larger banks have not. Some reasons for lending discomfort have included a wariness for shale's ability to ramp up quickly and for margins to evaporate before loans can be paid back. It's worth a remind that U.S. production has a higher cost floor than OPEC+. Larger banks appear not to be interested.

Additionally, the shrinking pool of bankers has been mirrored by a shrinking pool of investors. Firstly, returns must be carefully evaluated as many upstream producers have hedged their portfolios and some have limited their upsides to execute their strategies. They are watching profit margins go elsewhere for the time being. Also, as ESG concepts have gained momentum, many investors have weaned their appetite off oil and gas production. There are simply fewer institutional and private equity investors evaluating and participating in the space. According to a recent *Wall Street Journal* **article**, there are less than one-third the firms and capital available in the space compared to 2018. Simply put, it is harder for oil and gas producers to get expansion capital while they're simultaneously paying much of it out.

Talking heads and officials may be gaining political capital while talking about gouging, price controls and the like; but in a domestic industry populated with price takers and return oriented investors, prudence and temperance are driving decision making, not their ugly cousins – greed and avarice. Thank goodness for that.

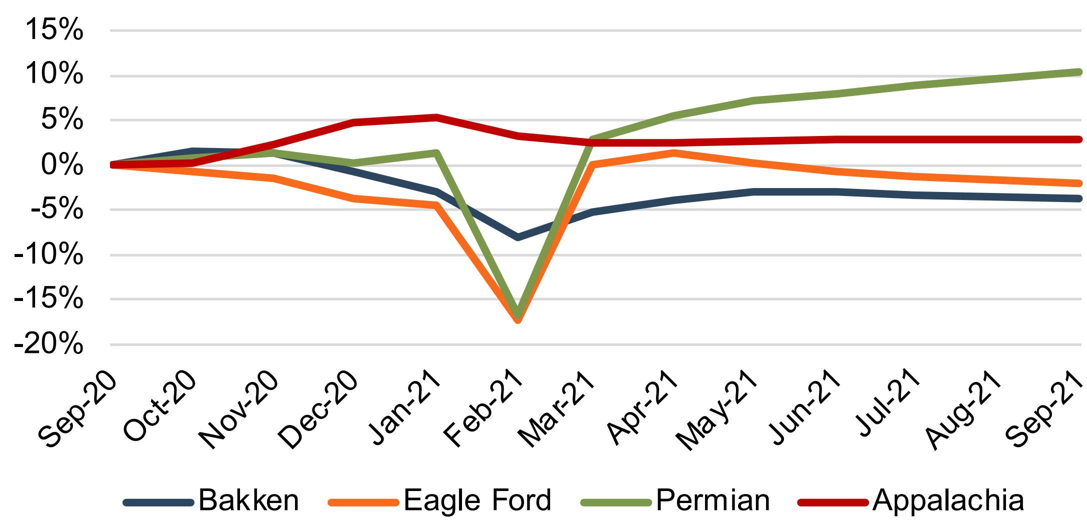
Region Focus: Bakken

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 Marcellus and Utica 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 Bakken.

Estimated Bakken production (on a barrels of oil equivalent, or "boe" basis) decreased approximately 4% year-over-year through September. Production in the Permian and Appalachia increased 10% and 3% year-over-year, respectively, while the Eagle Ford's production declined 2%. While production in the Bakken rebounded sharply once wells were brought back online after **curtailments in mid-2020**, it has generally trended lower during 2021. Production in the Eagle Ford and Permian was meaningfully impacted in February 2021, driven by Winter Storm Uri that disrupted power supplies throughout Texas.

1-Year Change in Production



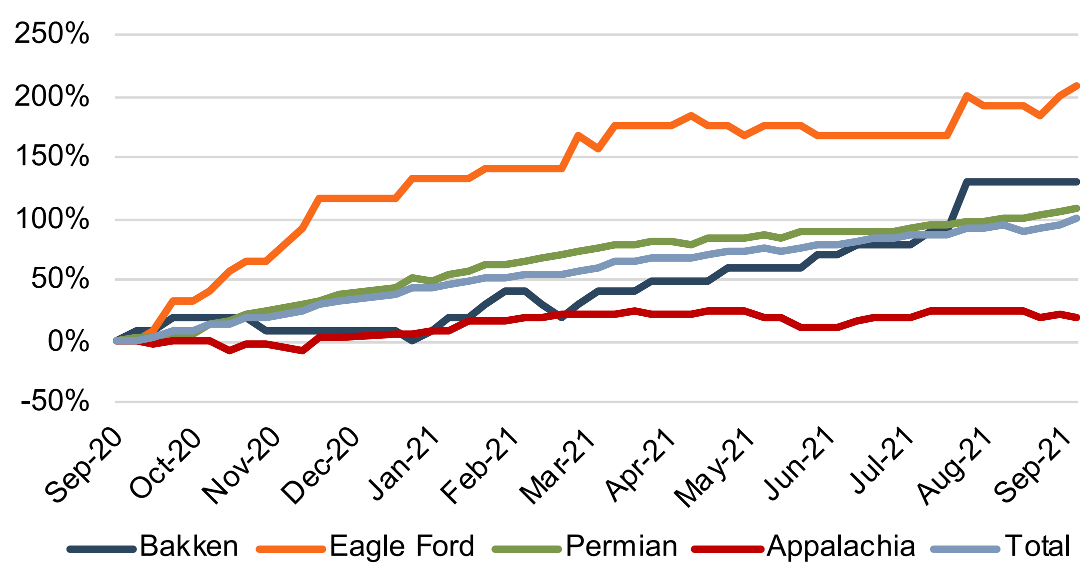
Source: Energy Information Administration

Production and Activity Levels (cont.)

There were 23 rigs in the Bakken as of month-end September 2021, up 130% from September 2020. Eagle Ford, Permian, and Appalachia rig counts were up 208%, 108%, and 19%, respectively, over the same period.

One may wonder why Bakken production has been on the decline given substantial rig count growth, while Permian production has continued to increase despite a more moderate 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 Bakken needs roughly 19 rigs running to offset existing production declines. That number for the Permian is approximately 200 rigs. The Bakken's rig count only recently broke above that maintenance level of drilling, whereas the Permian has had over 200 active drilling rigs since February 2021. Current activity in the Bakken should stem the recent production declines, but growth will likely be modest without additional rigs.

1-Year Change in Rig Count

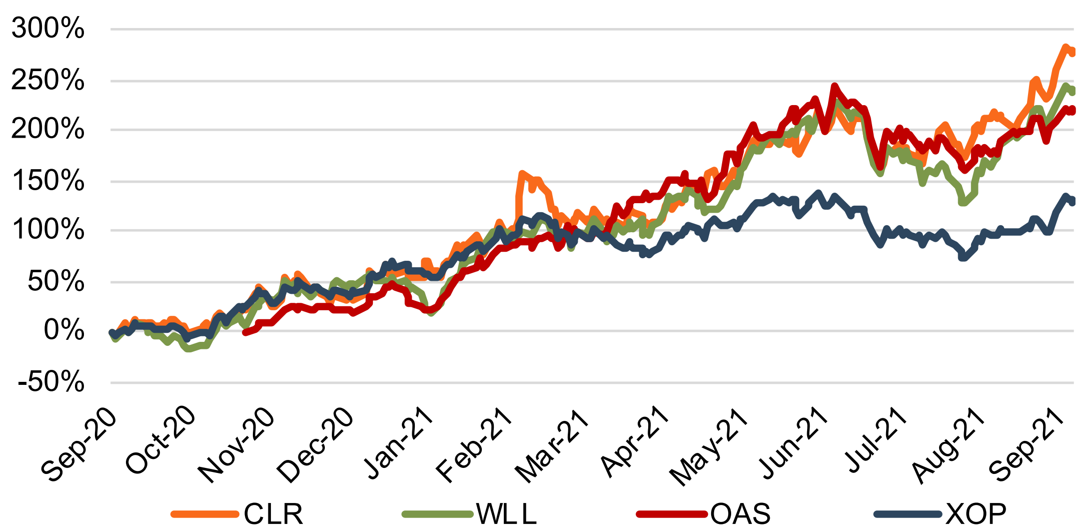


Source: Baker Hughes

Financial Performance

The Bakken public comp group saw strong stock price performance over the past year (through September 30th), with all constituents outperforming the broader E&P sector (as proxied by XOP). Continental and Whiting prices increased 276% and 238% year-over-year, compared to the XOP's increase of 130%. Oasis, which emerged from bankruptcy in November 2020, is up 221% from its initial closing price post-bankruptcy. However, this impressive stock price performance is probably more reflective of the dire straits of these companies last year. Both Whiting and Oasis declared bankruptcy in 2020 and appear to have benefited from a cleaned-up capital structure.

1-Year Change in Stock Price



Source: Capital IQ

Keystone XL Finally Cancelled

The Keystone XL pipeline, originally proposed in 2008, was finally cancelled by its developer, Canadian midstream company TC Energy. President Biden revoked a key permit needed for the project on his **first day in office**.

The proposed pipeline caused significant controversy during its planning stages as it provided takeaway capacity for production from Alberta oil sands (which is more energy intensive, and thus less sustainable, than other forms of hydrocarbon extraction) and its path through Nebraska's environmentally sensitive Sandhills region and Ogallala Aquifer. Keystone XL also would have provided additional pipeline capacity out of the Bakken, which could become very needed if the also-controversial Dakota Access Pipeline gets **shutdown**.

Market Valuations & Transaction History

Transaction Volume and Deal Size Rebound in 2021

Over the past year, deal activity in the Bakken has been steadily increasing after a challenging 2020. Eight of the nine deals referenced below occurred in the last eight months as the price environment has turned more favorable. As the industry seems optimistic that the worst of COVID-19 is behind, deal activity may continue to increase into next year, but there is always hesitation, especially with the Delta variant on the rise.

A table detailing E&P transaction activity in the Bakken over the last twelve months is shown below. Relative to **2019-2020**, deal count was unchanged, but median deal size increased by roughly $480 million, which was led by the $5.6 billion Devon-WPX transaction.

Transactions in the Bakken

Announced Date	Buyer	Seller	Deal Value ($MM)	$ / Acre	$ / Boepd
8/30/21	Undisclosed	Enerplus Corp.	$115	nm	$38,333
7/21/21	Whiting Petroleum Corp.	Undisclosed	$271	$30,964	$64,524
5/17/21	Ranger Energy Services	Patriot Well Solutions LLC	na	nm	nm
5/3/21	Oasis Petroleum Inc.	Diamondback Energy, Inc.	745	$7,842	$27,593
4/8/21	Enerplus Corp.	Hess Corp.	312	3,964	52,000
3/22/21	Oasis Midstream Partners LP	Oasis Petroleum Inc.	510	nm	nm
2/10/21	Grayson Mill Energy	Equinor	900	3,719	18,750
1/25/21	Enerplus Corp.	Bruin E&P Partners	465	3,079	19,375
9/28/20	Devon Energy Corp.	WPX Energy, Inc.	5,630	20,449	27,198
Median			**$488**	**$5,903**	**$27,593**
Average			**$1,119**	**$11,670**	**$35,396**

Source: Shale Experts

Market Valuations & Transaction History

Oasis Adds Strategic Acreage in Core Area

On May 3, 2021, Oasis Petroleum **announced** that it entered a definitive agreement to acquire select Williston Basin assets from Diamondback Energy in a cash transaction valued at approximately $745 million. The effective date of the acquisition will be April 1, 2021, and the deal has yet to officially close. The purchase consideration is expected to be financed by cash, revolver borrowings, and a bridge loan. Transaction highlights include:

- Production (2021 Q1) – 27 Mboe/d
- Acreage – 95,000 net acres in Dunn, McLean, McKenzie counties, ND
- 200 drilling locations
- Proved Reserves - 80.2 mmboe

A **pro forma table** of the transaction is shown below:

Willinston	Oasis	Acquisition	Pro Forma
Net Acres ('000s)	402	95	497
Held by Production	98%	99%	98%
Average Working Interest	73%	84%	76%
Oil Production (Mbbl/d)	31	18	49
Production (Mboe/d)	50	27	77
Company/Asset	**Oasis**	**Acquisition**	**Pro Forma**
Oil Production (Mbbl/d)	37	18	55
Production (Mboe/d)	57	27	84
2021 Q1 EBITDA ($mm)	$135	$62.5 - $67.5	$197.7 - $202.7
Annualized EBITDA ($mm)	$541	$250 - $270	$790.8 - $810.8
Net Debt ($mm)	($106)	$745	$639
Pro Forma Leverage			0.8x

Source: Oasis News Release dated May 3, 2021

Diamondback has built a reputation of being focused on the Permian Basin, but in late 2020, the **company acquired** QEP Resources which gave them exposure to Williston acreage. It took them roughly six months to sell their Bakken acreage package to Oasis, returning them to their pure-play Permian status.

Market Valuations & Transaction History

Equinor Lets Go of its Bakken Position

On February 10, 2021, Equinor **announced** that it was selling its Bakken asset portfolio to Grayson Mill Energy for $900 million. Grayson Mill Energy is a Houston-based exploration and production company backed by Encap Investments, a private equity firm that has raised over $38 billion of capital. An **exit from the Bakken**, which Equinor entered in 2011 by acquiring Brigham Exploration Company for $4.7 billion, follows the sale of its operated assets in the Eagle Ford for $325 million to Repsol in November 2019. The deal **closed** on April 27, 2021 and included the following:

- 242,000 net acres, and associated midstream assets
- 48,000 Boep/d as of Q4 2020

In parallel with the transaction, Equinor Marketing and Trading entered into a term purchase agreement for crude offtake with Grayson Mill Energy. Al Cook, Equinor's executive vice president of Development & Production, **referenced** that the company is focused on improving the profitability of its international portfolio.

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 as of 9/30/2021		
Company Name	**Ticker**	**9/30/2021 Enterprise Value**	**YoY % Change in Stock Price**	**EBITDAX Margin**	**EV/ EBITDAX**	**Daily Production (mboe/d)**	**Price per Flowing Barrel***
Global Integrated Oil and Gas Companies							
Exxon Mobil Corp	XOM	$307,772	71.3%	17.7%	7.2x	3,670	$83,856
Royal Dutch Shell PLC	RDS/A	$60,611	77.1%	18.5%	1.5x	3,283	$18,462
Chevron Corp	CVX	$228,370	40.9%	24.6%	6.9x	3,118	$73,248
BP PLC	BP	$123,872	51.1%	11.7%	5.1x	2,922	$42,387
Equinor ASA	EQNR	$729,588	71.3%	41.1%	25.9x	1,968	$370,655
Group Median			**71.3%**	**18.5%**	**6.9x**	**3,118**	**$73,248**
Global E&P Companies							
Marathon Oil Corporation	MRO	$14,427	234.2%	57.5%	5.3x	345	$41,823
Hess Corporation	HES	$31,477	90.8%	55.9%	8.8x	308	$102,235
ConocoPhillips	COP	$98,491	106.4%	42.2%	6.3x	1,549	$63,569
Occidental Petroleum Corporation	OXY	$68,600	195.5%	53.1%	5.8x	1,157	$59,285
APA Corporation	APA	$16,919	126.3%	57.4%	4.2x	359	$47,071
Murphy Oil Corporation	MUR	$7,068	179.9%	56.6%	5.0x	167	$42,418
Group Median			**153.1%**	**56.2%**	**5.6x**	**352**	**$53,178**

Source: Bloomberg L.P.

- Price per Flowing Barrel is EV/ daily production ($/boe/d)
- Companies included in the Guideline Group are not meant to be an exhaustive list. The selected companies' market caps exceed $1 billion and/or revenues exceed $500 million.
- 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

Company Name	Ticker	9/30/2021 Enterprise Value	YoY % Change in Stock Price	EBITDAX Margin	Pricing as of 9/30/2021 EV/ EBITDAX	Pricing as of 9/30/2021 Daily Production (mboe/d)	Pricing as of 9/30/2021 Price per Flowing Barrel*
Bakken							
Continental Resources, Inc.	CLR	$21,123	275.8%	78.9%	5.9x	286	$73,782
Whiting Petroleum Corporation	WLL	$2,364	237.83%	23.0%	8.1x	89	$26,674
Oasis Petroleum Inc.	OAS	$2,767	nm	8.0%	25.6x	60	$46,059
Group Median			**256.8%**	**23.00%**	**8.1x**	**89**	**$46,059**
Appalachia							
Range Resources Corporation	RRC	$8,380	241.8%	8.4%	35.0x	358	$23,439
EQT Corporation	EQT	$13,912	58.2%	-36.7%	-7.9x	836	$16,649
Coterra Energy Inc	CTRA	$9,598	174.0%	0.3%	1742.8x	361	$26,554
Antero Resources Corporation	AR	$11,500	584.0%	28.6%	7.2x	554	$20,754
Southwestern Energy Company	SWN	$9,996	135.7%	-30.1%	-7.4x	555	$18,001
Group Median			**174.0%**	**0.3%**	**7.2x**	**554**	**$20,754**

Source: Bloomberg L.P.

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Selected Public Company Information

Company Name	Ticker	9/30/2021 Enterprise Value	YoY % Change in Stock Price	EBITDAX Margin	EV/ EBITDAX	Daily Production (mboe/d)	Price per Flowing Barrel*
					Pricing as of 9/30/2021		
Permian Basin							
Diamondback Energy, Inc.	FANG	$24,591	214.3%	57.5%	8.1x	352	$69,940
Centennial Resource Development, Inc.	CDEV	$2,890	1012.2%	47.5%	7.1x	61	$47,749
Callon Petroleum Company	CPE	$5,078	918.3%	27.3%	11.3x	82	$62,141
Laredo Petroleum, Inc.	LPI	$2,595	727.2%	10.4%	22.5x	80	$32,345
Pioneer Natural Resources Company	PXD	$47,161	93.6%	31.1%	10.6x	616	$76,543
Cimarex Energy Co.	XEC	$1,116	11.3%	nm	nm	257	$4,337
Group Median			**470.8%**	**31.1%**	**10.6x**	**169**	**$54,945**
Eagle Ford							
EOG Resources, Inc.	EOG	$50,710	123.3%	50.9%	5.6x	773	$65,572
Magnolia Oil & Gas Corporation	MGY	$3,196	244.1%	137.2%	2.9x	66	$48,656
SilverBow Resources, Inc.	SBOW	$678	523.4%	25.1%	9.3x	32	$21,536
Penn Virginia Corporation	PVAC	$970	nm	48.5%	5.0x	27	$35,432
Group Median			**244.1%**	**49.7%**	**5.3x**	**49**	**$42,044**
OVERALL MEDIAN			**174.0%**	**29.8%**	**7.0x**	**358**	**$46,059**

Source: Bloomberg L.P.

- Price per Flowing Barrel is EV/ daily production ($/boe/d)
- Companies included in the Guideline Group are not meant to be an exhaustive list. The selected companies' market caps exceed $1 billion and/or revenues exceed $500 million.
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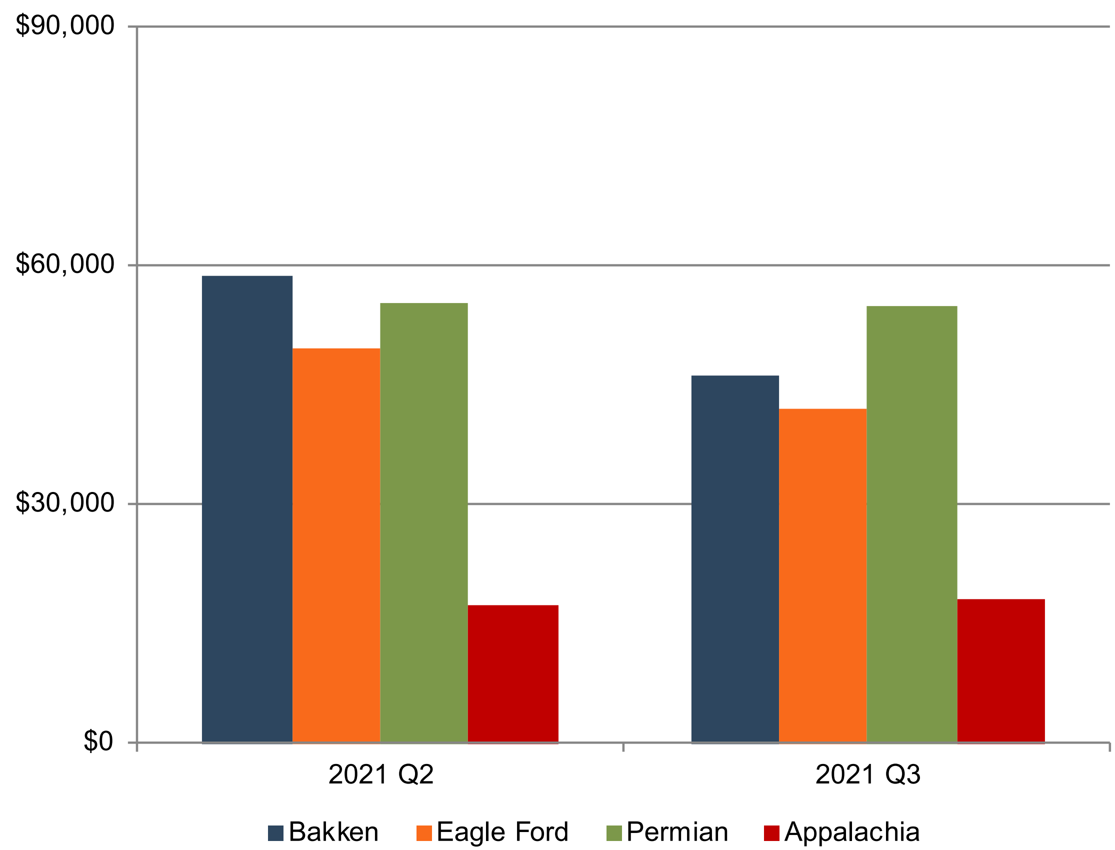
Appendix A

Selected Public Company Information

The following graph depicts the median of EV/production multiples, also known as price per flowing barrel, for Q3 2021, as compared to the median multiples for Q2.

Price per Flowing Barrel



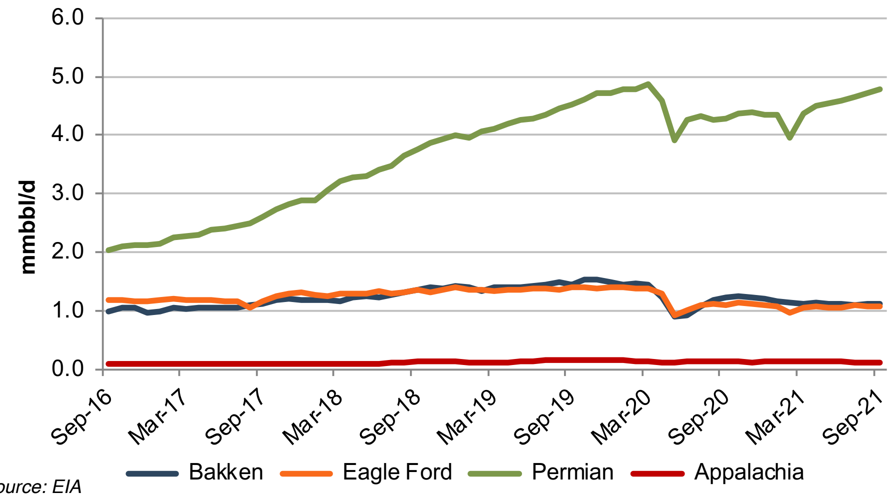
- This is simply a graphic depiction of median figures of our selected public companies for each region. This should be interpreted solely in the context of relative valuation between the various basins over time. Bloomberg aggregates this raw data, and Mercer Capital does not represent or warrant these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

Appendix B

Production

Daily Production of Crude Oil

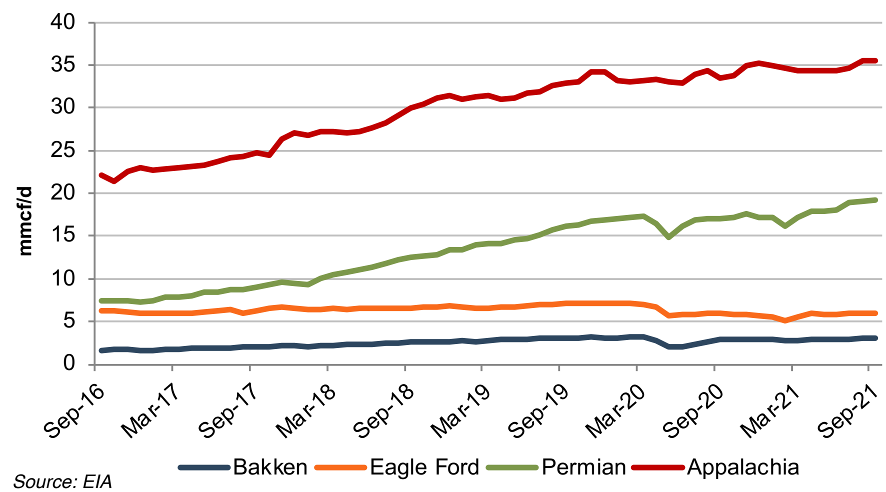
Oil production in the Bakken, Eagle Ford, and Appalachia declined over the last year by 8.9%, 2.6%, and 12.6%, respectively. The Permian, however, experienced significant production growth of 11.4% year-over-year.



Source: EIA

Daily Production of Natural Gas

Natural gas production in the Bakken, Permian, and Appalachia all increased over the last year 5.1%, 12.4%, and 6.4%, respectively. Natural gas production in the Eagle Ford was essentially flat, with growth of just 0.2%, year-over-year.



Source: EIA

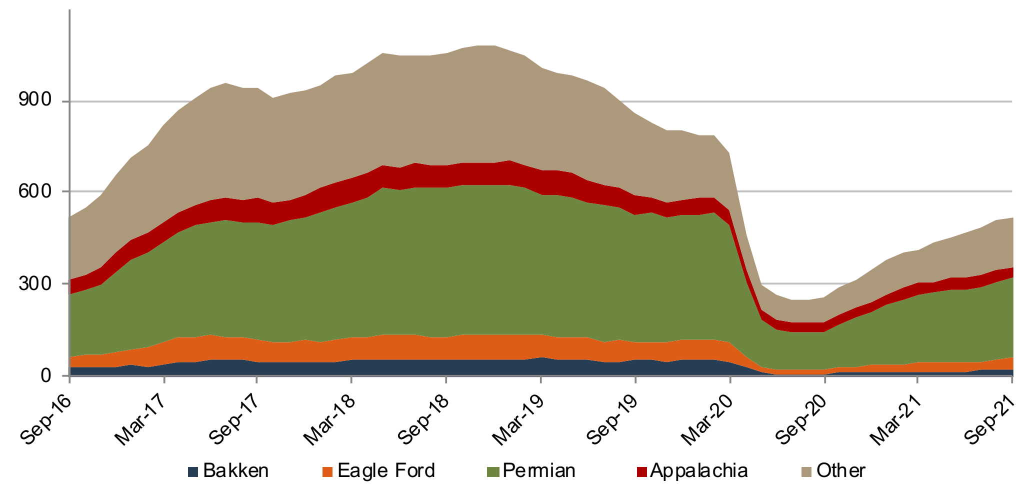
Appendix B

Rig Count

Baker Hughes collects and publishes information regarding active drilling rigs in the U.S. 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 United States as of September 30, 2021 stood at 520, slightly more than double the 258 count as of September 30, 2020, and 10.6% greater than the count in June 2021. The rig count in the Bakken increased from 10 to 23 rigs over the last year as energy prices increased.

Rig Count by Region

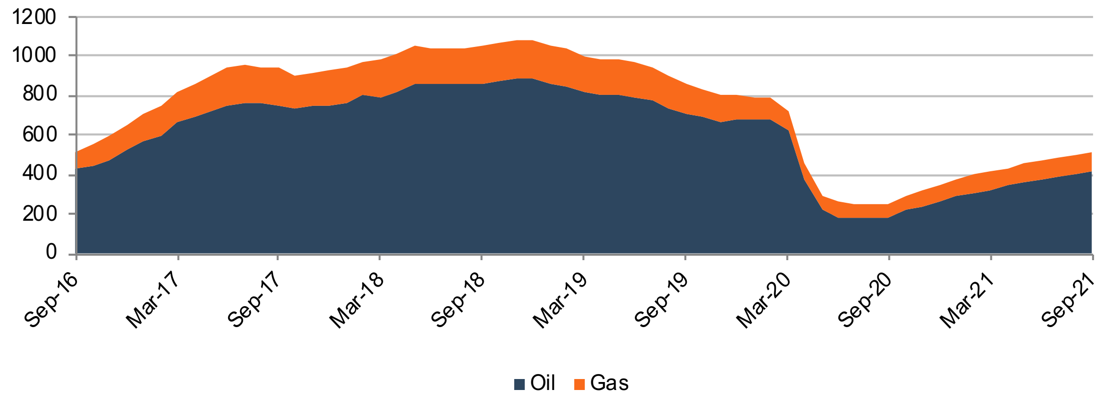


Source: Baker Hughes

Appendix B

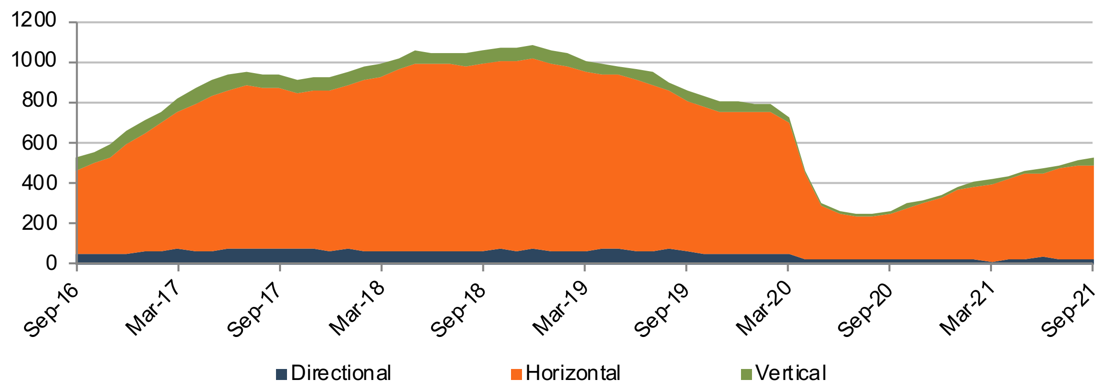
Rig Count

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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