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PLS TD Report: Analysts see a reawakening in natural gas markets

Gas producers' 2017 guidance reflects cautious optimism after long, slow decline in activity and investment over the past two years. Despite record Permian M&A mostly tilted to oil, some analysts see some shifts in the market to natural gas.

Let's look at some transformative trends:

- Gas producers are raising investment by an average 43%, but total is only half of 2014 spending
- Rigs: After plunging from nearly 1,000 in 2010 to 82 in June 2016, the gas rig count has increased by 73% to 142 last month.
- Gas reawakening is broad-based, with rig counts rising by 14, in the Marcellus, 12 in the Utica, 13 in the Haynesville.
- Gas-weighted M&A transaction value rebounded to $18.1 B in 2016 from a historic low of $7.1 B in 2015 including transformative deals in the Marcellus and Haynesville.

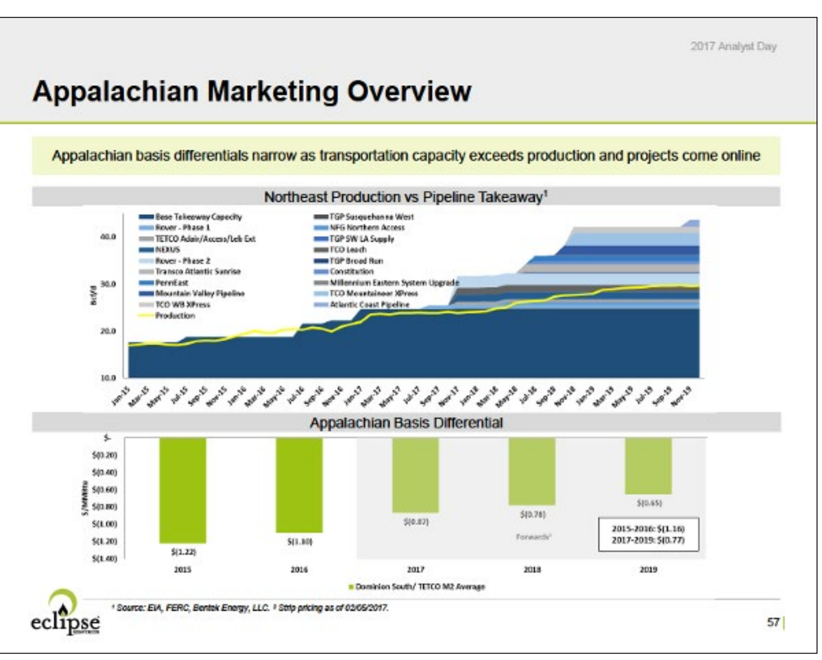
Price stability, growing petrochemical and export markets could transform investor attitudes toward gassy E&Ps.

- Investors have turned away from gas producers in favor of oily peers, with equity valuations for gas-weighted E&Ps ($7.36 enterprise value/boe) hovering well below the industry average of $13.00/boe and far lower than the $25-$60/boe value of Permian producers.
- With prices staying above $2.50/MMBtu since June 2016, gas producer investment is setting up for significant output gains in 2018 and beyond to feed pipelines to the Mexican market, LNG/NGL exports and rising petrochemical/power generation demand.
- Surging production and higher profits should narrow valuation gap with oil producers.
- Despite some write-downs in the Rockies (Exxon), the mood in the Dallas/Houston/San Antonio triangle is talkative about the Barnett, Haynesville, Cotton Valley and traditional Gulf Coast exploration.

Obviously we will learn more after NAPE about the state of natural gas E&P and M&A, but for now here are seven slides that paint a developing positive for natural gas.

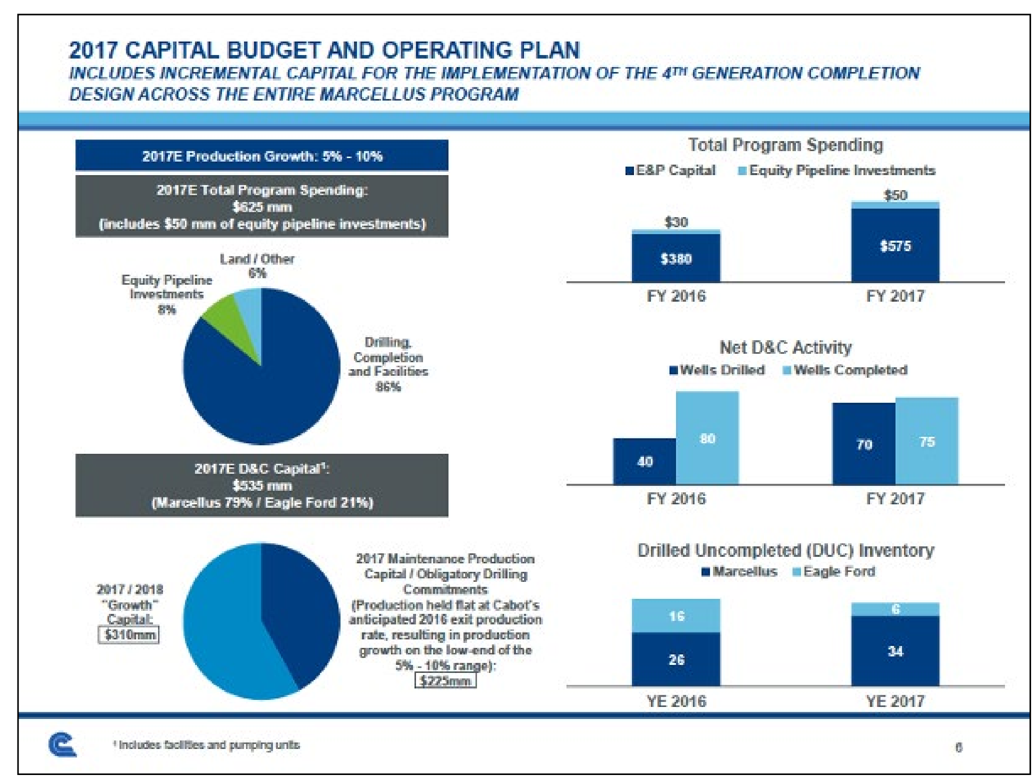
<u>Driving more gas investments are improving differentials back East:</u>

- In 2015 Marcellus gas got $1.22 discount to HH and just a year ago was less than $1 at the wellhead. New takeaways are steadily improving differentials which are narrowing to just 87 cents this year. In early January, Tallgrass' REX Zone 3 Project increased takeaway by 800 MMcf/d. It appears the supply/takeaway is closer in balance and this in turn is spurring the reawakening.



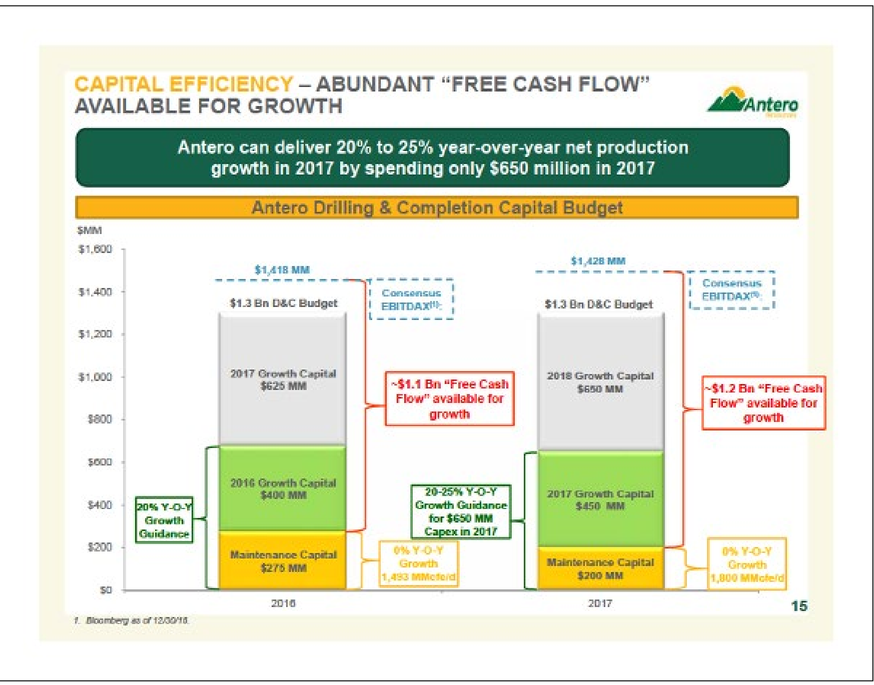
<u>Cabot's 2017 capital spending program sets up for 2018 production growth</u>

- Cabot plans to increase capital spending by 50% to $535 MM in 2017 after a drastic 76% decline between 2014 and 2016. Cabot is allocating 80% of its capital outlays to the Marcellus and 20% to the Eagle Ford. Of its half a billion plus capex, $225 MM is required to keep production flat. The balance is for growth, which will result in 5%-10% output growth in 2017. The company is awaiting the completion of additional Marcellus takeaway capacity to further ramp up investment to meet a 15-25% production growth forecast for 2018.



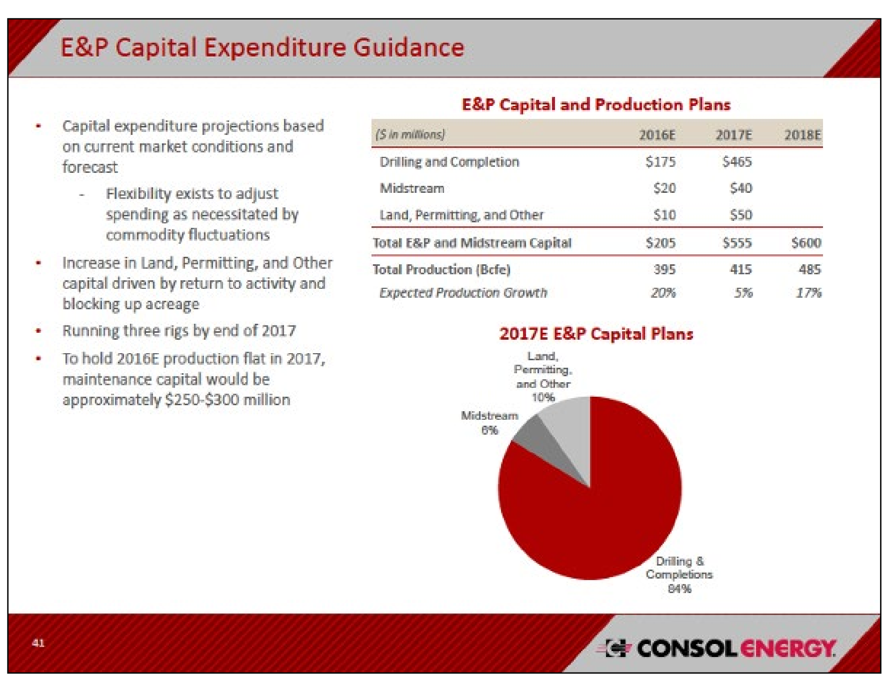
Despite flat capex, Antero expects strong production gains in 2017

- Antero Resources, which cut capital spending by just 20% from 2015-2016 and has maintained the highest investment level in Appalachia, is keeping 2017 drilling and completion spending flat at $1.3 B in 2017. As a result, it is funding investment entirely with cash flow. About 15% of the 2017 capital budget will be for maintenance capital. Another 50% of the capital budget is earmarked for 20-25% production growth in 2017. The remaining $450 MM will be for growth projects supporting 2018 production.



Consol to develop its massive acreage position after dissolving Noble Energy JV

- Consol slashed capital spending from $762 MM in 2014 to just $175 MM in 2016, the most drastic cut of any gas producer. Consol dissolved its CONE joint venture with Noble Energy and is now free to set its own development timetable. And that it will. Consol is now more than doubling capex to $465 MM in 2017 where it will invest $250 MM on the dry gas Utica Shale and another $180 MM on the Marcellus. Consol is shooting for 5% production growth this year and 17% in 2018.



($ in millions)	2016E	2017E	2018E
Drilling and Completion	$175	$465	
Midstream	$20	$40	
Land, Permitting, and Other	$10	$50	
Total E&P and Midstream Capital	$205	$555	$600
Total Production (Bcfe)	395	415	485
Expected Production Growth	*20%*	*5%*	*17%*

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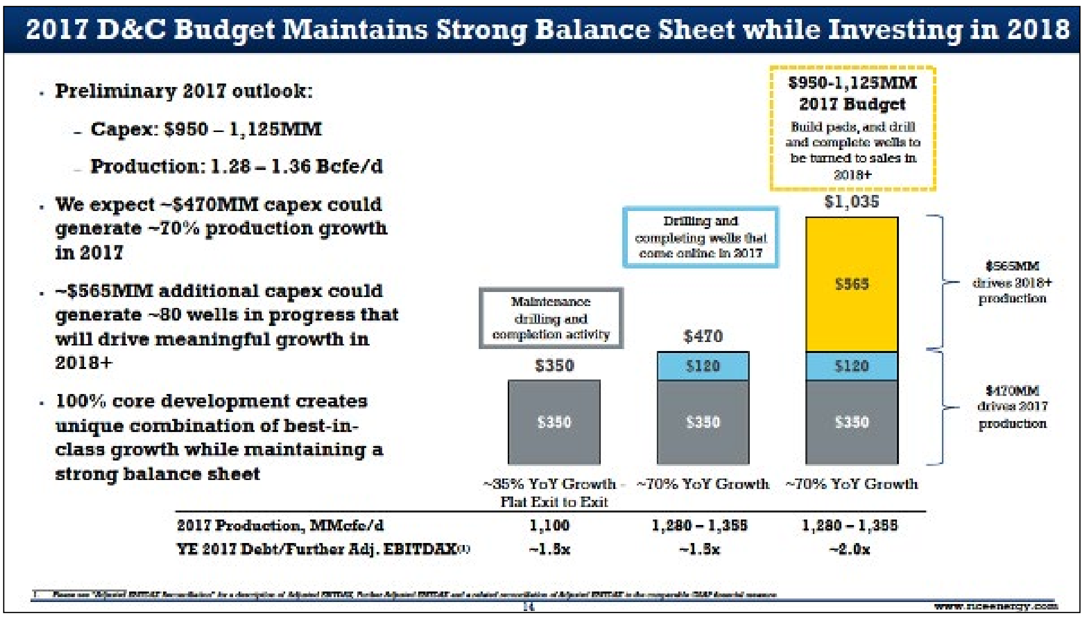
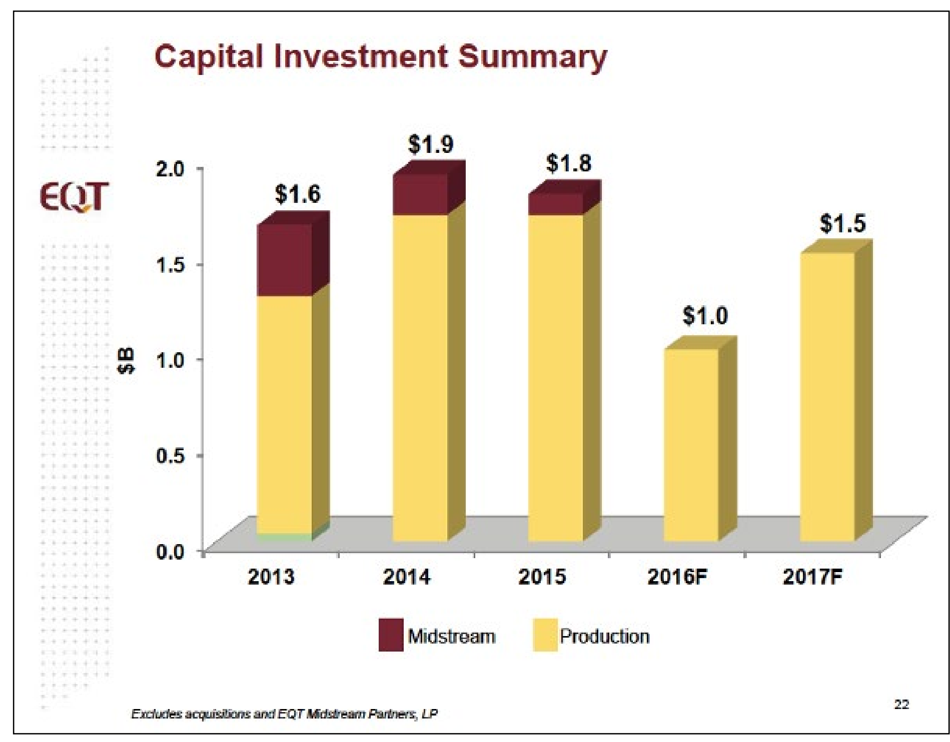


EQT boosting capital spending in 2017 for production growth starting in 2018

– EQT is increasing investment to $1.5 B in 2017, a 50% increase over 2016 after the company made over $1 B in acreage acquisitions in 2016. Although EQT's focus is the Marcellus, where it plans 119 wells at a cost of about $6 MM per well, it will also be testing the deeper dry gas Utica that underlies its acreage. It is planning seven Utica Shale wells at a cost of $12-$13 MM per well. The capital spending program will produce a 9% production gain in 2017, but the company expects that to increase to 15-20% production growth starting in 2018.



Southwestern Energy targeting Appalachia growth to offset Fayetteville production declines

- Southwestern began 2016 by slashing capital spending by 92% as it struggled with debt repayment and plunging cash flows. But after a $2.4 B equity offering that bolstered its balance sheet in mid-year, it raised its capital budget from $125 mm to $505 mm to resume drilling with five rigs, four in Appalachia and one in the Fayetteville. Southwestern is continuing that drilling program in 2017, which the company estimates will consume $475 MM, 5% below the 2016 level. This investment is expected to keep production flat, with 10% growth from the Marcellus offsetting declines in the Fayetteville Shale.

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