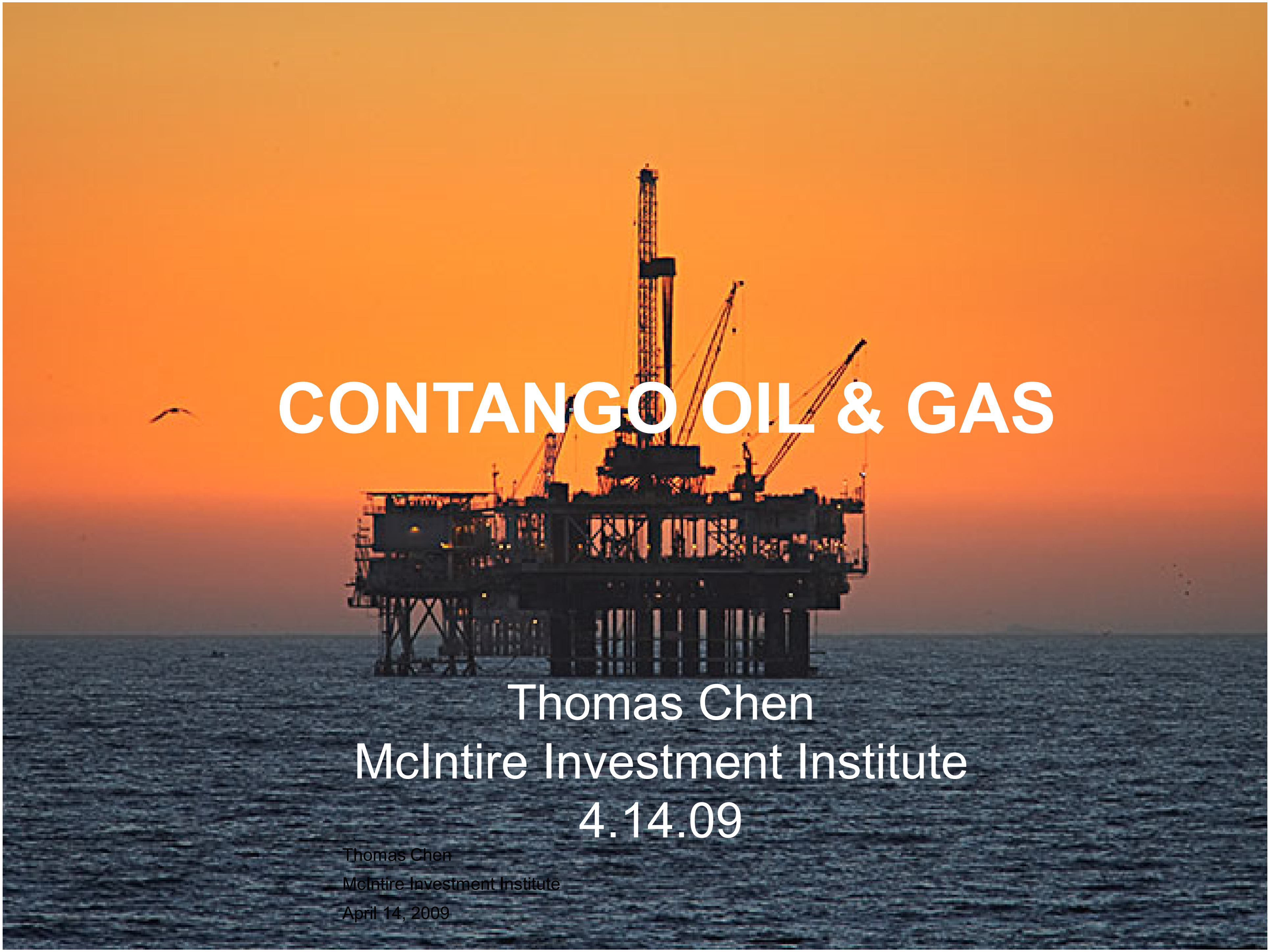


CONTANGO OIL & GAS

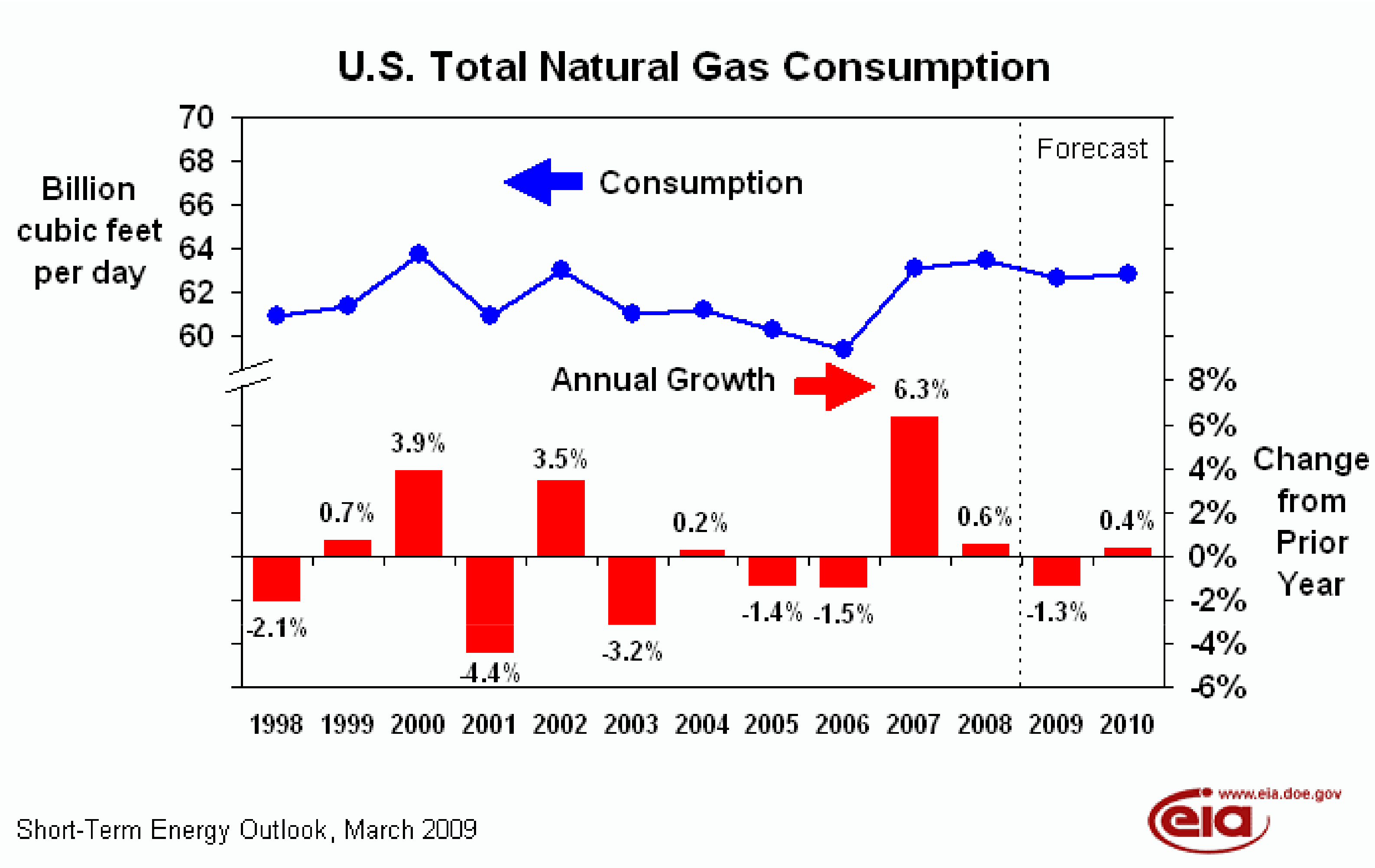
Thomas Chen
McIntire Investment Institute

4.14.09

Thomas Chen
McIntire Investment Institute
April 14, 2009

Outline

- Macro Factors
  - Short-term
  - Long-term
- Company structure
- Valuations
- Risks



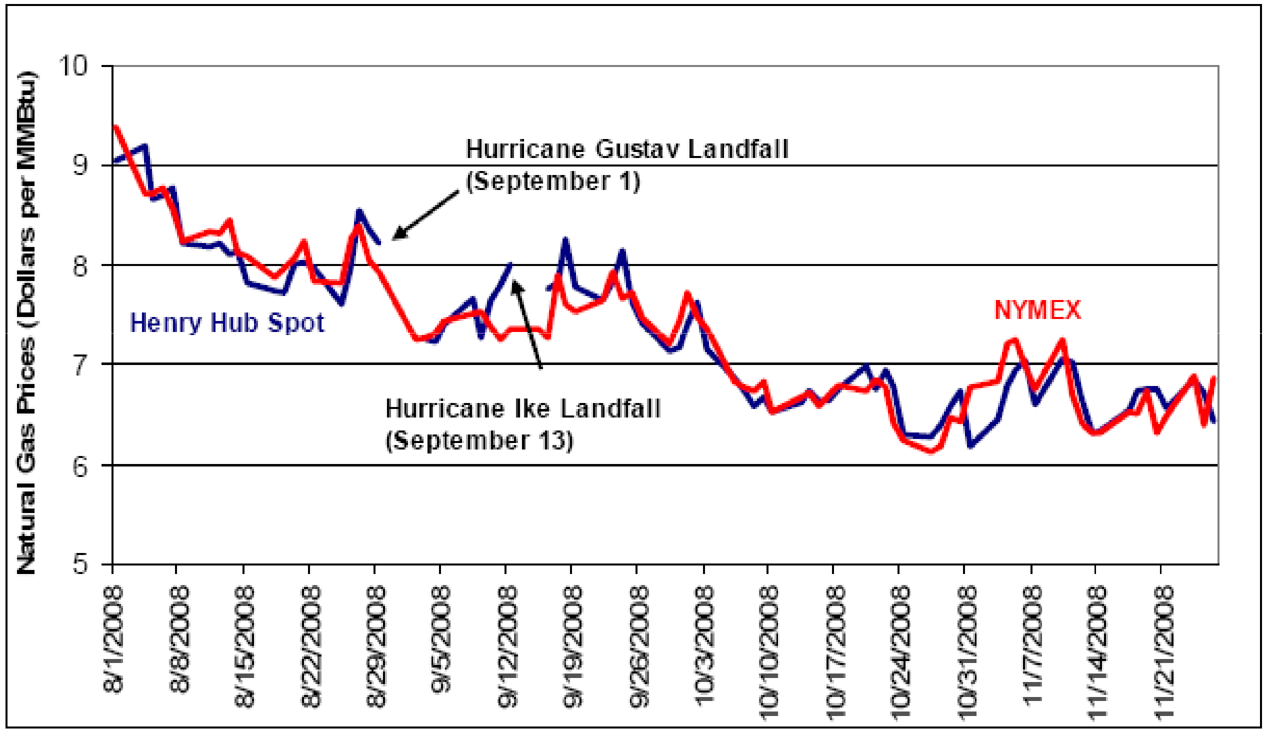
Total natural gas **consumption** is projected to **decline by 1.3** percent in 2009 and then **increase by 0.4** percent in 2010

Total U.S. marketed natural gas **production** is expected to **remain flat in 2009** and then **fall by 0.8 percent in 2010**.

Macro Outlook: Short term

- Cyclical demand
- Weather
- US Economy
  - Industry output
- Fuel Switching
  - residential

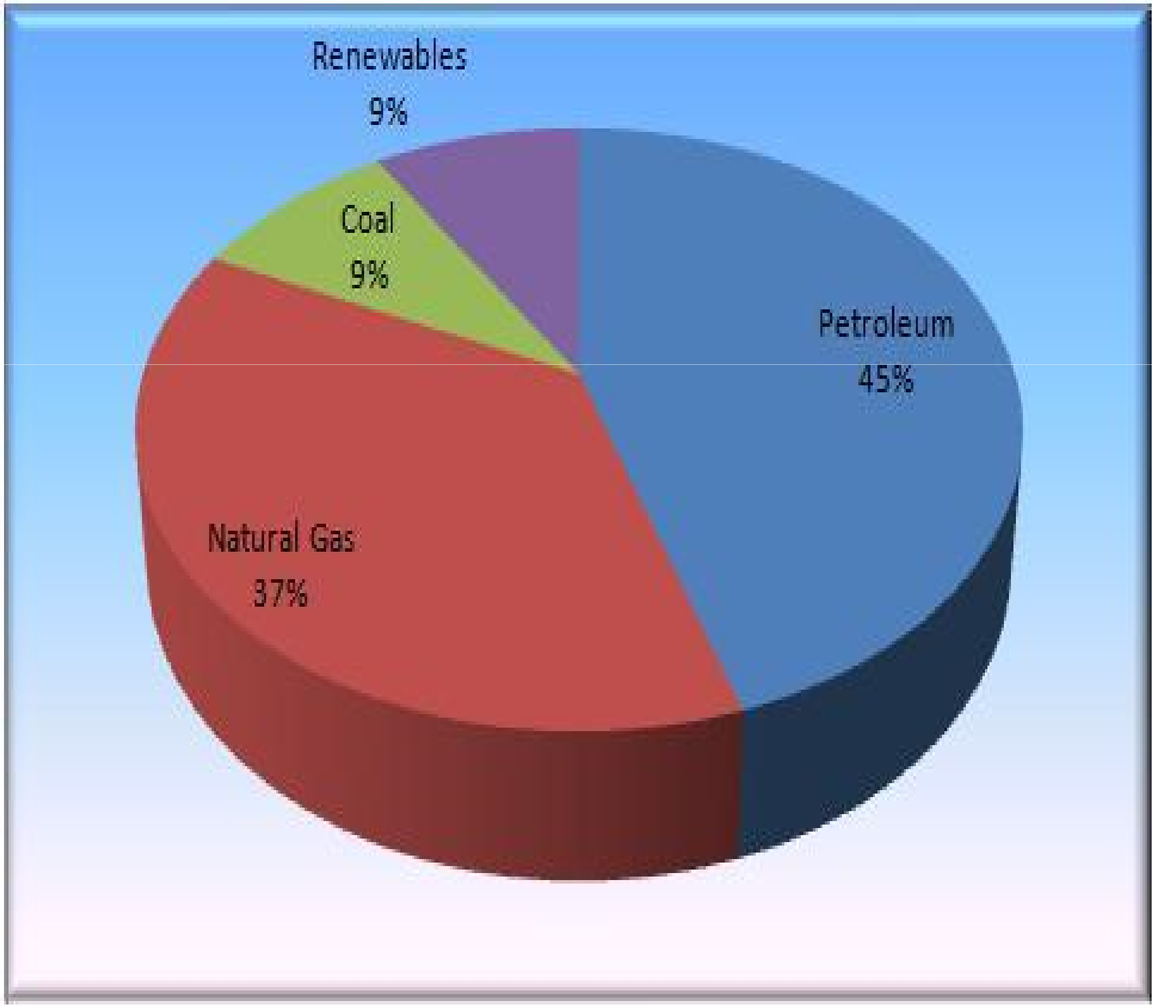
Figure 3. Henry Hub Spot Price and the NYMEX Futures Prices Increased Only Temporarily Following the Hurricanes



Source: Natural Gas Intelligence, *Daily Gas Price Index*.

Macro Outlook: Long-term

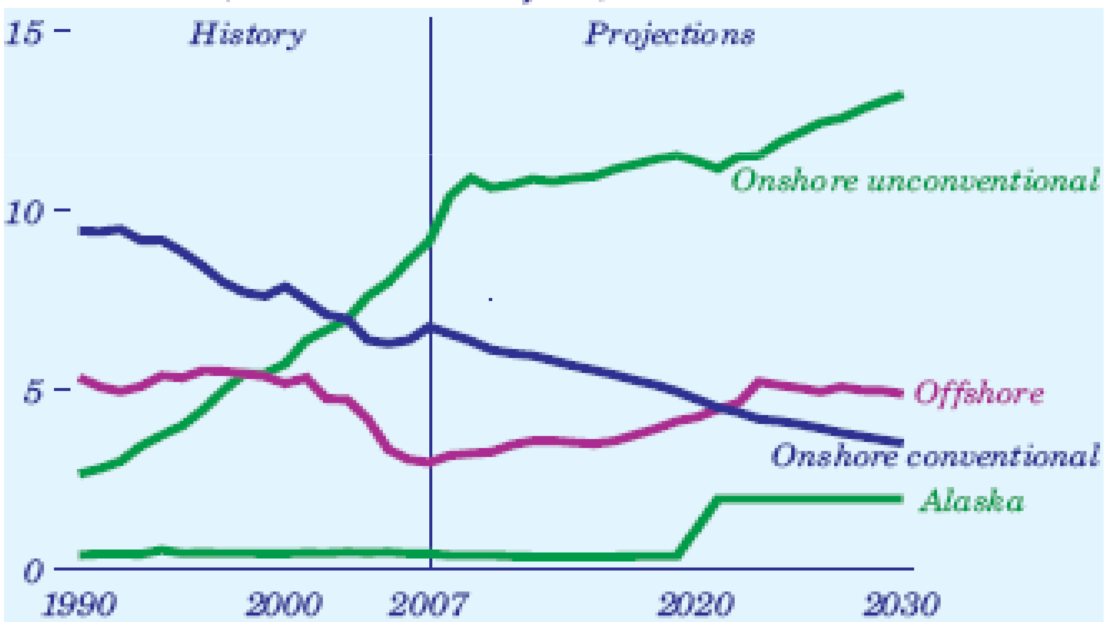
- The EIA expects residential energy demand to increase **25** percent between 2002 and 2025.
- Residential natural gas consumption accounts for **22 percent of all consumption** in the U.S.



Where do we get Natural Gas?

Largest Source of U.S. Natural Gas Supply Is Unconventional Production

Figure 66. Natural gas production by source, 1990-2030 (trillion cubic feet)



- Onshore unconventional: natural gas in tight sand formations; production from shale is fastest growing
- Offshore also important: 15% but increase largely from deepwater formations

Points

- When demand for gas is **rising**, and prices rise accordingly, producers will respond by **increasing** their exploration and production (E&P) capabilities.
- In an environment of **falling** gas prices, the converse will be true. Producers will respond to lower natural gas prices over time by **reducing** their expenditures for new exploration and production.
- The global economic contraction continues to depress energy demand.

Thesis Points

- Natural Gas industry rebound
- Financials (ROIC, buyback, debt, credit line)
- Management team
- Contango's business structure:
  - operation structure
  - costs, track record, and probable reserves
- Undervalued
  - Sellers Capital LLC.
  - Buyback

Why invest in Natural Gas E&P Stocks

- Will not stay below $5 long term
- Appropriate hedge: short UNG (natural gas ETF)
- Volatile stocks
- Tangible assets → cash quickly

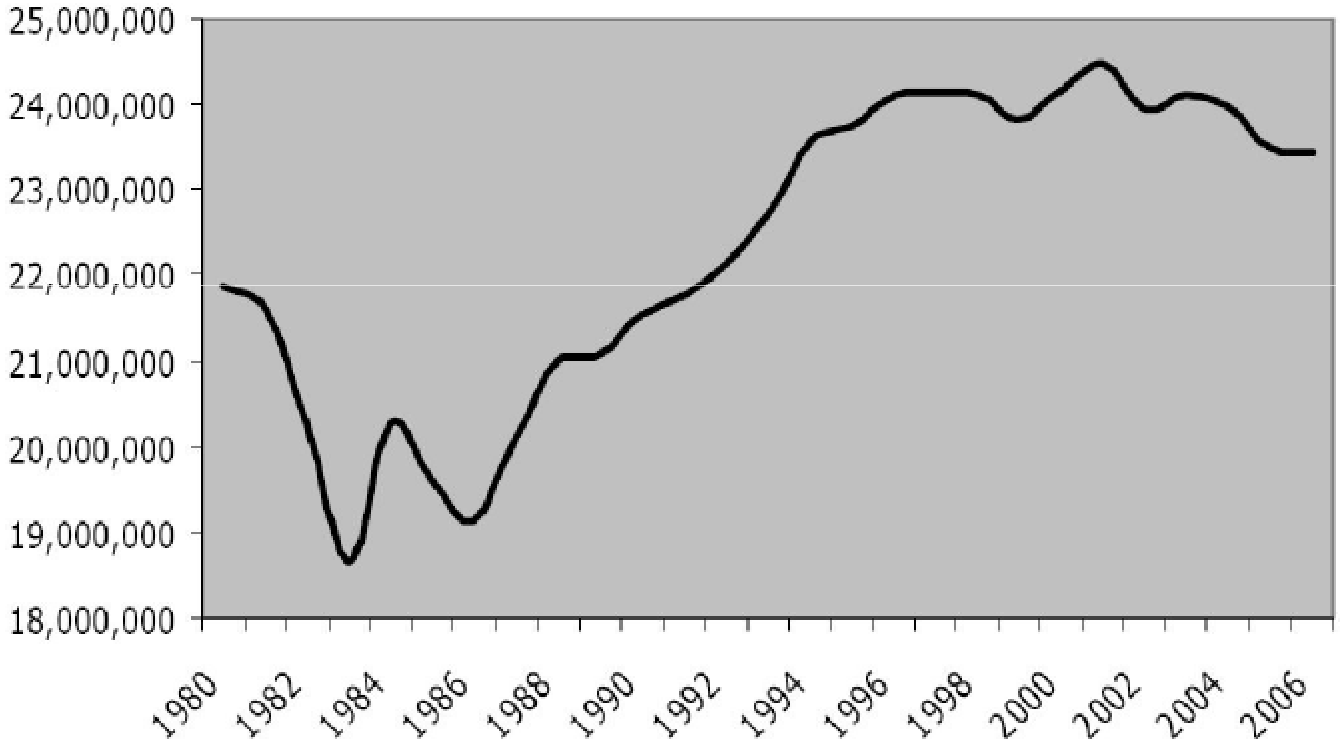
Source: Praetorian Value Fund Pendo, LLC

Industry overview

- Depletion rates up from 17% to 32% over past 15 years
- As Gulf of Mexico (offshore) depletes, onshore NG more important
- Land based finds easier to deplete
- Finding new gas reserves more expensive

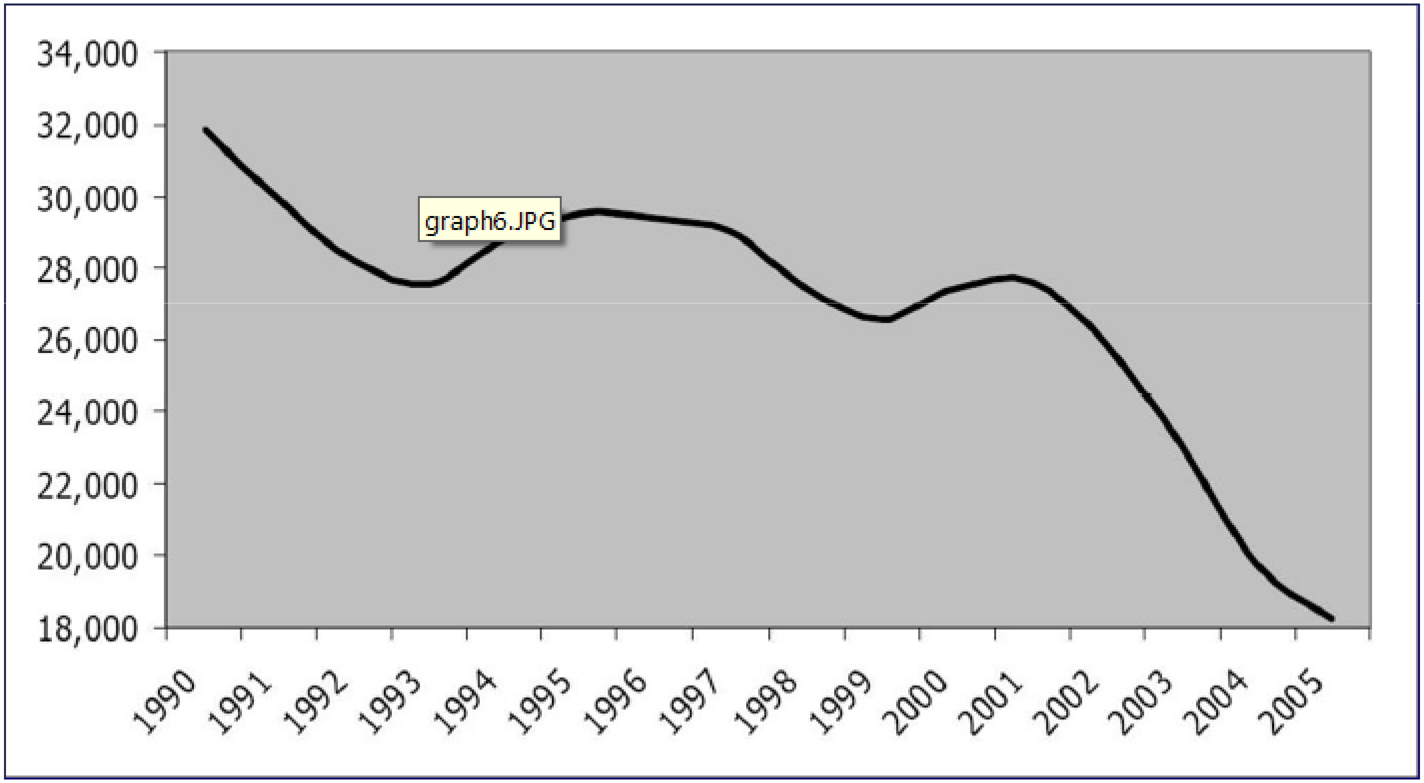
Source: Praetorian Value Fund Pendo, LLC

Annual U.S. Natural Gas Production



Source: U.S. Government Energy Information Administration

U.S. Gulf of Mexico – Total Reserves (bcf)



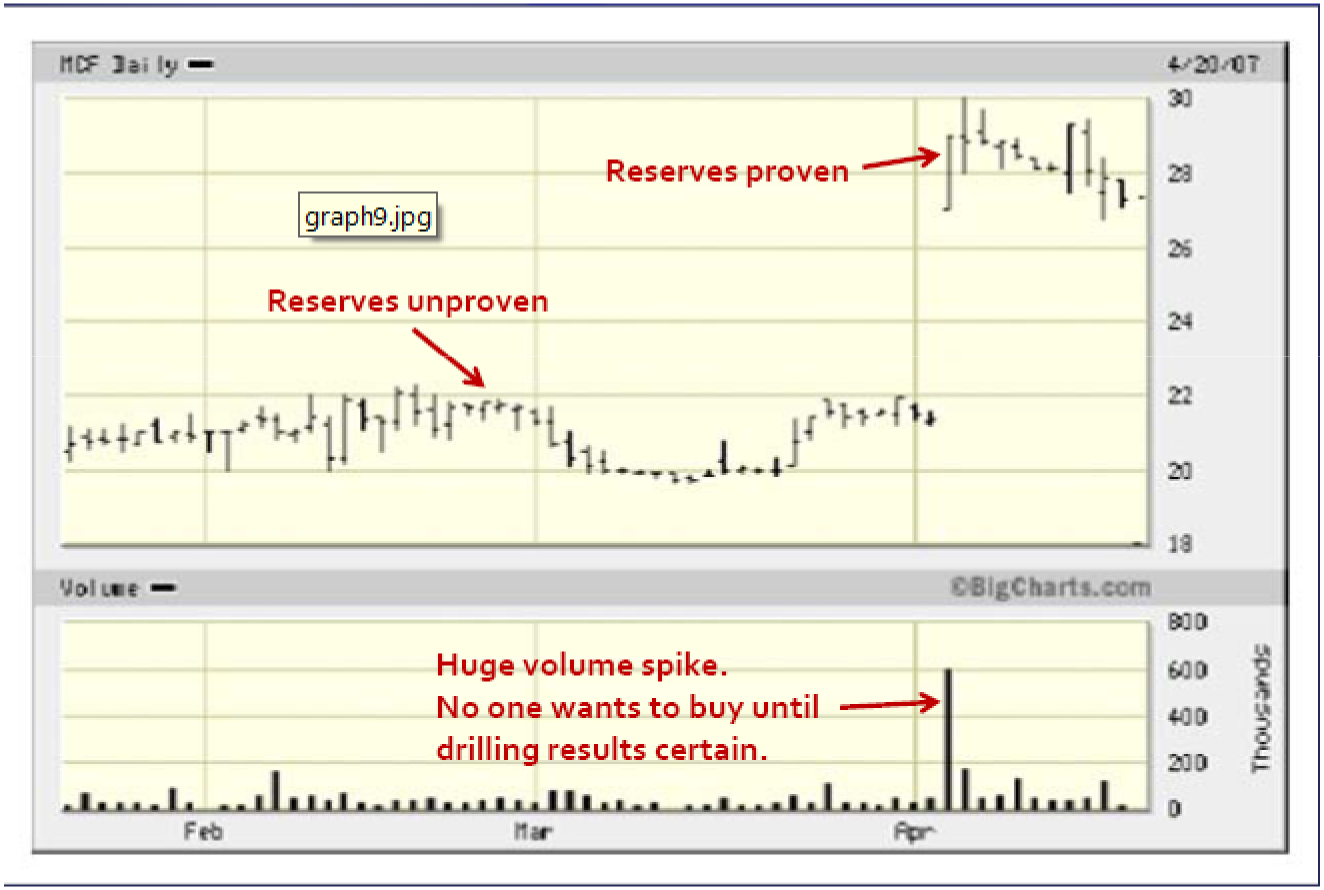
Source: U.S. Government Energy Information Administration
Bcf = billions cubic feet

Market Overview

- Coal is cheaper but natural gas is more dominant in usage
- M&A should pick up
- Factors affecting pricing:
  - Short term: weather
  - Long term: increasing depletion rate, rising Finding and Development (F&D) costs, avoidance of greenhouse gases

Source: Praetorian Value Fund Pendo, LLC

Market won't pay for unproven prospects until proven



Source: Praetorian Value Fund Pendo, LLC

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Contango Snapshot

- Contango Oil & Gas Company (Contango) is a natural gas and oil company. The Company's business is to ***explore,*** develop, produce and acquire natural gas and oil properties primarily offshore in the Gulf of Mexico.

Company Philosophy/Beliefs

- “Not what we do but the way we do it”
- “We want to have the highest profit margin per equivalent unit of production (boe for oil or mcfe in the case of natural gas, we use mcfe since we produce more natural gas than oil), the lowest G&A per mcfe produced, the highest revenue dollar per employee, and the lowest finding and developing cost per mcfe.”

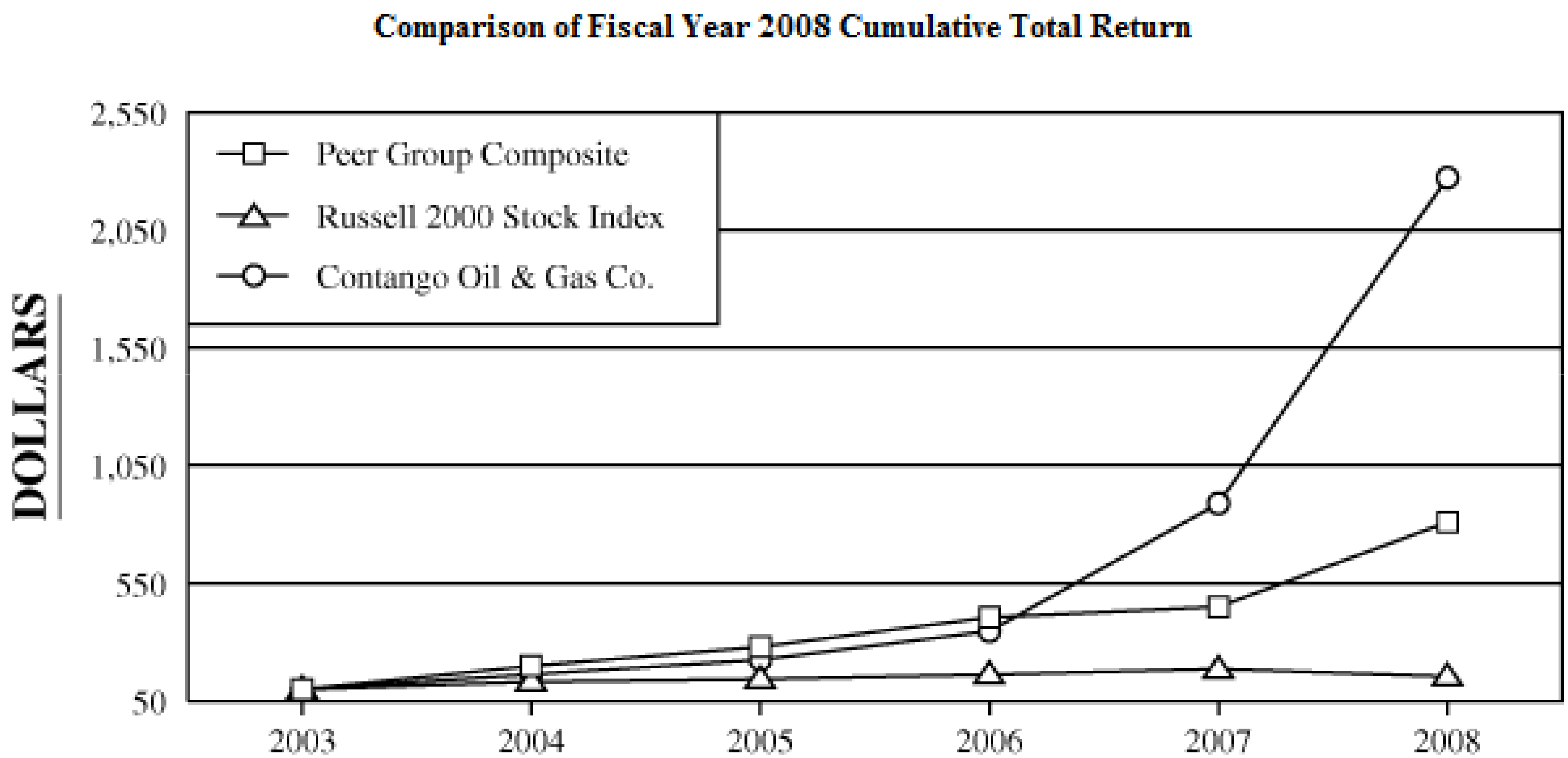
Contango Oil & Gas (ticker: MCF)

- Currently trading at: $40.75/share
- 52wk high/low: $92.16/$31.69
- Beta: 0.92
- Market Cap: $664.95M
- Shares Outstanding: 16.32M
- EPS: $7.01
- Dividend: none
- Owned by institutions: 62%
- Insider ownership 23%

Financials

- No long term debt
- P/E: 5.75 compared to industry 3.43
- Return On Invested Capital (ROIC): 108.23
- Quick&Current ratios > 1
- Price-to-book: 1.81
- Price-to-sales: 3.13
- ROE: 41.95% compared to industry 8.93%
- Revenue/employee: 20,825,900 compared to industry 3,340,660
- $50million untapped credit line

Cumulative Total Stockholder Return



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Company History

- Founded by Ken Peak in 1999
- Company started with $30MM capital, has grown to $660MM market cap
- Focuses on highest ROI part of the E&P value chain: exploration
- 7 employees
- Outsources everything except planning and idea generation

Source: Praetorian Value Fund Pendo, LLC

It takes 7 to con-tango…

- **Ken Peak:** Chairman, President, CEO, CFO, Secretary and Director; navy and engineer ("Buffett of energy"); BS physics from Ohio University; MBA from Columbia University
- **Lesia Bautina:** Senior VP and Controller; auditor from Arthur & Anderson LLP; CPA
- **Sergio Castro:** VP and Treasurer; lead credit analyst for Dynergy Inc.; auditor from Arthur & Anderson LLP specialized in energy companies CPA and Certified Fraud Examiner
- **Marc Duncan:** President & COO of Contango Operators, Inc.; senior executive with USENCO International; senior project and drilling engineer; MBA in Engineering Management from UDallas
- 2 best geologists in gulf are contracted by Contango

Accounting Style

- The successful efforts accounting method, as opposed to the other widely used accounting method known as “full cost”
  - requires Contango to expense dry holes, seismic costs, G&A, and interest expenses as incurred
  - Quarterly income statements bear the brunt of unsuccessful exploration and seismic costs immediately, and since we don't capitalize any G&A or interest, our GAAP earnings are closer to actual cash generation than those of our full cost competitors.

Thesis Points

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How Contango Operates

The E&P Value Chain - 80/20 at Work

Chain Link	Gather	Organize	Select	Drill	Produce
Function	Sub-surface data Re-process 3-D seismic Shoot new 3-D	Generate prospects	Lease Farm-in AFE	**FUND**[1] Evaluate Complete Hook-up	Operate Sell Collect
Personnel needed	Geologist Geophysicist Geotech Landman	Geologist Geophysicist Geotech Landman	Geologist Geophysicist Geotech Landman Lawyer Accountant Engineer	Geologist Geophysicist Geotech Landman Lawyer Accountant Engineer	Geologist Geophysicist Geotech Landman Lawyer Accountant Engineer Field personnel Marketing

[1] The riskiest, most expensive and most value added link. The goal of Contango is to focus on this link exclusively and outsource everything else.

Question: What functions should a firm perform internally?

Contango's answer: Only those activities that cannot be performed more efficiently and effectively by another entity.

Business Structure

Contango Oil &
Gas

Juneau Exploration
L.P.

Gulf of Mexico
Offshore
Prospects:
Exploration

Drilling &
Operating

Contango
Operators
Inc. (COI)

Contang
o
Resourc
es
Compan
y (CRC)

Republica
n
Exploratio
n LLC.
(REX)

Contango
Offshore
Exploration
LLC. (COE)

In English…

- Contango’s job is quite similar to a hedge fund manager’s:
  capital allocation.
- JEX generates natural gas and oil prospects and evaluates exploration prospects generated by others.
- Contango and JEX share in the upfront costs.
- Then if a prospect is successful, Contango will fund the development and JEX will share in the revenue.
  - Dutch and Mary Rose fields
- For development and operation, Contango hires contractors and independent third party operators to do the job.

Exploration Strategy

- Predicated on two core beliefs:
  - The only competitive advantage in the commodity-based natural gas and oil business is to be among the lowest cost producers
  - Virtually all the exploration and production industry's value creation occurs through the drilling of successful exploratory wells.

Juneau Exploration

- “Our core competency at Juneau Exploration is oil and gas exploration. We utilize state-of-the-art seismic technology to locate underground oil and natural gas deposits”
- "Since installation, we have stayed up and running without a hitch through five recent local power outages.“
- Undisclosed seismic technology

Thesis Points

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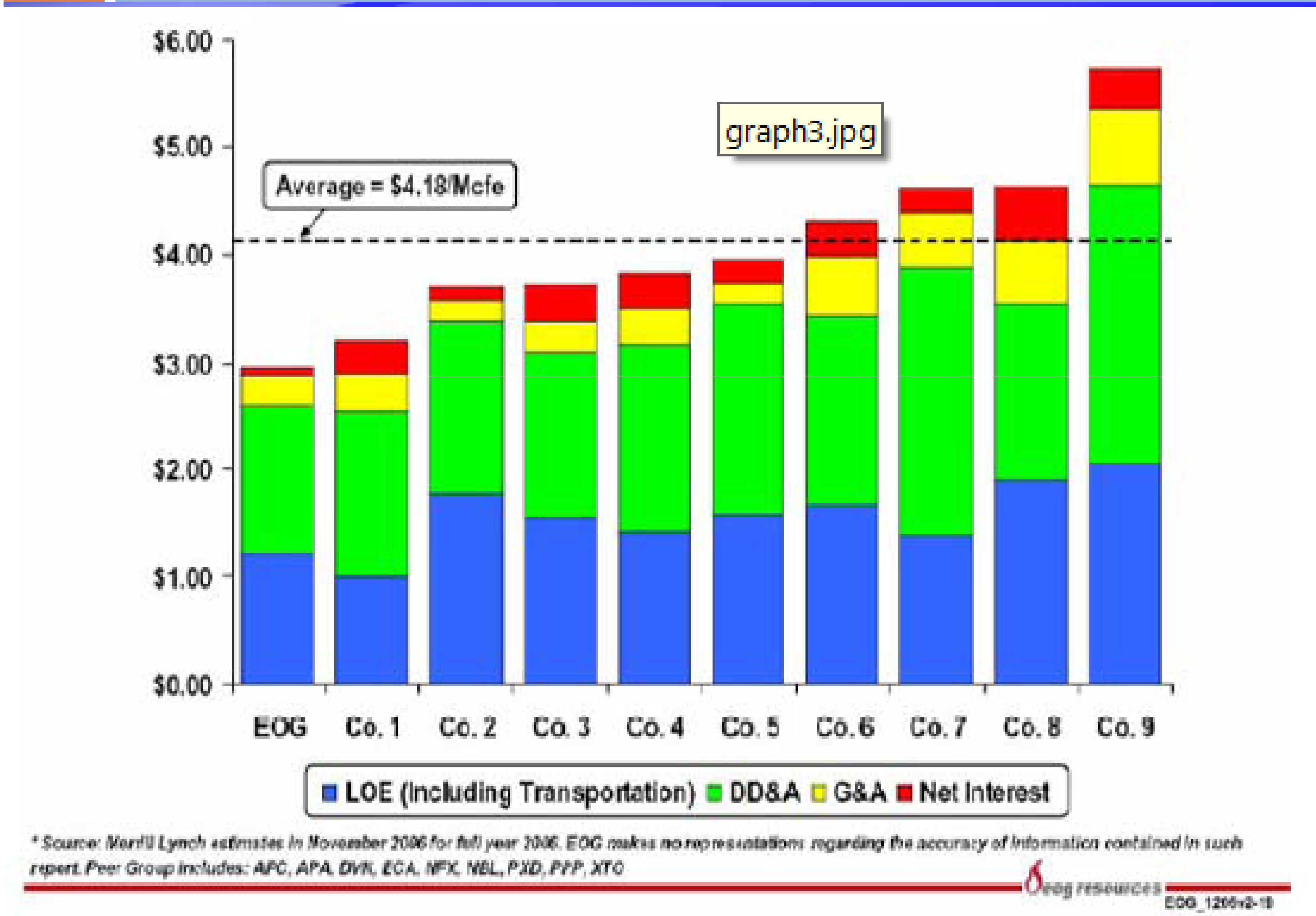
Costs



Source: Calyon Securities

Contango's Total Costs: ~$2/mcf

Operating cost: $.082/mcfe (2008)

F&D costs: $1.36/pcf

Largest cost is actually taxes: 38%

Company Track Record

- Contango's expertise mitigates gulf drilling risk
- Targets shallow Gulf waters
- Have hit gas on 4 out of 6 Gulf wells drilled so far (67% success rate)
- Company uses a undisclosed seismic technique
  - Dutch well is one of the largest discoveries in the Gulf shelf in over a decade

Source: Praetorian Value Fund Pendo, LLC

Contango’s Existing Gulf of Mexico Reserves

- Proven Gulf reserves approx 53 bcf. Market value at $5.00/mcf = $265MM
- Probable Gulf reserves booked 77bcf. Market value @ $2.50/mcf = $190MM
- Total liquidation value of Gulf reserves = $455MM

Source: Praetorian Value Fund Pendo, LLC

Leases – Gulf of Mexico

- Peak says Contango plans to drill 15-20 lease blocks over next few years
- Assuming 15 wells drilled, 50% “hit” rate (conservative), 30 bcf average per lease block (conservative) = total Gulf reserves yet to be discovered of ~200bcf
  - Future value of these reserves = 200 bcf x $3.50/mcf = $700MM
- Discount this back 3 years at 15% discount rate and present value is $450MM -$100MM drilling costs = $350MM net present value

Source: Praetorian Value Fund Pendo, LLC

Ken Peak says…

- We have run an economic case for our proved reserves, assuming the following:
  - We drill five rate acceleration wells
  - $7.00 per Mmbtu natural gas and $70.00 per barrel of oil
  - NYMEX prices flat forever
- We then subtracted 35% from pre-tax income for projected federal income taxes
- The PV-10 of this case is approximately $1.3 billion or $78.00 per share, assuming 16.9 million shares outstanding
- Our reserves have been in place for about 50million years and aren't going away because of a storm

Source: Praetorian Value Fund Pendo, LLC

Valuation Analysis

Year	Beg BCF Total BCF	Annual Depletion	mcfeE	Price	Dutch Revenue	Contango 38%	Capex	Other Costs	Operating Income	Tax Rate 38% Net Income	Discount Rate 12% PV	
1	964.00	98.55	120.45	8.00	963.60	366.17	5.00	10.00	351.17	217.72	1.0000	217.72
2	865.45	98.55	120.45	8.00	963.60	366.17	5.00	10.00	351.17	217.72	0.8929	194.40
3	766.90	98.55	120.45	8.00	963.60	366.17	5.00	10.00	351.17	217.72	0.7972	173.57
4	668.35	98.55	120.45	8.00	963.60	366.17	5.00	10.00	351.17	217.72	0.7118	154.97
5	569.80	98.55	120.45	8.00	963.60	366.17	5.00	10.00	351.17	217.72	0.6355	138.37
6	471.25	98.55	120.45	8.00	963.60	366.17	5.00	10.00	351.17	217.72	0.5674	123.54
7	372.70	98.55	120.45	8.00	963.60	366.17	5.00	10.00	351.17	217.72	0.5066	110.31
8	274.15	98.55	120.45	8.00	963.60	366.17	5.00	10.00	351.17	217.72	0.4523	98.49
9	175.60	98.55	120.45	8.00	963.60	366.17	5.00	10.00	351.17	217.72	0.4039	87.94
10	77.05	77.05	94.17	8.00	753.38	286.28	5.00	10.00	271.28	168.20	0.3606	60.65
11	0.00	98.55										
12	(98.55)	98.55										
13	(197.10)	98.55										
14	(295.65)	98.55										
15	(394.20)	98.55										
16	(492.75)	98.55										
											NPV	**1,359.95**

Shares outstanding: 17.2

Price per share: $79.07

Source: Praetorian Value Fund Pendo LLC

Valuation

- Outlook:
  - ~70 Gulf lease blocks not yet drilled despite 67% success track record
  - Conversion of 77 bcf Gulf of Mexico “probable” reserves to “proven” reserves – 70% probability of success
  - NG price volatility. 50% chance NG prices remain above $7 long term
- In the most likely scenario: stock is 40-50% undervalued

Source: Praetorian Value Fund Pendo, LLC

Thesis Points

- Natural Gas industry rebound
- Financials (ROIC, buyback, debt, credit line)
- Management team
- Contango's business structure:
  - operation structure
  - costs, track record, and probable reserves
- Undervalued
  - Sellers Capital LLC.
  - Buyback

Why is it undervalued:

- No analysts cover the company
- Liquidations by one hedge fund
- Hurricanes

Financial Hurricane, Then Real Hurricane, Then Hedge Fund Hurricane

- Financial Hurricane
- Hurricane Ike: caused damage and shut or slowed production of the company's wells
- Sellers Capital put almost their entire fund in the stock and then used some leverage as well
- When the stock started to fall→Sellers Capital locking the fund up and preventing a forced sale of its over 15% position in Contango
- Company assets up for sale in Summer 2008 but NG prices fell – Peak will not sell at fire sale prices

Source: Sabre Value Fund

Sellers Capital LLC

- Mark Sellers: oil/gas wells can be liquidated above current market price
- “The other thing that's unique about our strategy is our selling process. We sell a lot. We sell when a stock hits our fair value and we think we'll only get a market return.”
- “Another thing we think is unique is that if we realize we're wrong, or if we develop a distrust and no longer respect a management team, we'll sell the stock immediately.”
  - Sellers LLC forced proxy battle against Premier because of bad management but respects Peak

Sellers Capital LLC part 2

- Told Mr. Peak to aggressive buyback shares on October 08 but insider trading shows Sellers selling shares
- Sellers, who put a lock on redemptions, plans to liquidate the fund over the next year or two
- Felix Salmon (SeekingAlpha):
  - The only reason to spend a year or two liquidating your fund is if it has very illiquid investments. I'm not sure that the NYP's characterization of Sellers Capital as an "energy fund" is correct, but if it is, then energy investments are nearly always very liquid.

Stock purchases, sales, and option exercises reported by insider *Sellers Capital Llc* since 2005.

Trade Date	Symbol	Company Name (Issuer)	Trade Type	Shares	Price ($)	Value ($)
2009-03-05	MCF	Gas Co	Sale	100,000	34.62	3,461,999
2009-03-06	MCF	Gas Co	Sale	56,000	32.72	1,832,320
2009-03-10	MCF	Gas Co	Sale	44,000	33.42	1,470,480
2009-03-02	MCF	Gas Co	Sale	78,000	34.04	2,655,120
2009-03-03	MCF	Gas Co	Sale	22,100	34.34	758,914
2009-03-04	MCF	Gas Co	Sale	170,400	36.86	6,281,796
2009-02-26	MCF	Gas Co	Sale	18,000	35.76	643,680
2009-02-12	MCF	Gas Co	Sale	8,000	45.03	360,240
2009-02-10	MCF	Gas Co	Sale	5,000	46.90	234,500
2009-02-11	MCF	Gas Co	Sale	8,000	45.09	360,720
2009-02-03	MCF	Gas Co	Sale	5,000	47.28	236,400
2009-02-02	MCF	Gas Co	Sale	5,000	44.94	224,700
2009-02-09	MCF	Gas Co	Sale	6,000	49.32	295,920
2009-02-06	MCF	Gas Co	Sale	5,000	48.12	240,600
2009-02-05	MCF	Gas Co	Sale	25,000	48.98	1,224,500
2009-02-04	MCF	Gas Co	Sale	21,000	49.62	1,042,020
2008-09-16	MCF	Gas Co	Sale	241,000	46.43	11,189,630
2008-09-18	MCF	Gas Co	Sale	11,200	51.05	571,760
2008-08-13	MCF	Gas Co	Purchase	5,100	72.97	372,147
2008-08-12	MCF	Gas Co	Purchase	3,620	71.27	257,997
2008-08-07	MCF	Gas Co	Purchase	5,000	81.85	409,250
2008-08-06	MCF	Gas Co	Purchase	9,300	80.07	744,650
2008-08-05	MCF	Gas Co	Purchase	2,000	76.92	153,840
2008-07-29	MCF	Gas Co	Purchase	8,000	85.20	681,600
2008-07-21	MCF	Gas Co	Purchase	3,000	83.02	249,060
2008-07-22	MCF	Gas Co	Purchase	4,000	83.93	335,720

Loss of 30.1% in Q4

So now what?

- The failed sale of the company, the collapsing energy markets, the hurricane damage and finally the flight from the stock due to fears of massive selling and essentially, the stock has never recovered
- Sellers Capital told has sold over 800,000 shares, reducing their position to 13.2%, or 2.24 million shares
- The firm announced in a filing dated March 10th, that the firm was done selling to meet redemptions. This removes a short-term pressure from the stock that has seen relentless selling pressure.

Source: Sabre Value Fund

Thesis Points

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- Financials (ROIC, buyback, debt, credit line)
- Management team
- Contango's business structure:
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  - costs, track record, and probable reserves
- Undervalued
  - Sellers Capital LLC.
  - Buyback

Contango Catalysts: "With A Balance Sheet like Fort Knox MCF is Buying Back Lots of Stock"

- Peak is the largest shareholder and has never sold a share (and is buying more)
- Continue drilling in the Gulf
- Eventually, Peak will sell the Gulf assets and retire, but not until the value is maximized (2-3 years?)
- Company is aggressively buying back stock ($100MM already approved and begun)

Source: Praetorian Value Fund Pendo, LLC

Catalysts part 2

- In one filing, Sellers Capital announced they sold 100,000 shares back to the company. Natural gas production is about to plummet
  There has been a sharp decline in drilling rigs of natural gas in response to the price drop of natural gas.
- U.S. drilling rigs are down 37% year to date and poised to keep falling and Canadian natural gas rigs are down 52%.
- This is very important because natural gas fields deplete much faster than oil fields.
- More importantly, much of the growth in natural gas has come from gas found in shale and at current prices it is not economic to drill there.
- Compounding this is that production at a shale gas well will fall over 75% from Day 1 to Day 90, so you **need to constantly be drilling wells** to keep production up.

Catalysts part 2

- The PV-10 (standard net present valuation used for oil and gas production companies) of this company with natural gas prices at around $6 per mcf is over $72 per share.
- At $9 per mcf of natural gas it is $106 per share. This shows the upside the company has when natural gas prices recover.
- And prices will recover because we need more natural gas production, not less

Source: Sabre Value Fund

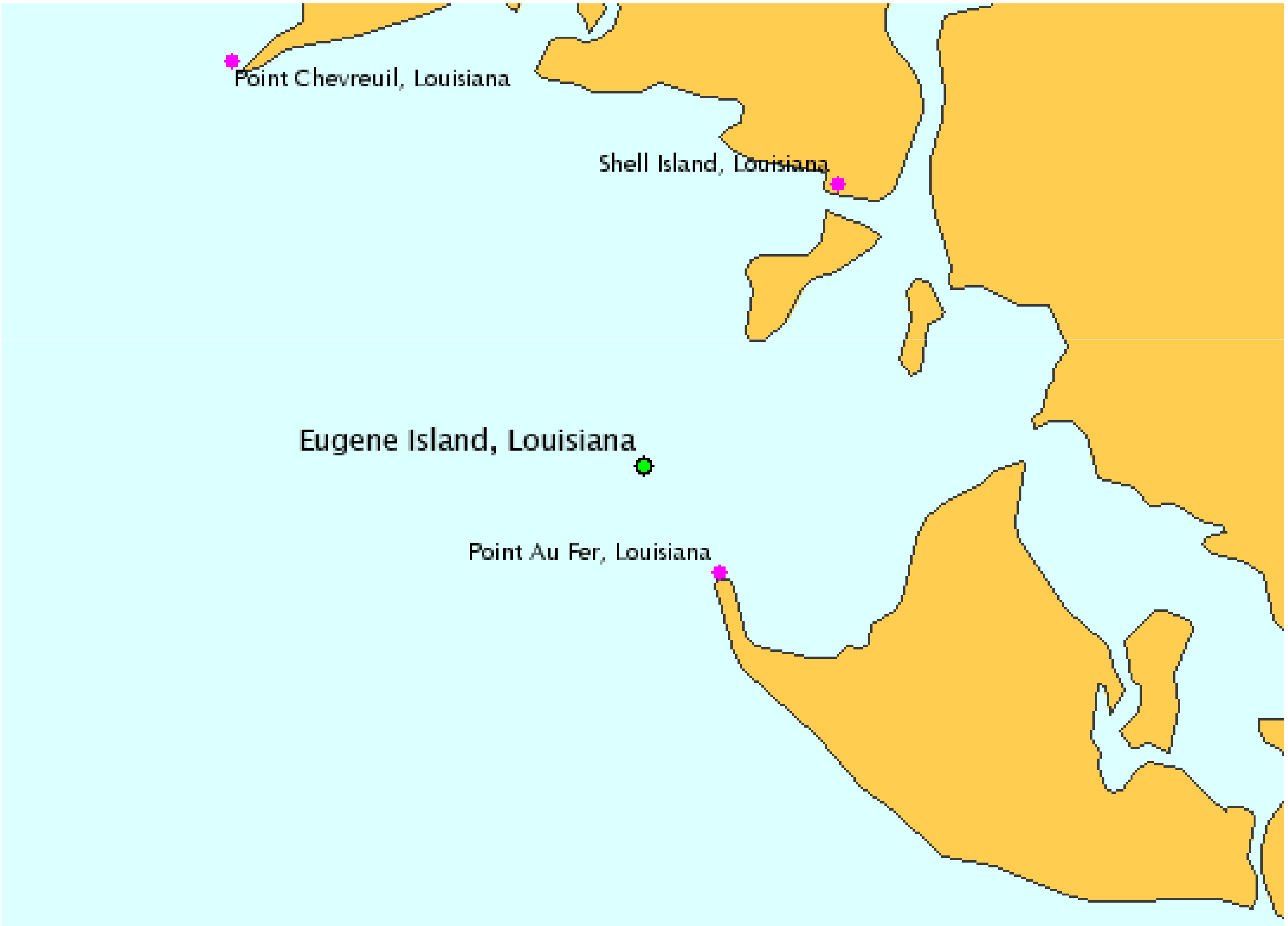
In Conclusion

- Natural gases poised to rise
- Solid balance sheet
  - No debt
  - ROIC
- One of the lowest cost structures of any E&P company
- Proven/probable reserves + track record
- Undervalued due to Sellers Capital but changing
- 100MM buyback

VAR 1

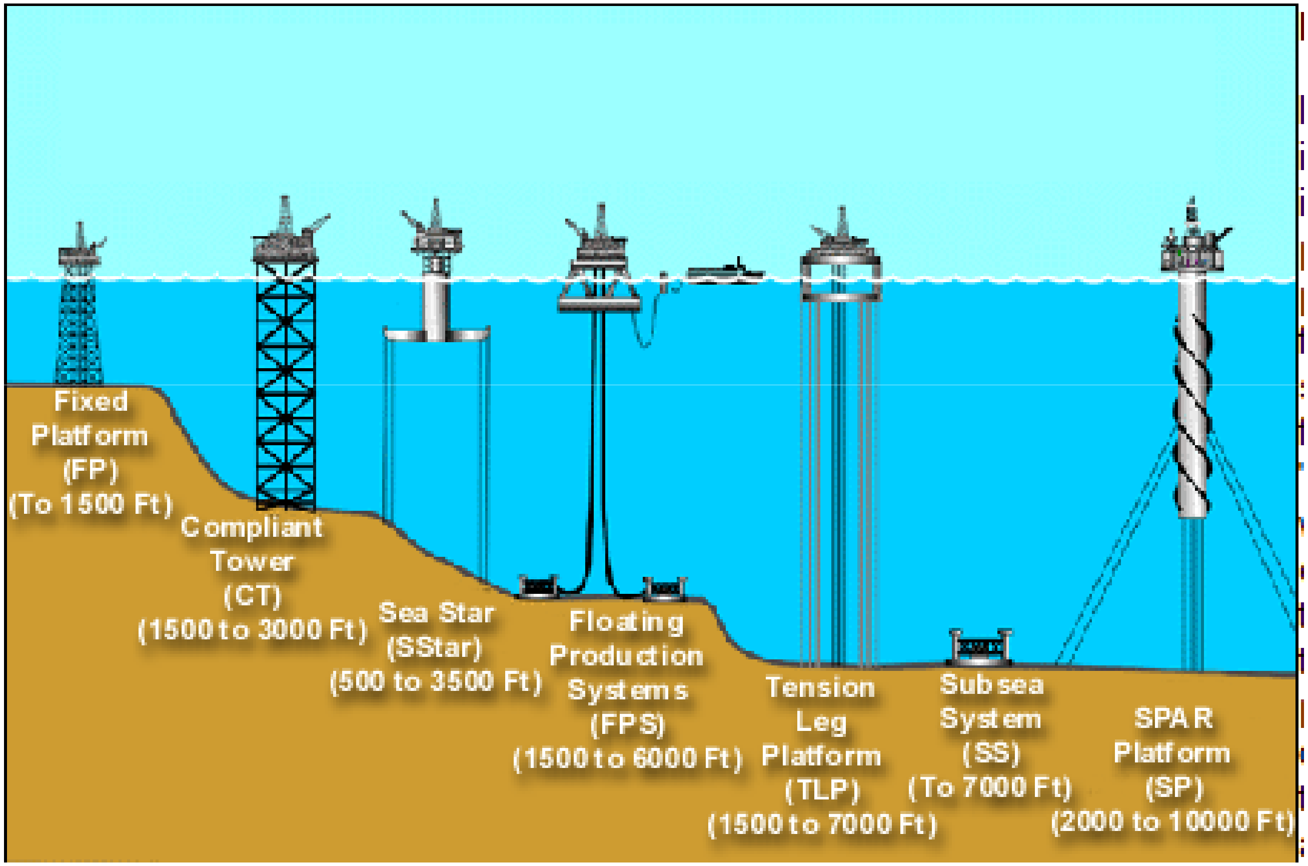
- Mrs. Erickson: Having no long-term debt is not unheard of; some companies do not have the type of assets that provide collateral for long-term borrowing. Others generate enough cash internally that they have no need for outside financing other than for seasonal (short-term) needs. For example, IBM did not issue long-term debt until the mid to late 1970's.
- Contango: contract w/ ADTI to drill for us we operate; Drilling rig owned by TransOcean – leased/rented by ADTI (applied drilling technology inc), contracted w/ Contango to operate drilling (VAR from Contango)
- Felix Salmon (SeekingAlpha): “Sellers took a bath on it…” (lost a lot of money) in the second half of this year, and he's decided to hold and pray rather than liquidate at a loss.

Risks: Location (shallow waters)



- Location of Dutch Field: Eugene Island

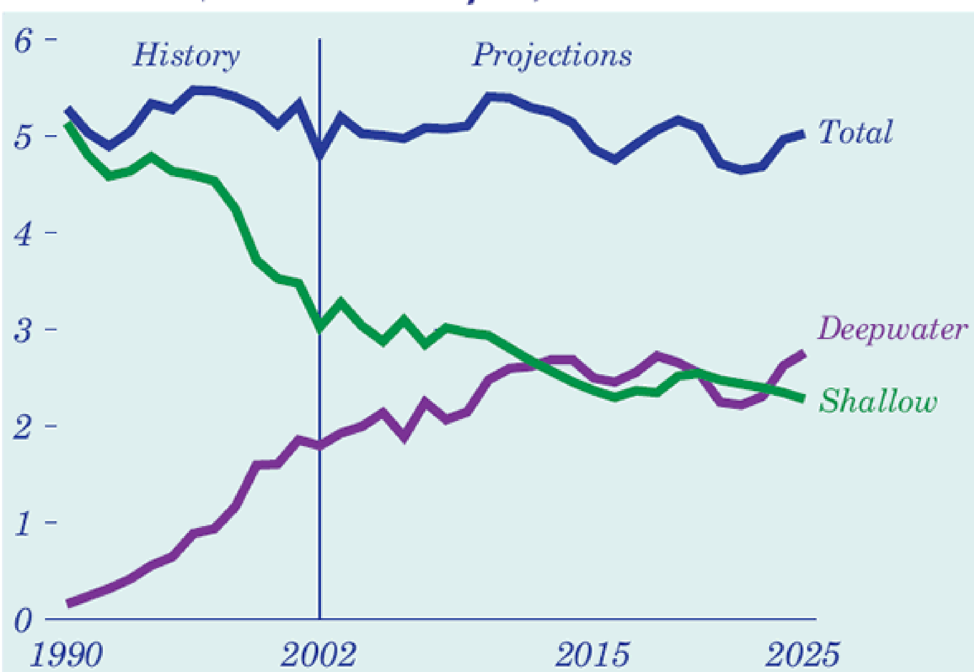
Types of rigs



- Does seismic technology work in deepwater ?

Rig-orous

Figure 13. Gulf of Mexico natural gas production, 1990-2025 (trillion cubic feet)

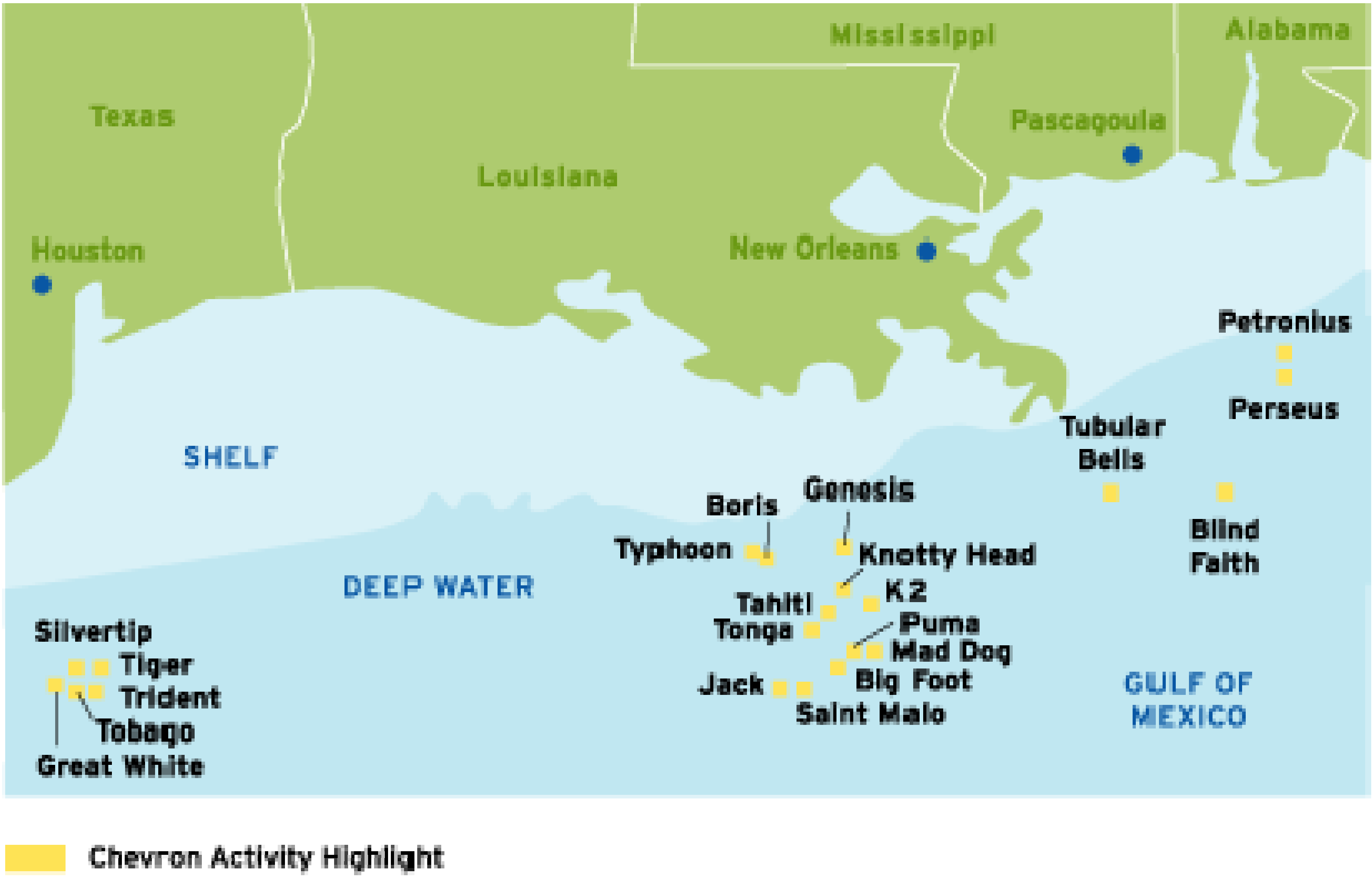


- Focus shift to deepwater
- Baker-Hughes reports 916 natural gas rigs working in the United States as of March 6, 2009, a **decline of 43 percent** from August 2008.
- Consequently, the robust growth in natural gas production in the Lower-48 region (excluding the Gulf of Mexico) over the last

Competitors

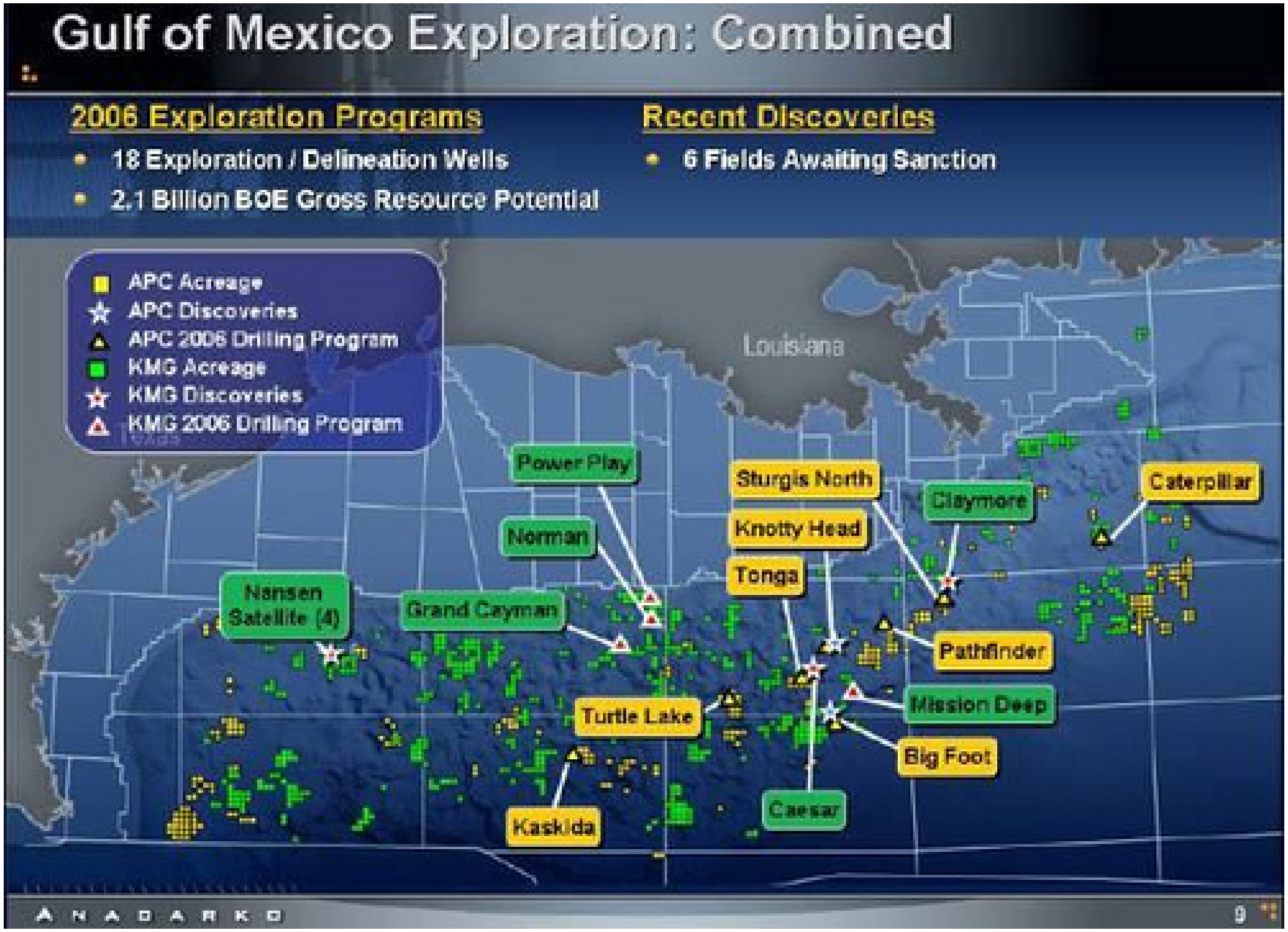
- BP
- Royal Dutch Shell
- Chevron
- Exxon Mobil
- (AnaDarko) APC
- (Newfield Exploration) NFX

Chevron



Texas
Louisiana
Mississippi
Alabama
Pascagoula
Houston
New Orleans
SHELF
DEEP WATER
Petronius
Perseus
Tubular Bells
Boris
Genesis
Typhoon
Knotty Head
Blind Faith
Tahiti
K2
Tonga
Puma
Mad Dog
Silvertip
Tiger
Trident
Tobago
Great White
Jack
Big Foot
Saint Malo
GULF OF MEXICO
Chevron Activity Highlight

APC KMG


Gulf of Mexico Exploration: Combined
2006 Exploration Programs
18 Exploration / Delineation Wells
2.1 Billion BOE Gross Resource Potential
Recent Discoveries
6 Fields Awaiting Sanction
APC Acreage
APC Discoveries
APC 2006 Drilling Program
KMG Acreage
KMG Discoveries
KMG 2006 Drilling Program
Louisiana
Power Play
Norman
Nansen Satellite (4)
Grand Cayman
Sturgis North
Knotty Head
Tonga
Claymore
Caterpillar
Pathfinder
Mission Deep
Big Foot
Turtle Lake
Kaskida
Caesar
ANADARKO
9

Risks

- “Natural gas prices may well continue to be under pressure through the summer/fall, but the foundation for a sustained rebound in prices is now on the horizon. According to recently published EIA data, onshore U.S. gas production fell in December 2008 vs. November 2008. Further, a number of analysts are calling for the U.S. rig count to bottom at around 800 to 1,000 rigs, or a 50% to 60% peak to trough decline.”

- Ken Peak: “In addition, non-vertical rigs are declining in tandem with vertical rigs which means shale play production, which declines at 60% to 80% per annum the first year, will help accelerate the fall in U.S. supply. With a gas rig count of perhaps 600 rigs and a recent average of 22 gas well completions per rig per year, U.S. gas completions could fall to less than half of the average of 30,000 gas well completions of the last three years. Demand, though down, will come back and natural gas – the most competitive hydrocarbon under any cap and trade greenhouse gas program – is the clear winner.”

Risks: Contango Operations

- Assuming the role of an operator represents a significant increase in the risk profile of the Company since the Company has limited operating experience. While COI and CRC have historically drilled turnkey wells, adverse weather conditions as well as difficulties encountered while drilling our offshore wells could cause our contracts to come off turnkey and thus lead to significantly higher drilling costs.

Risks: 10-K

- ***Exploration is a high risk activity, and our participation in drilling activities may not be successful.***
  - Unexpected drilling conditions.
  - Pressure or irregularities in formations.
  - Tropical storms, hurricanes and other adverse weather conditions.
  - Compliance with governmental requirements and laws, present and future.
  - Our turnkey drilling contracts reverting to a day rate contract which would significantly increase the cost and risk to the Company.
  - Problems at third-party operated platforms, pipelines and gas processing facilities over which we have no control.
- Poor results from our drilling activities would materially and adversely affect our future cash flows and results of

Other risks

- Federal income tax
  - Planned sale of company in ‘08
- Oil Pollution Act of 1990 (OPA)
  - Oil spills/liabilities

VAR2: RoundRock Capital LLC.

- Mr. Wade Suki (Co-manager and Executive Director)
  - RoundRock Capital: Energy-based hedge fund
- What is your opinion on natural gas futures (stay below $5? Long term?)
  - Market concensus: NYMEX $6.60 long term
- When will demand for NG go up with the current economy?
  - Demand is very weather-dependent
  - Industrial/power (economically sensitive) → some growth in 2010 (non-weather related)
- Appropriate derivative? Other ways?
  - Stock-Commodity disconnect
  - Options (calls/puts)

Continued

- Natural gas outlook: onshore/offshore
  - Onshore growing more rapidly; offshore decline (depletes quicker, 3 yrs vs. 20yrs)→disadvantage
  - Deepwater much more expensive, huge prospects for justification of investment
- M&A pickup?
  - Yes but no imminent
- F&D costs? → "Falling off a cliff"
  - With commodity prices what they are, there is very little exploration going on (more domestic development) and even that is teetering off

Continued

- Have heard of Contango, don’t focus on
  - “has grossly underperformed recently”
- 80% natural gas, with natural gas prices what they are (not so positive in near term)
- $20,000 enterprise value per flowing molecule > group
- Mr. Suki likes long reserve life, onshore
- Gulf of Mexico: high declines, high exploration costs, to keep production flat → high maintenance cost
- Contango: falls short