

# Desautels Capital Management

Honours in Investment Management

Coterra Energy Inc. (NYSE: CTRA)

Fall 2022

## Energy & Utilities

*Quynh Huynh, Senior Analyst*

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*Jordan Rindler, Junior Analyst*

*Thibault Quelavoine, Junior Analyst*

October 26, 2022



Recommend a HOLD – More potential downside to come before thesis materialization

## Business Overview

- An independent oil and gas company, engages in the development, exploration and production of oil, natural gas, and natural gas liquids in the United States
- Merger of Cabot Oil & Gas and Cimarex Energy in October 2021
- Operates in 3 major plays in the United States:
  - Marcellus Shale (~177,000 Net Acres)
  - Anadarko (~182,000 Net Acres)
  - Permian (~234,000 Net Acres)
- 2022E exit guidance: 635 Mboepd.

## Market Valuation

Values as of October 24, 2022

Share Price	\$29.67
Shares Outstanding (M)	795.6
<b>Market Capitalization</b>	<b>23,605.3</b>
Add: Total Debt	3,420.0
Add: Minority Interest	-
Add: Preferred Stock	11.0
Less: Cash & Cash Equivalents	(1,059.0)
<b>Enterprise Value</b>	<b>\$ 25,977.3</b>

## Investment Theses

1

**US natural gas prices are on track to begin converging with European prices**

Supply constraints, increasing domestic demand, and exponential LNG export growth will eventually unify natural gas markets

2

**Market is underappreciating Coterra's positioning to capitalize on our bullish outlook on US gas prices**

Excellent positioning due to high quality rock combined with an aggressive hedging strategy and industry-leading Capex program

Current Price:  
**\$29.67**

Price Target:  
**\$33.77**

Implied Upside:  
**13.8%**

Source: Bloomberg, CapIQ, Company Filings

## **I. DCM Energy Team's Strategy**

## **II. Sector Overview**

- i. Upstream overview**
- ii. U.S. Deep Dive**
- iii. Asset Review**

## **III. Company Overview**

## **IV. Investment Theses**

- I. Thesis 1: Stage set for US–European natural gas price convergence**
- II. Thesis 2: Underappreciated capital allocation strategy, hedging position, asset base**

## **V. Valuation**

- I. Comparables Multiple Valuation**
- II. Discounted Net Asset Valuation**

## **VI. Risks & Catalysts**

# Desautels Capital Management

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## Energy Portfolio & Sector Outlook

Section I



# A Portfolio Management Strategy That Aligns With Our Outlook

The DCM Energy Team closely monitored the market and capitalized on surge in O&G prices



**- 100%**

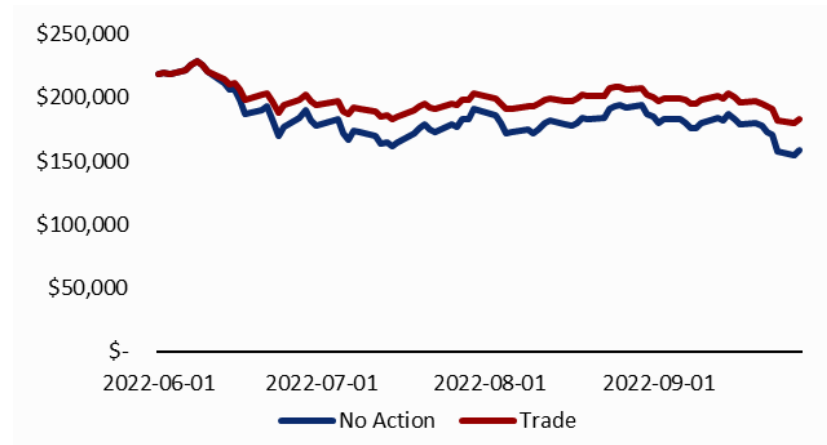


**- 50%**



**- 35%**

The tactical decision to trim 30% of the energy portfolio and move away from oil mid-June resulted in gains / savings of \$25k



# Our Approach

What we have learned since we joined the program and how the learning is reflected in our approach / strategy

## LESSON LEARNED

## IMPLICATIONS ON THE DCM ENERGY'S APPROACH

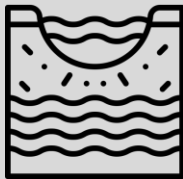
1



The **Energy sector** is heavily **dictated** by **macroeconomic conditions**

- **Time Allocation:** disproportionately large amount of time spent on the Industry Overview to build conviction and to form an informed outlook on the industry and its subsector
- **Screening:** top-down approach (rather than bottom-up)
- **Thesis Formation:** “macro-based” theses

2



A major idiosyncratic factor differentiating one O&G player from another is the **quality of the assets** (rocks) themselves

- **Importance of reaching out to O&G experts** (ERs, PMs, geologists, etc.) to gather as much information as possible on the quality of the assets



Ray Kwan (ER MD @ BMO)



Adam Frey (Partner @ Bain & Co.)

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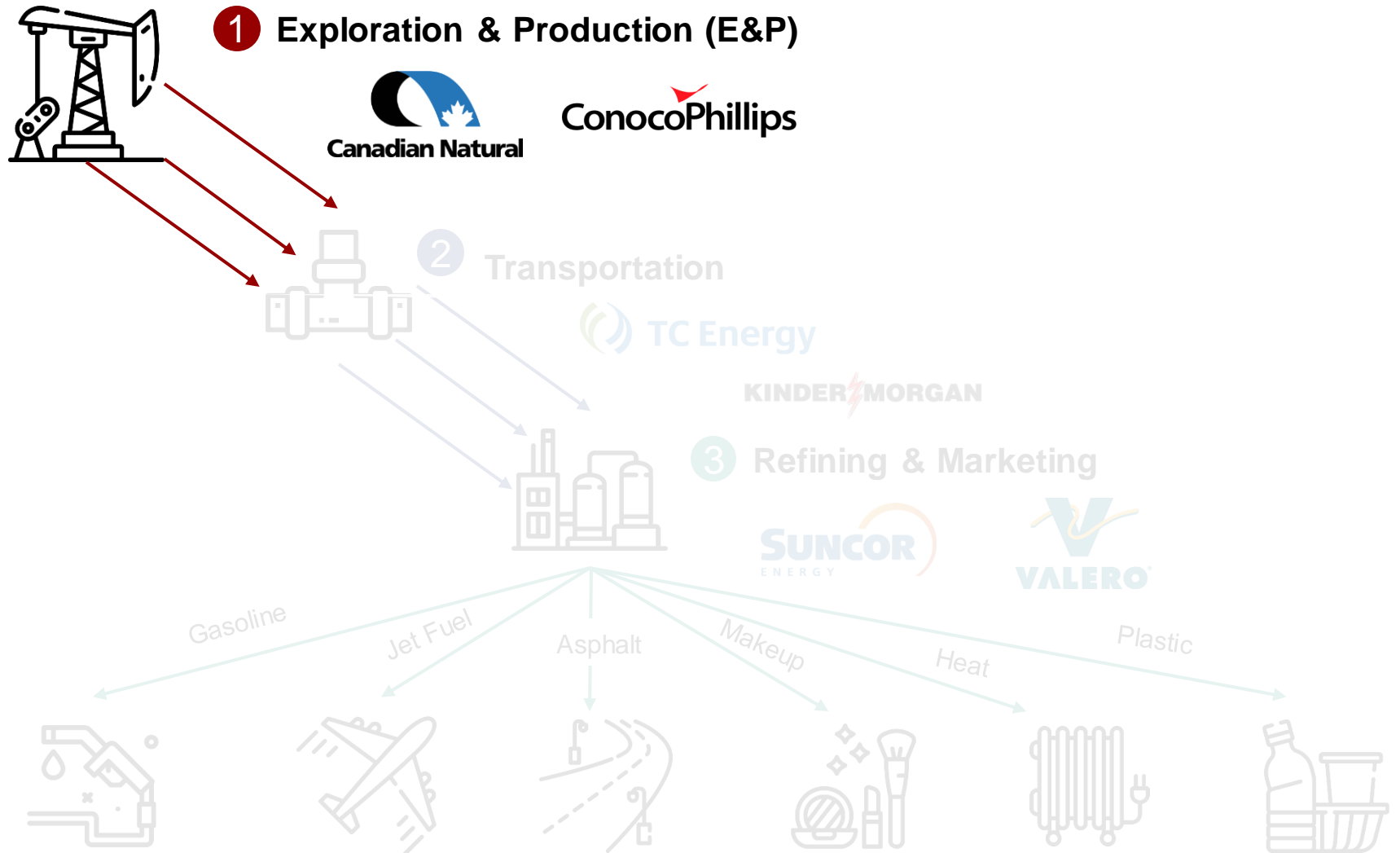
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## Sector Overview

Section II

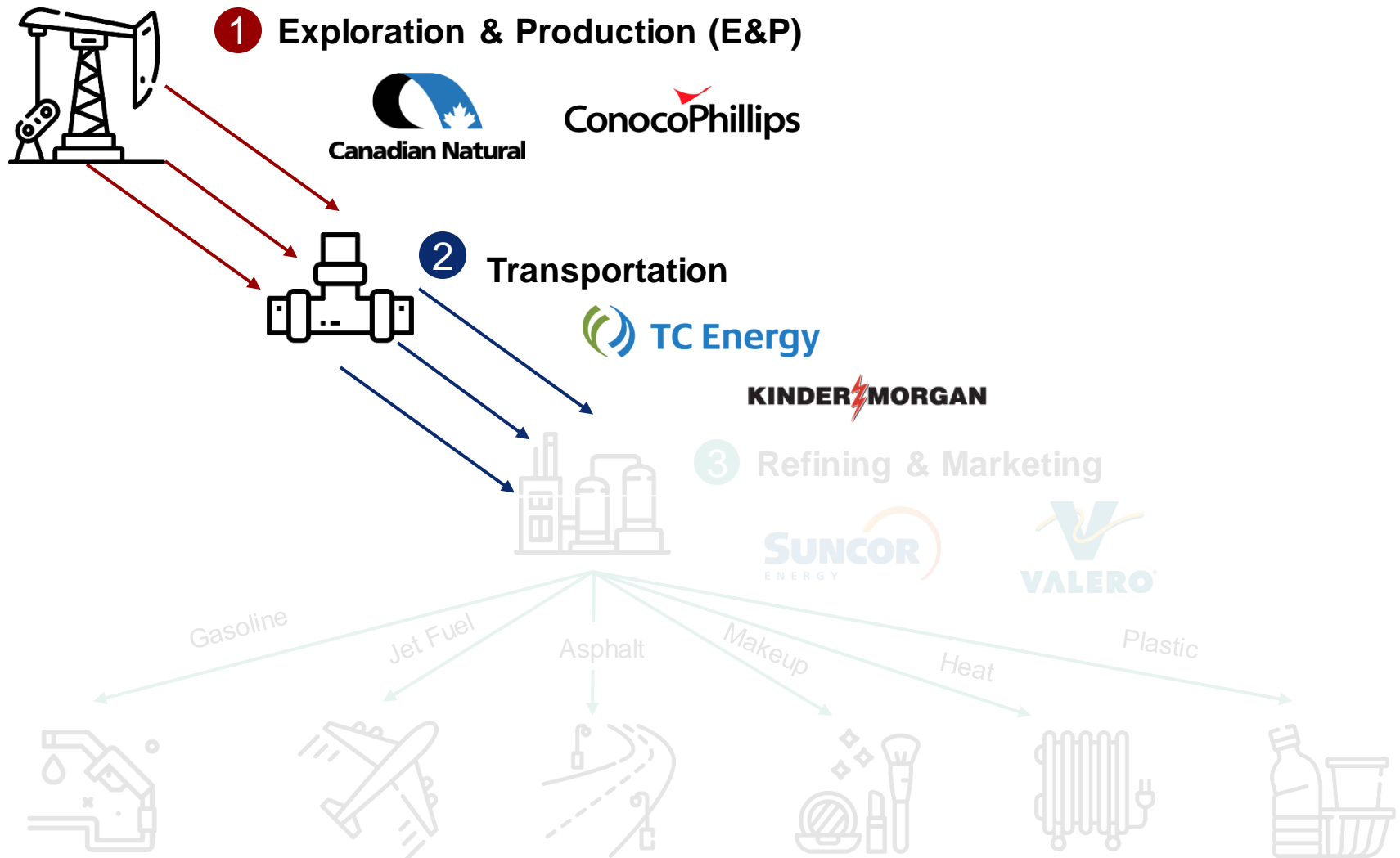


Thank you, dinosaurs

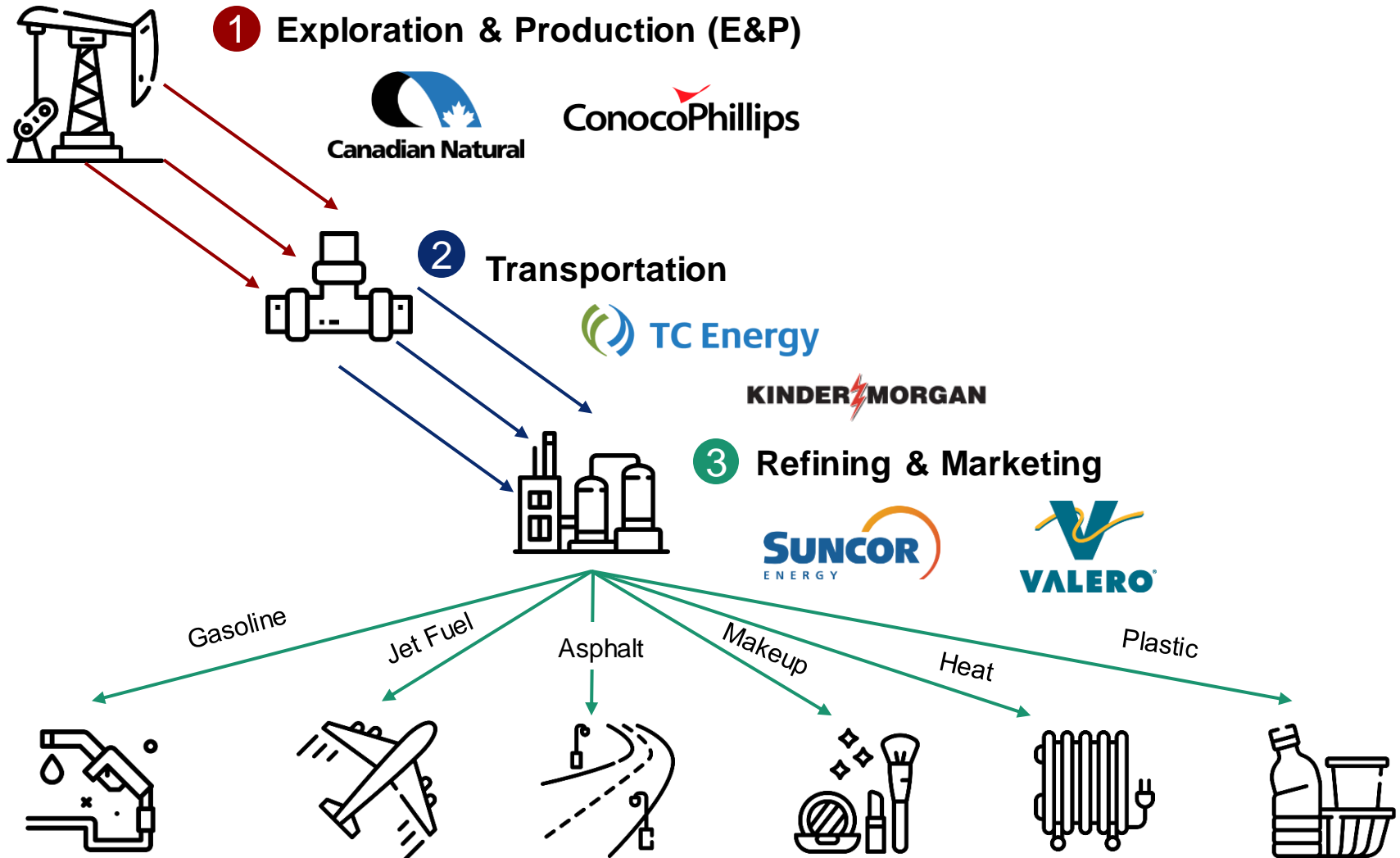




Thank you, dinosaurs



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## The Big 3 of O&G

### Common Benchmarks



### Crude Oil

- Liquid hydrocarbon found in reserves beneath the earth's surface
- Product quality and ease of extraction varies significantly
- 10% of the world's crude reserves are in shale formation reserves

**WCS**

**WTI**

**Brent**



### Natural Gas

- Colourless, odourless and cleaner burning than petroleum products
- Largely composed of Methane ( $\text{CH}_4$ )
- Measured in cubic feet (1000s) or BTUs
- Extracted conventionally or unconventionally
- Very similar verticals to petroleum

**AECO**

**HHub**

**TTF**

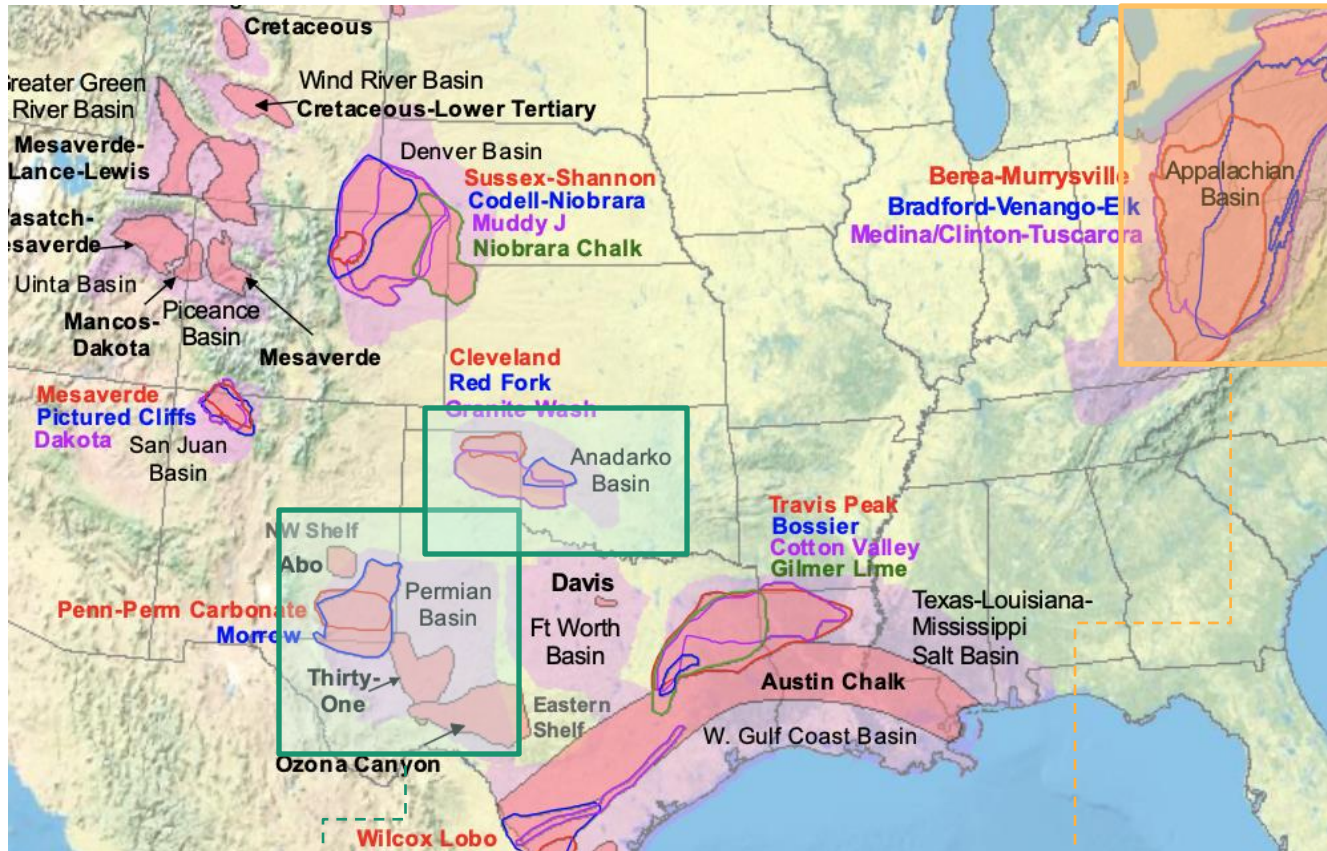


### Natural Gas Liquids (NGL)

- Also called associated hydrocarbons, often valuable by-products of natural gas
- Propane and condensate are common
- Useful in heating, crude refining, etc.
- Previously "flared off", now mainly captured and used
- An increasingly important percentage of production for some upstream producers

Source: RBC

We got gassy, we got liquid, what you want?



### Permian / Anadarko Basin

- More Liquid plays located in West Texas
- Composed mainly of 3 basins:
  - Midland Basin
  - Delaware Basin
  - Marfa Basin

### Marcellus Shale (AKA Appalachia)

- More Gas plays
- Largest volume of recoverable natural gas in the U.S.

To be (conventional) or not to be (conventional)

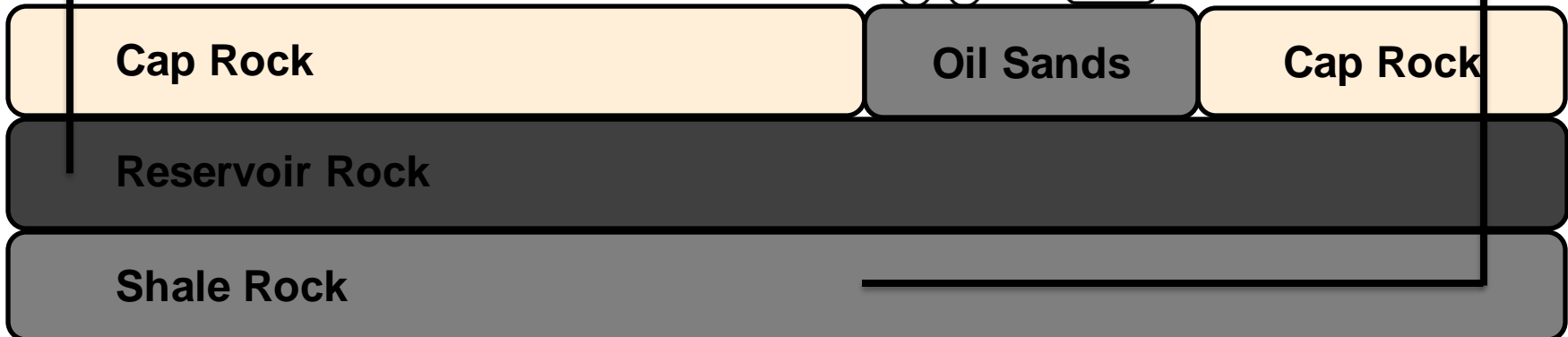
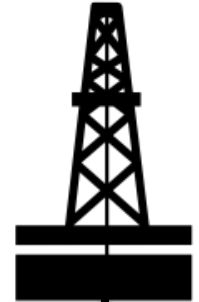
## Conventional

- Includes traditional vertical drilling for crude oil and natural gas
- Typically includes the extraction of oil that is liquid at normal atmospheric pressure and temperature conditions
- These techniques have been used for 90 years
- Usually considered as extracted without the use of heat or steam



## Unconventional

- Traditional unconventional extraction includes **hydraulic fracturing (fracking)** and **horizontal drilling** to extract **shale oil** and gas as well as process oil sands.
- Modern extraction techniques have opened up reserves that were previously unviable



Despite having larger footprints, Unconventional wells require less space overall

# Desautels Capital Management

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## Company Overview

Section III



## Cabot + Cimarex = One Great Company

### Coterra Energy Inc.

- Merger of Cabot Oil & Gas (49.5%) and Cimarex Energy (50.5%) in October 2021
- 85% of CapEx is drilling related
- Operates in 3 major plays in the United States:
  - Marcellus Shale (~177,000 Net Acres)
  - Anadarko (~182,000 Net Acres)
  - Permian (~234,000 Net Acres)
- Focusing on strong execution and performance while maintaining capital discipline and maximizing shareholder returns
- 2022E exit guidance: 635 Mboepd

### 2021 YE Reserves Data (net)

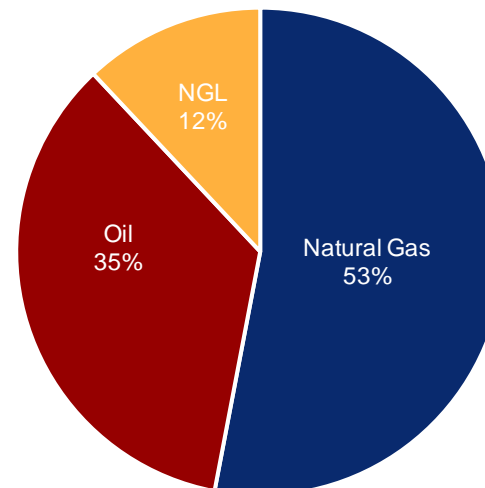
Reserve Category	Crude Oil (Mbbbl)	NGLs (Mbbbl)	Natural Gas (MMcf)	Total (Mboe)
PDP	153,010	193,598	10,691,000	2,128,441
PDNP	5,240	6,104	411,936	80,000
PUD	31,179	20,913	3,792,064	684,103
<b>1P</b>	<b>189,429</b>	<b>220,615</b>	<b>14,895,000</b>	<b>2,892,544</b>

### Market Data

Values as of October 24, 2022

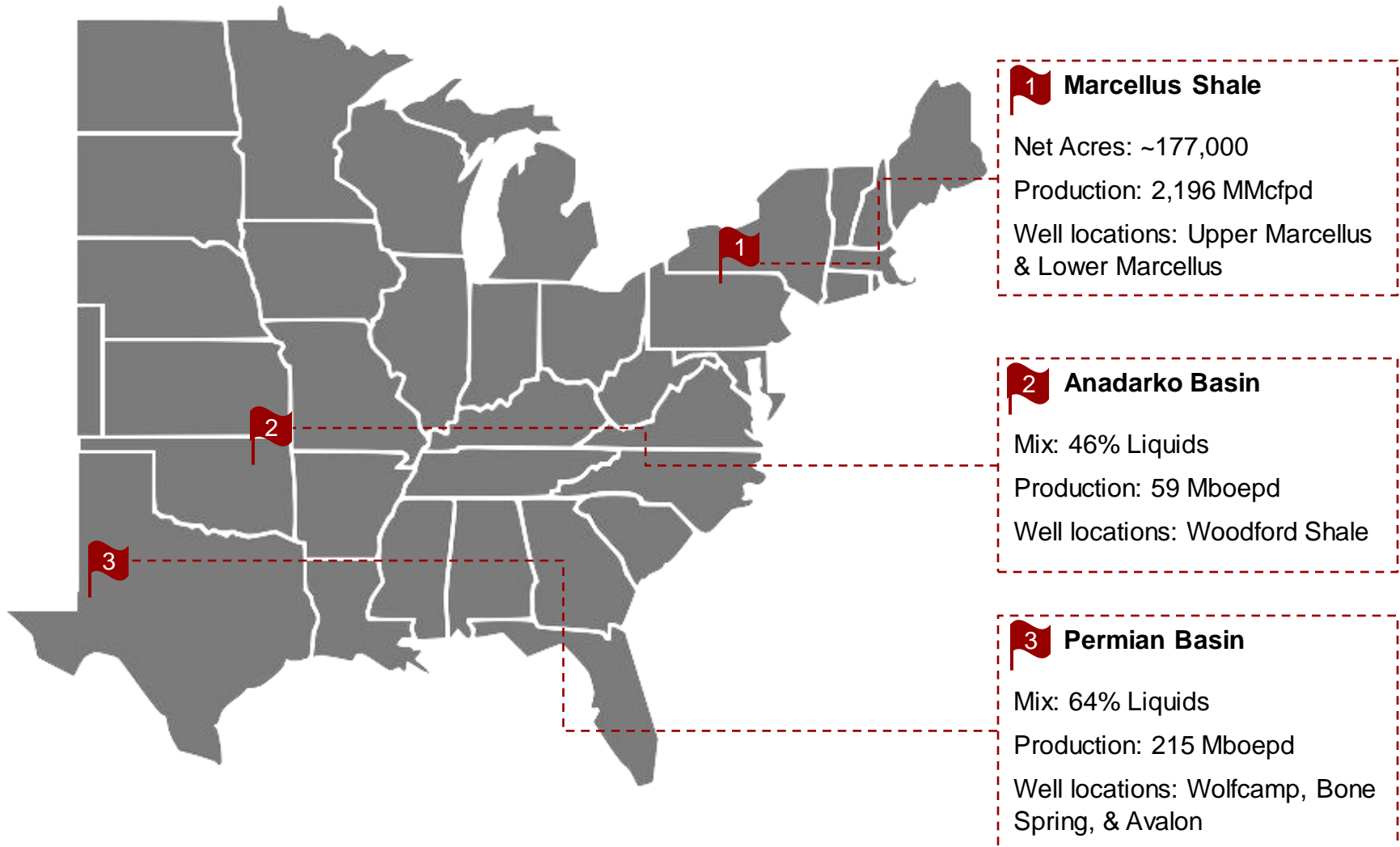
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Less: Cash & Cash Equivalents	(1,059.0)
<b>Enterprise Value</b>	<b>\$ 25,977.3</b>

### 2022E Revenue by Commodity



CTRA primarily focuses on the Marcellus Shale, with significant plays in the Permian Basin and Anadarko Basin

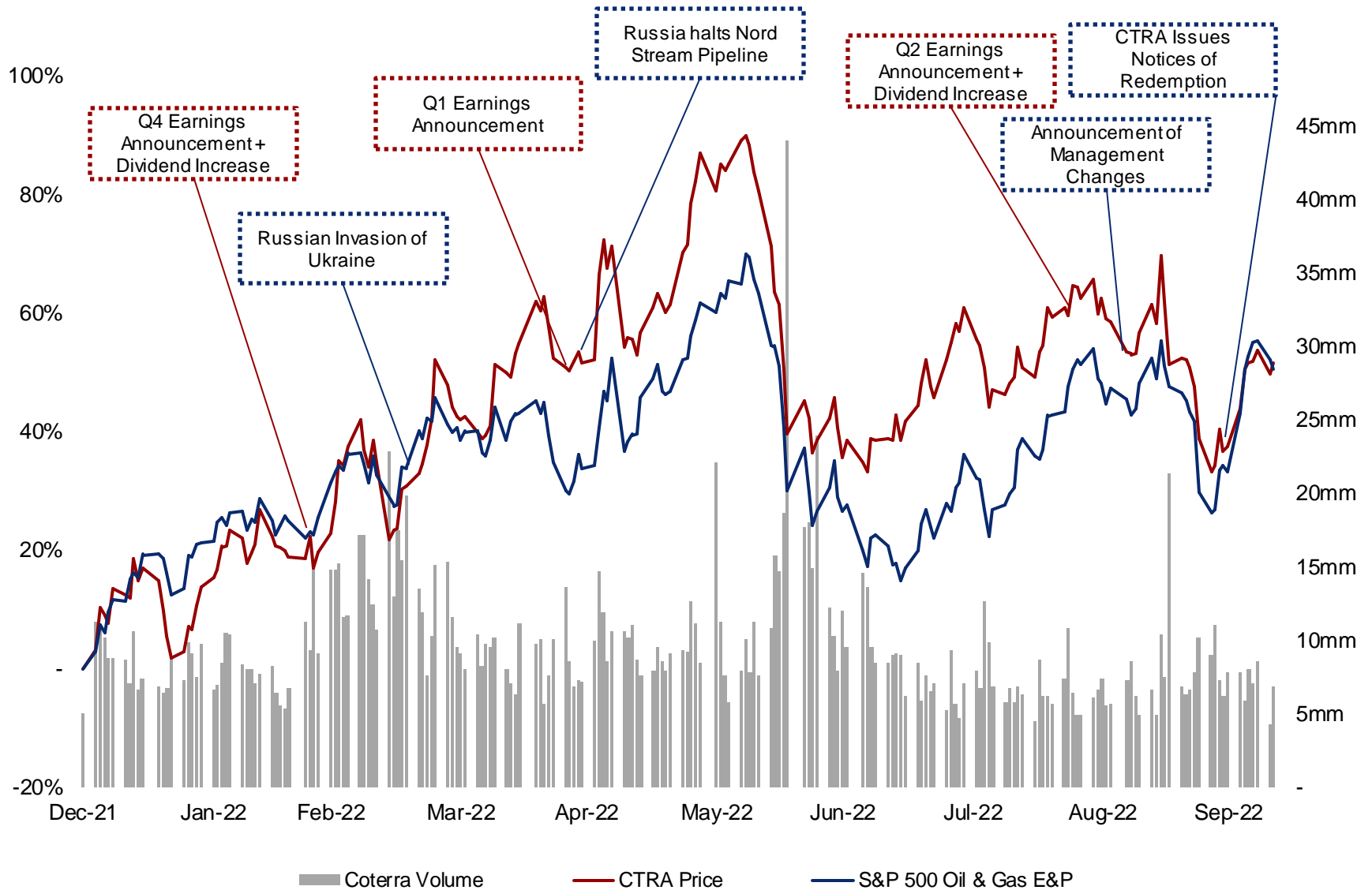
East > West



CTRA has strong positions in both major plays in the U.S.



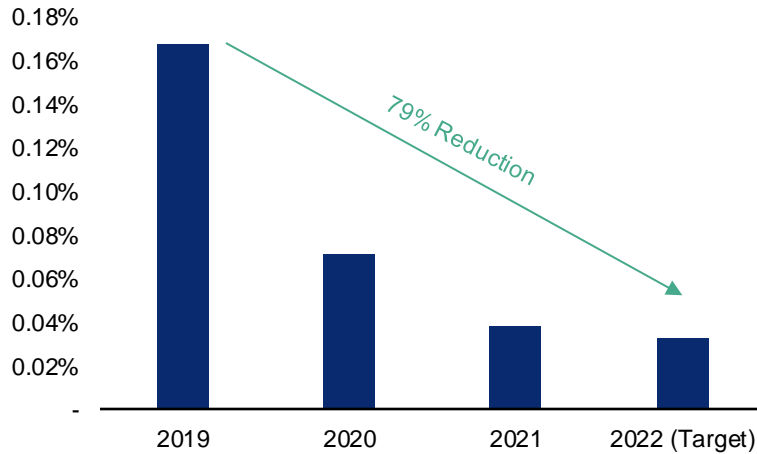
More volatile to Commodity pricing than market information



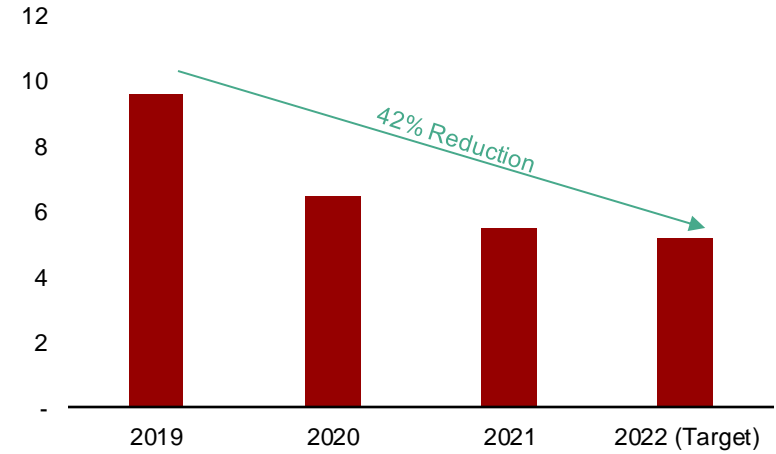
CapIQ, Thomson Reuters

## Environmentally friendly fracking!

### Methane Emission Intensity Projection



### Greenhouse Gas Emissions Intensity Projection



### Management Initiatives

- Installation of pneumatic controllers
- Well-site compression resulting in reduction of emissions from liquid unloading events
- Further investment in **emission monitoring** technology

- Focused on **Engineering Solutions**
- Higher relative Permian volume growth
- Strengthening of **Leak Detection and Repair** program

Management is focused on strong ESG initiatives to drive the company into the future

# Desautels Capital Management

Honours in Investment Management

## Investment Theses

Section IV



Macros are positive, CTRA is well positioned


## OUR INVESTMENT RATIONALES


### A Systematic Factors


Thesis 1: Stage set for US–European natural gas price convergence

### B Idiosyncratic Factors

Thesis 2: CTRA's superior positioning to capitalize on rise in the US natural gas prices

1   
Capital Allocation Strategy

2   
Attractive Hedging Position

3   
High-Quality Asset Base

# Desautels Capital Management

Honours in Investment Management

## Thesis 1: Natural Gas Price Convergence

Section IV



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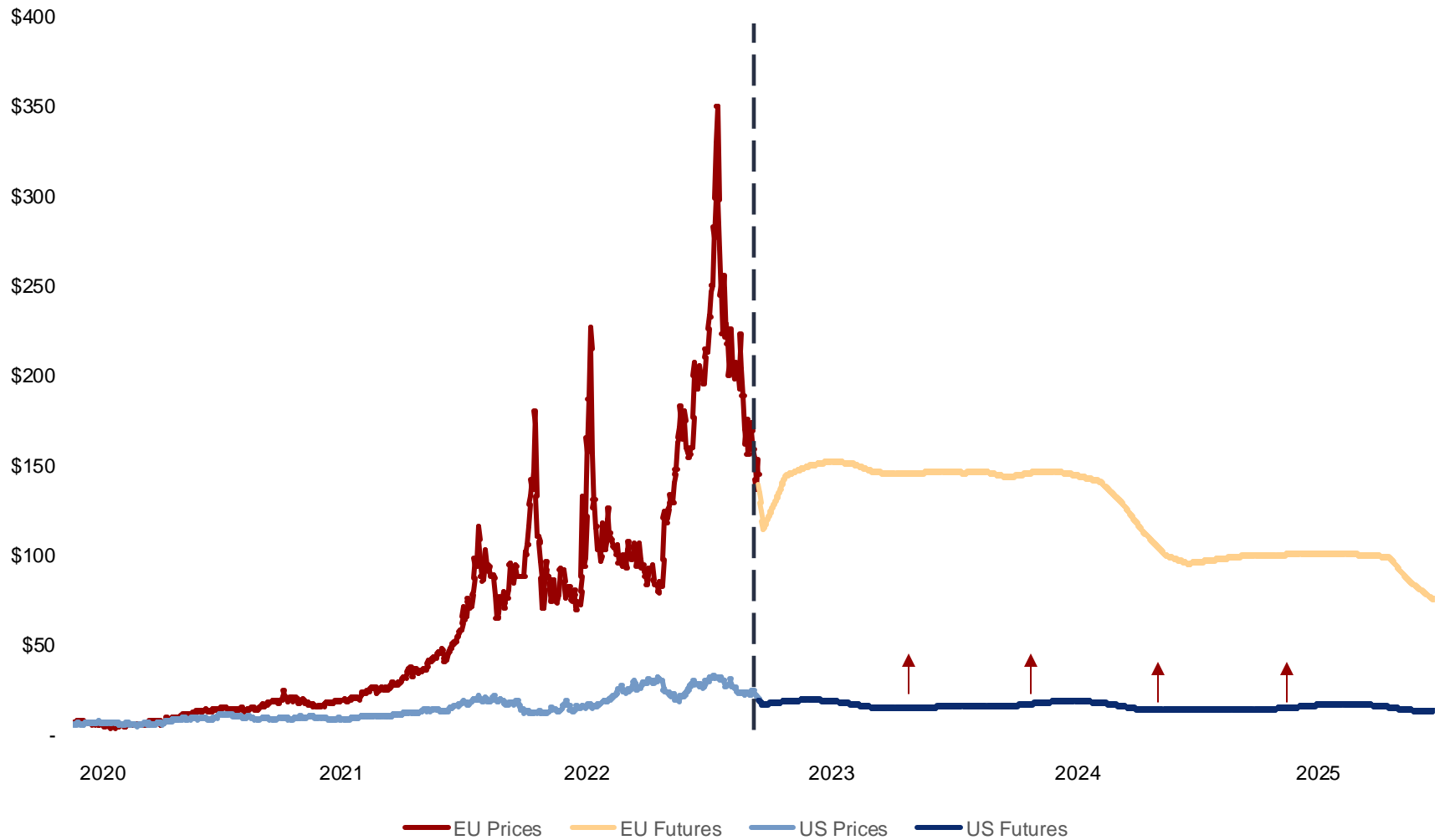
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Capital Allocation Strategy

2   
Attractive Hedging Position



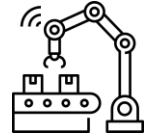

3   
High-Quality Asset Base

## NG Prices standardized to \$/MWh

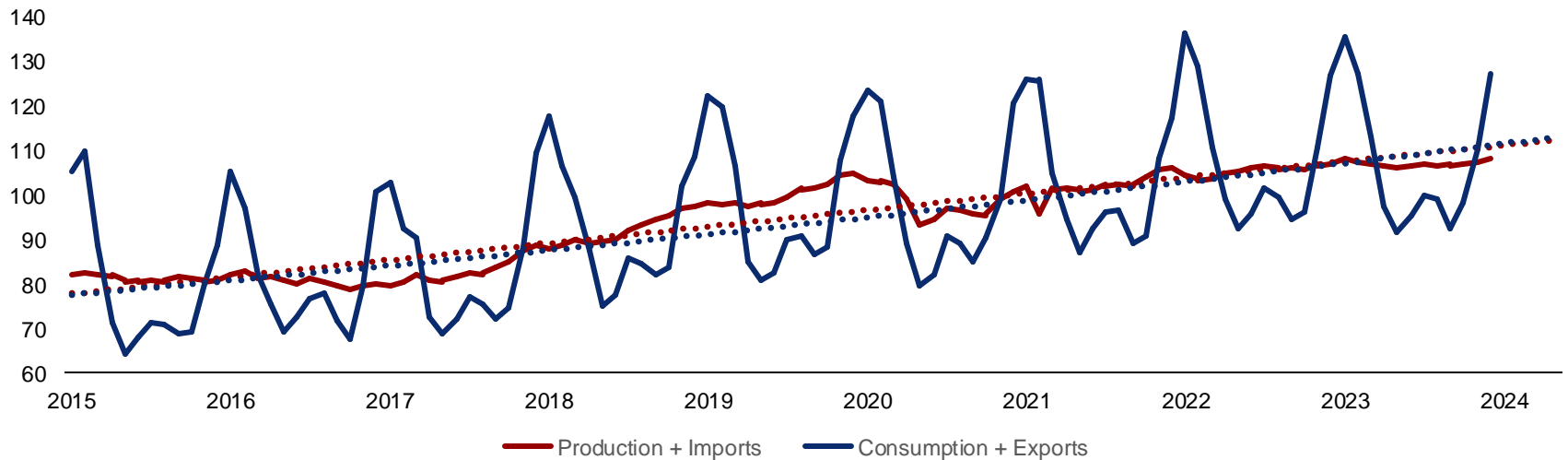


Setting the stage for a price convergence

## Contributing Factors

<p><b>1 Underinvestment in NG E&amp;P</b></p>  <ul style="list-style-type: none"> <li>Real Capex up only 8%</li> <li>ESG investor pressures</li> <li>DUC inventory dwindling</li> </ul>	<p><b>2 Ongoing Supply Chain Constraints</b></p>  <ul style="list-style-type: none"> <li>Labor shortages in O&amp;G</li> <li>Frac sand, pipes, field servicing, <b>diesel</b>, transport</li> </ul>	<p><b>3 US Manufacturing Renaissance</b></p>  <ul style="list-style-type: none"> <li>Higher labor costs and <b>IP security concerns</b> in China</li> <li>1.3M new jobs since 2015</li> </ul>	<p><b>4 Rapidly Increasing LNG Exports</b></p>  <ul style="list-style-type: none"> <li>US LNG exports projected to rise <b>30%</b> 2021-2023</li> <li>US replacing Russia in EU</li> </ul>
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## Net US Natural Gas Production and Consumption



Source: EIA, Reuters, McKinsey, EU Council



# Consumption Growth is Overtaking Production Growth

Setting the stage for a price convergence

## Contributing Factors

**1 Underinvestment in NG E&P**



- Real Capex up only 8%
- ESG investor pressures
- DUC inventory dwindling

**2 Ongoing Supply Chain Constraints**

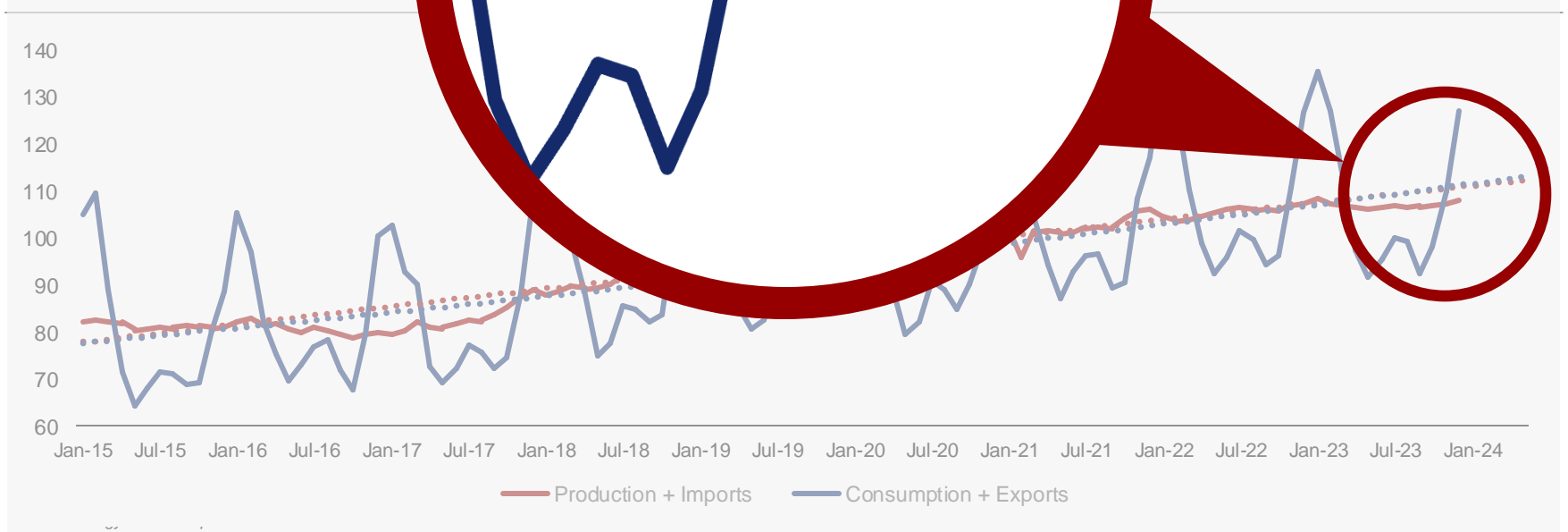
**3 US Manufacturing Renaissance**

**4 Rapidly Increasing LNG Exports**



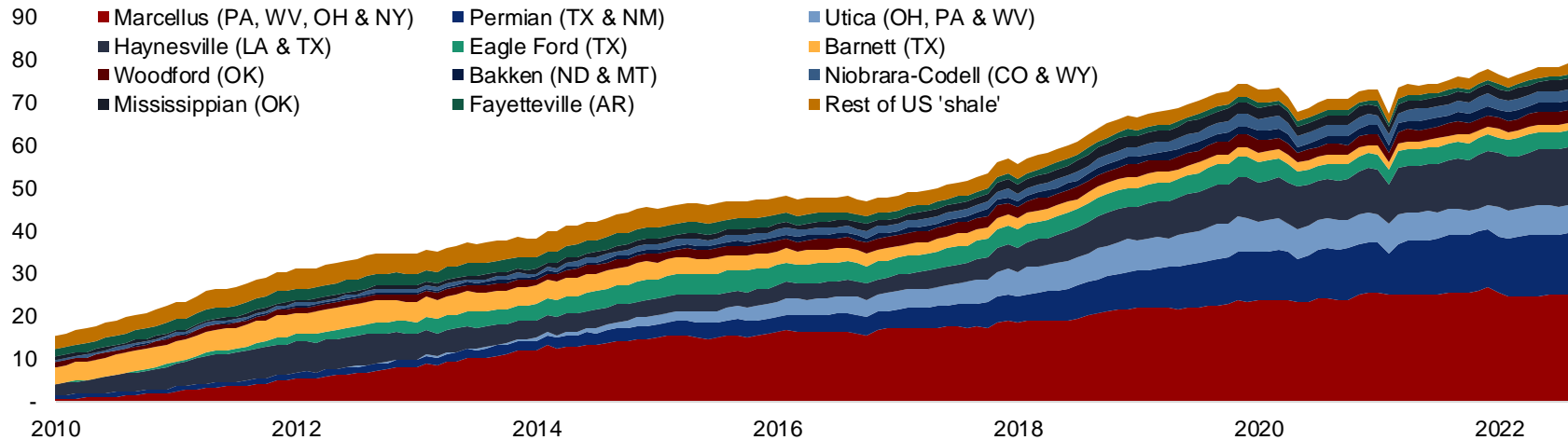
- US LNG exports projected to rise 30% 2021-2023
- US replacing Russia in EU

## Net US Natural Gas Production



Natural gas reached an all-time high production in 2022, but can it last?

## US Shale Gas Production by Basin (Bcf/d)



## Identifying Supply Risks

### Decreasing Rigs in US Basins

- Reduced Capex has led to a shortage of new wells
- Labor costs and inputs have been rising due to inflation

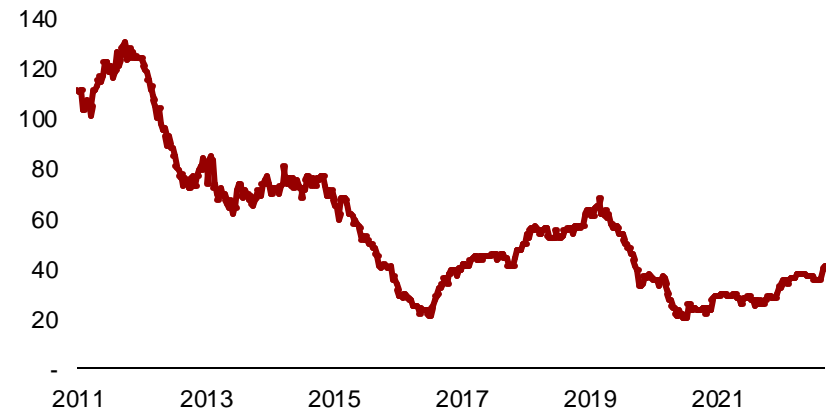
### DUC Well Count Dwindling

- Drilled but uncompleted well inventory expanded over COVID, but may slow as wells are completed and not replaced

### Uncertainty Regarding Future Reserves

- Very little geological research has been done in the Marcellus since 2017, raising questions as to the longevity of production

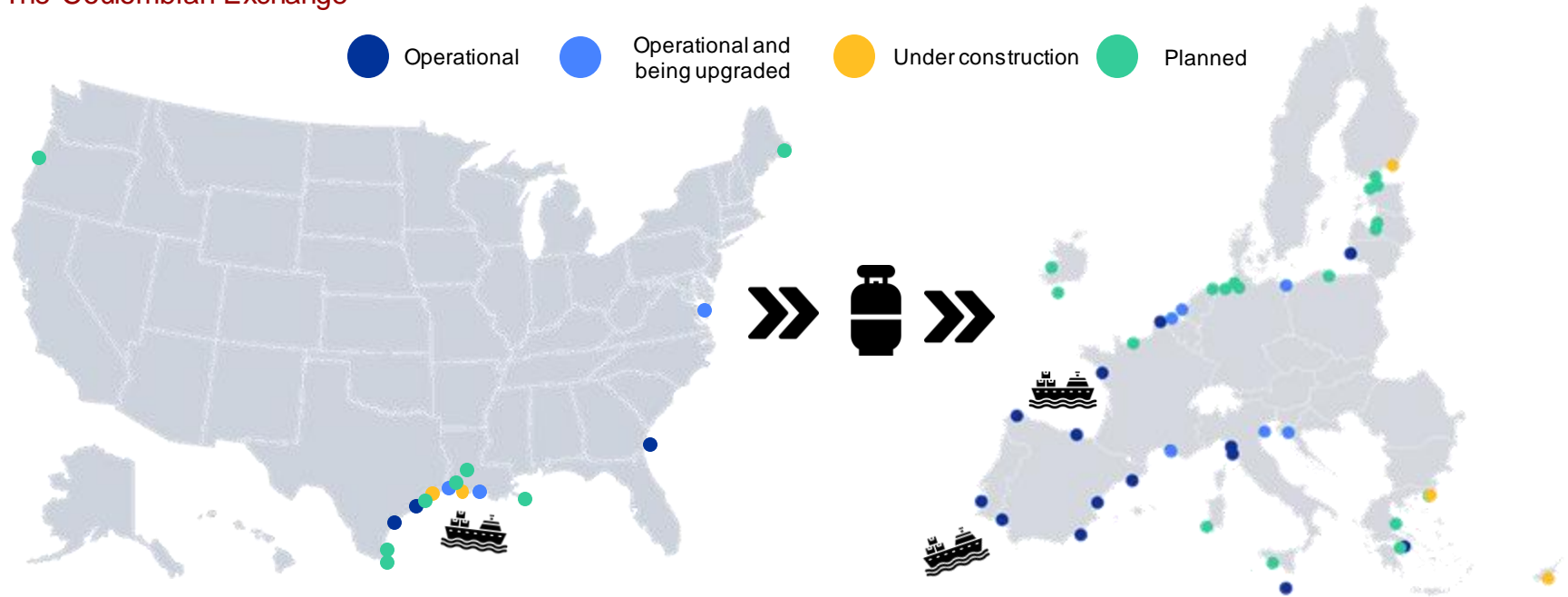
## Marcellus Rig Count



Near-term demand destruction obfuscating long-term supply issues

Source: EIA

## The Coulombian Exchange



### US Natural Gas Export Forecast

**Increasing Export Capabilities – Rapid Growth**

- Sabine Pass and Cove Point adding capacity
- Golden Pass and Calcasieu will add 3.6 Bcf/d (25%)
- Export capacity projected to 2x to 28Bcf/d by 2030

**US Freeport LNG Fire – Supply Disruption**

- Largest export terminal caught fire in June
- Makes up 20% of US LNG exports
- Led to prices crashing in the US due to oversupply

### EU LNG Import Forecast

**Import Bottleneck – Lacking Infrastructure**

- 36 LNG carriers are circling the Mediterranean
- Regasification plant capacity set to double by 2027
- Germany building plants to supplement Nordstream

**Energy Security – Rebuilding without Russia**

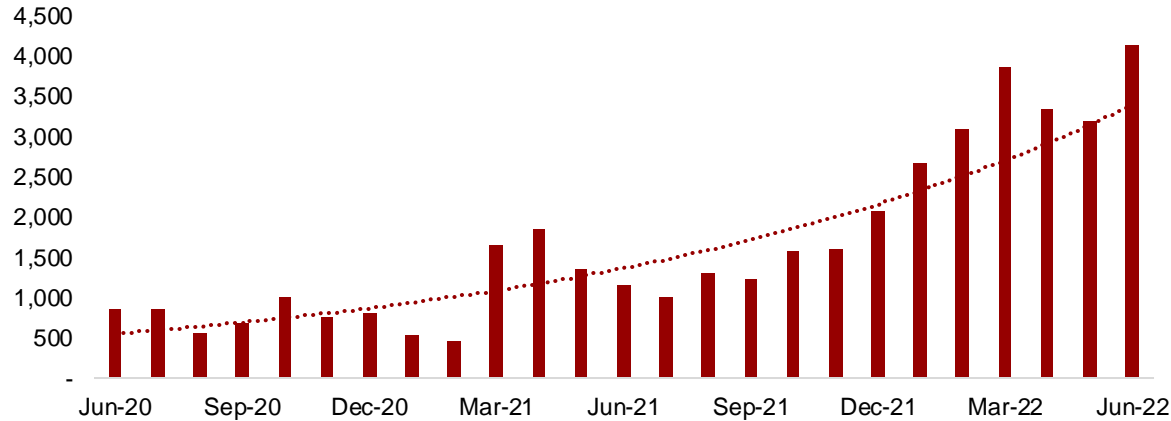
- US already supplying more NG than Russia did
- Long-term US-EU contracts + support from Biden
- US LNG imports doubled YoY, over 50% of demand

Monumental investments to increase LNG capacity on both sides

EU Council, EIA, Golden Pass LNG, Cheniere LNG, Bloomberg

US replacing Russia as Europe's #1 friend NG supplier

## US LNG Exports to Europe (Million cubic meters)



## Realistic rescue or impossible promises?

### Biden Pledges Additional 15Bcm LNG to Europe in March

- Met with skepticism from both sides of the aisle
- US blew past promise and hit 39Bcm before Freeport fire

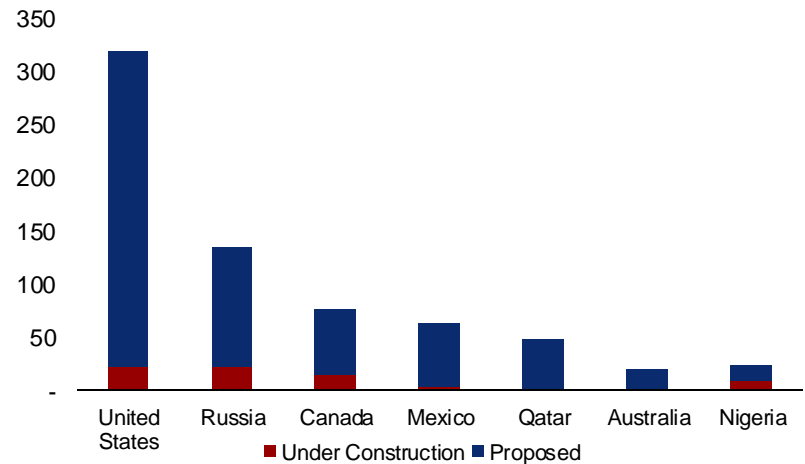
### Accelerated Regulatory Permits

- Current timeline from proposal to construction is 6-8 years
- About 60% of that is moving through the regulatory pipeline

### Production Defense Act

- Last invoked by Trump during COVID for PPE & ventilators
- Worst case scenario measure, unlikely to be used

## Future LNG Export Capacity (Mta)



Long process between refining and end product

# Desautels Capital Management

Honours in Investment Management

## Thesis 2: CTRA's strategic positioning

Section IV



Macros are positive, CTRA is well positioned

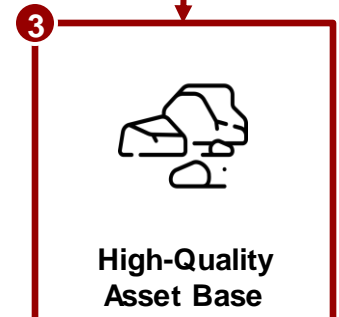
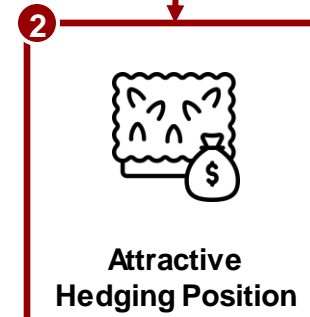
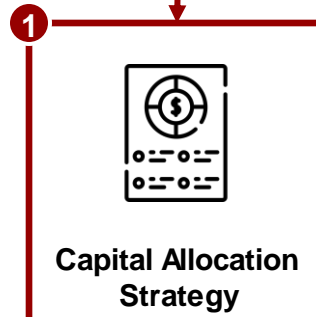
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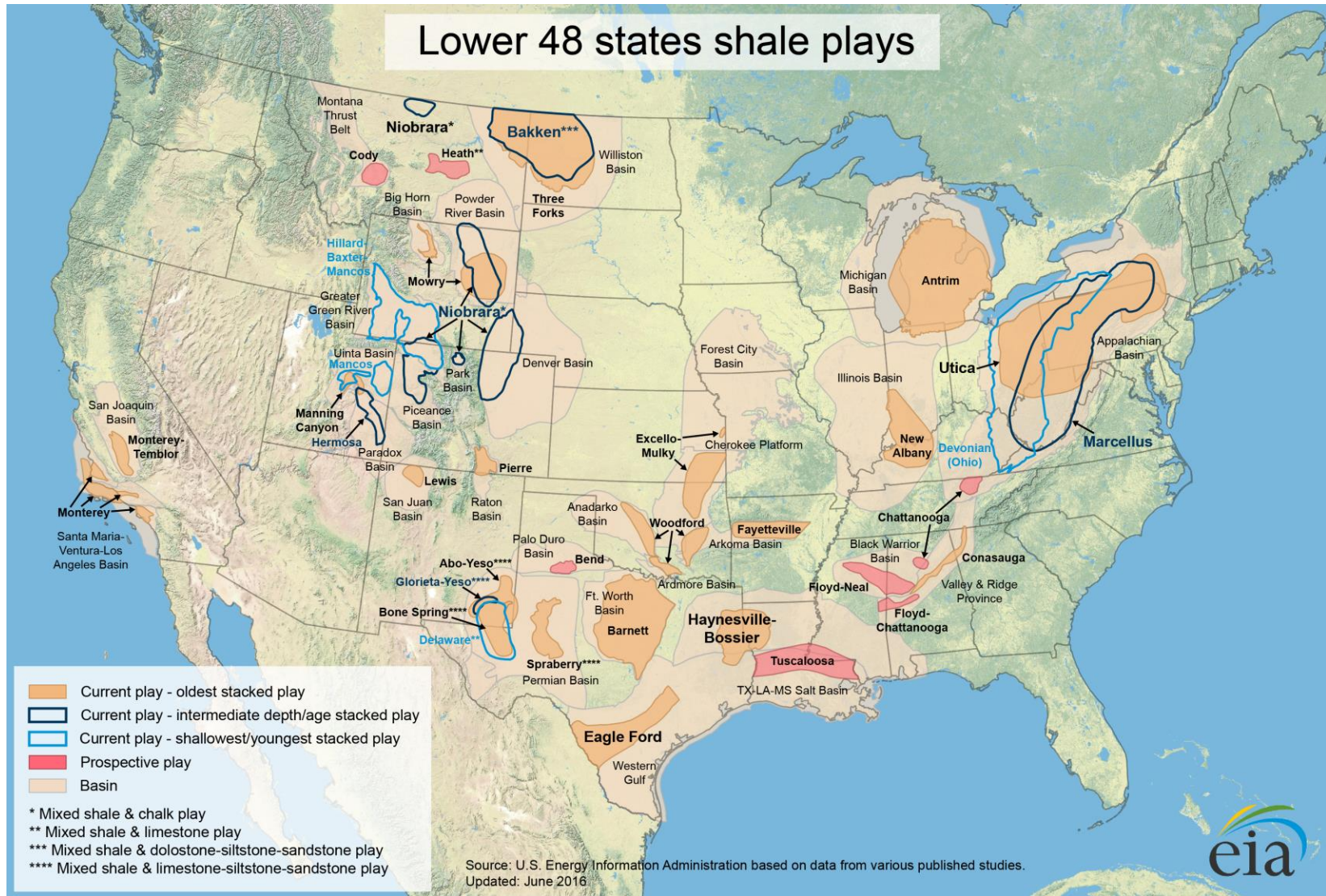
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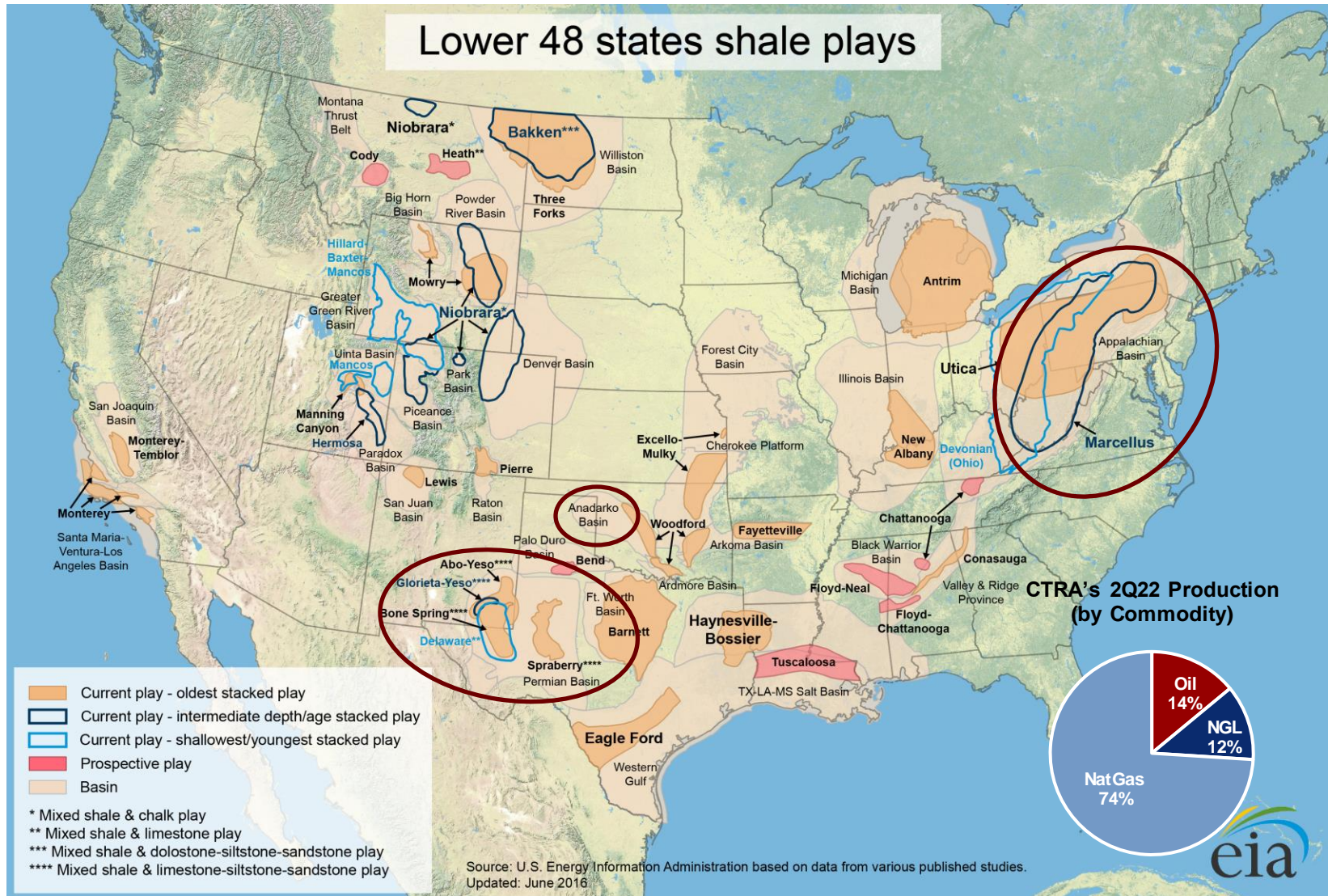




Source: EIA



Marcellus, Permian, and Anadarko Assets



Source: EIA



## Acreages in The Marcellus, Permian, and Anadarko Basins – a gas-heavy portfolio to capitalize on thesis #1

	PERMIAN BASIN	ANADARKO BASIN	MARCELLUS SHALE
<b>Brief Description</b>	Acreage is located in the Delaware Basin region which spans west Texas and southeast New Mexico.	Acreage currently focused on the Woodford Shale in Western Oklahoma	Acreage operations in the region are primarily concentrated in Susquehanna County, Pennsylvania.
<b>Acreage</b>	234,000	182,000	177,000
<b>Oil / Gas Mix (2021)</b>	64% Liquids	46% Liquids	100% Natural Gas
<b>Target Zones</b>	Upper Wolfcamp, Bone Spring, and Avalon	Woodford Shale	Lower Marcellus Upper Marcellus
<b>YE 2021 Reserves</b>	514 MMBOE	198 MMBOE	2,179 MMBOE
<b>2021 Production Volume</b>	186 MBOEpd	59 MBOEpd	2,228 MMCFpd
<b>ESG Practices</b>	Use of electric horsepower for power generation, an on-demand pipeline system for recycling water, and lowering emissions through reducing flaring activity	Use of electric horsepower for compression and continuous emission monitoring	Field site reclamation, water recycling at nearly 100%, and the restriction of flaring to safety concerns only

Source: Coterra Filings

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Source: Coterra Filings

Some of the highest TOC content of the O&G plays in the US

## EIA's Geology Review Report on the Marcellus Shale

## Review of Academic Literature



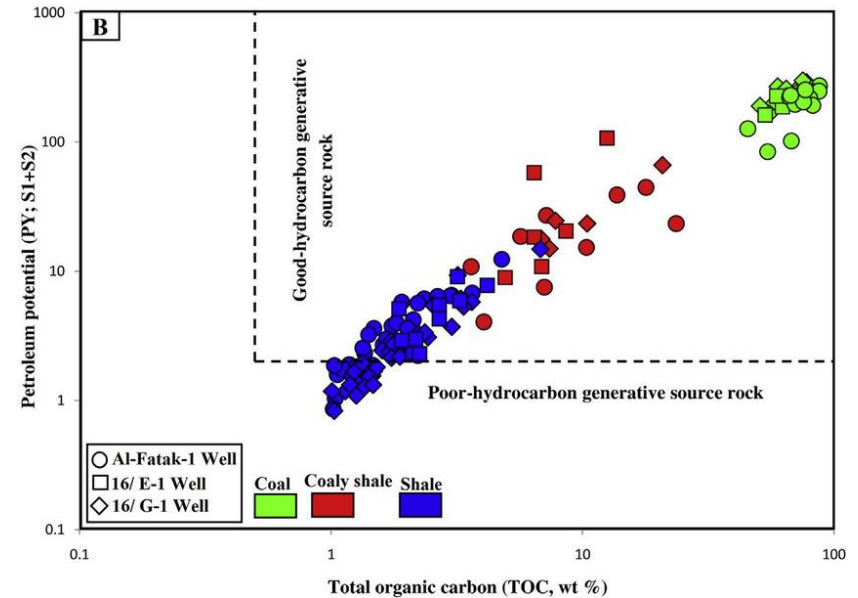
### Marcellus Shale Play

Geology review

2017



Analytical results from multiple well core samples indicate that Total Organic Carbon (TOC) content in the Marcellus formation ranges from less than 1% to 20% (Zielinski and Mciver, 1982; Nyahay et al., 2007; Reed and Dunbar, 2008). Known good source rocks typically contain 2.0% TOC or higher. As such, the **Marcellus Shale has some of the highest TOC content of plays in the United States.**



- **Total Organic Carbon (TOC):** important parameter in reservoir evaluation, exploration, and source rock characterization
- Positive correlation between total organic carbon content and petroleum potential

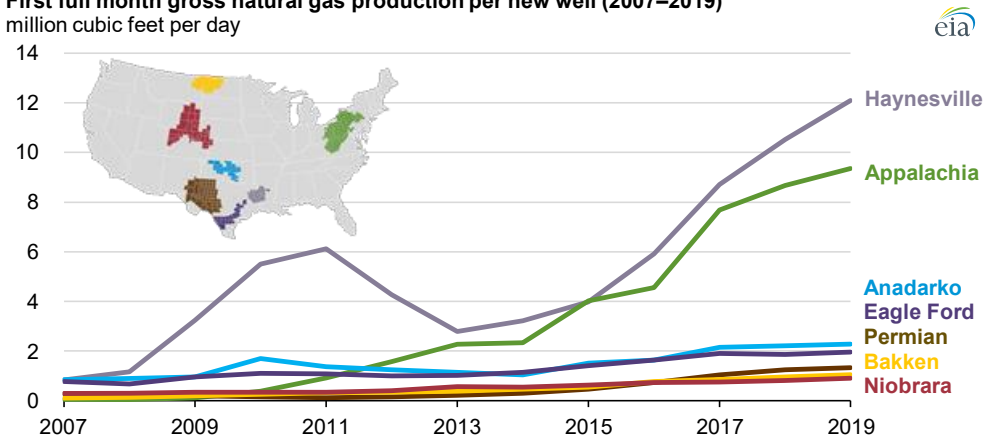
High TOC, high petroleum potential

Source: ResearchGate, EIA

Exposure to Appalachia via the acquisition of Cabot (2021)

## Increasing Initial Production (IP) Rates As a Result of Well Productivity

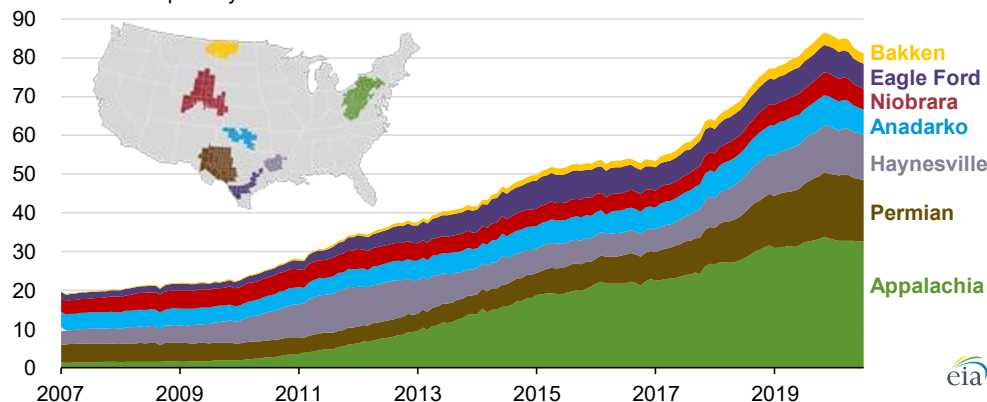
First full month gross natural gas production per new well (2007–2019)  
million cubic feet per day



- **More effective drilling techniques**
  - Injection of more proppant—sand or similar particulate material suspended in water or other fluid—during the hydraulic fracturing process
  - Ability to drill longer horizontal well components (laterals)
- **Improvement in well productivity**

## Appalachia (Marcellus Shale) Represents The Largest Natural Gas Basin in the US

Monthly gross natural gas production in selected regions (2007–2019)  
billion cubic feet per day



- Since 2007, gross natural gas production from the Appalachia region has grown at an **average annual rate of 20%** (same for Haynesville)
- Production of associated natural gas in the oil regions remains significant, accounting for 46% of the natural gas production from all regions

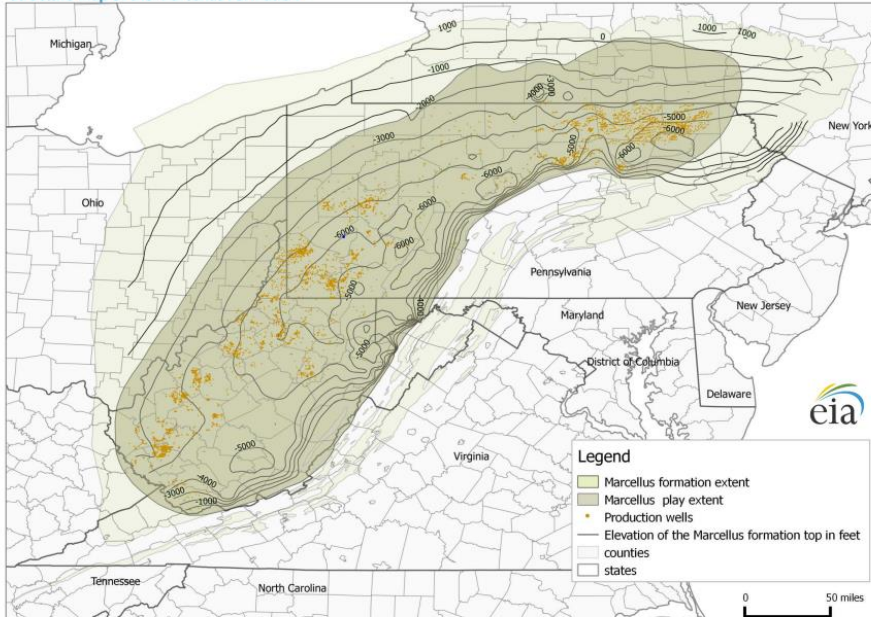
Source: EIA

# Is Susquehanna Hilly?

Adam says the less hilly, the better

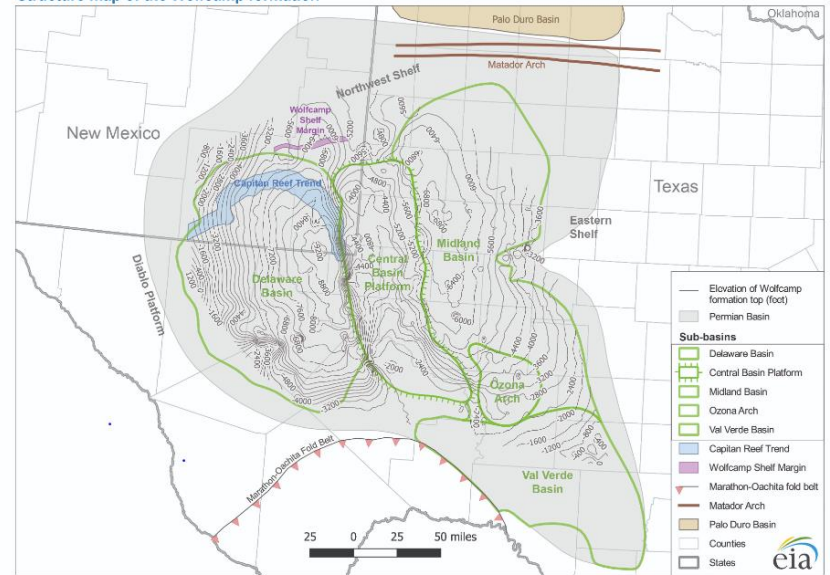
## Comparison between Marcellus vs Permian Basins' Topography

Structure map of the Marcellus Formation



Source: U.S. Energy Information Administration, based on DrillingInfo Inc., New York State Geological Survey, Ohio State Geological Survey, Pennsylvania Bureau of Topographic & Geologic Survey, West Virginia Geological & Economic Survey, and U.S. Geological Survey.  
 Note: Map includes production wells from January 2003 through December 2014.

Structure map of the Wolfcamp formation



Source: U.S. Energy Information Administration based on DrillingInfo Inc., Bureau of Economic Geology, U.S. Geological Survey.

## An Avant Garde DD Process

Jordan

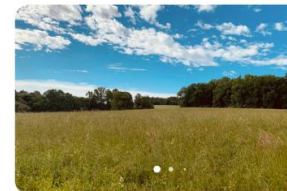
Try to look up hikes in susquehanna on google and see what ppl are saying



Easy or difficult LMAO

I think we won

### Les meilleures randonnées (15)



Modérée • ★ 4.4 (508)

**#1 - Rock Run Grist Mill Trail**  
 Susquehanna State Park  
 Distance : 7,7 km • Est. 2h 16m

Source: EIA

# Desautels Capital Management

Honours in Investment Management

## Valuation

Section V



# Comparable Companies Analysis

These are some liquid companies pt.2

	Criteria 1: Location	Criteria 2: Liquids Mix	Criteria 3: Reserve Size
E&P Companies	> 80 % Permian Basin & Marcellus Shale	< 40% Liquids	< 3000 Mmboe
	✓	✓	✓
	✓	✓	✓
	✓	✓	✓
	✓	✓	✓
	✓	✓	✓

Public Comparable Companies <i>(In USD millions, except per share and reserves data)</i>	Stock Price 10/25/2022	Enterprise Value	Performance Measures				Valuation Multiples				
			Mboe/D	Liquids Mix	EBITDA FY1	1P Reserves (Mmboe)	EV/ FY1 EBITDA	EV/Production	EV/ 1P Reserves	P/E	
Devon Energy Corporation (NYSE:DVN)	\$74.94	52,849	570.3	32%	10575	1626	5.00x	92.67x	32.51x	9.54x	
EOG Resources, Inc. (NYSE:EOG)	\$132.86	81,151	847.5	28%	16195	3747	5.01x	95.75x	21.66x	13.63x	
CNX Resources Corporation (NYSE:CNX)	\$34.10	5,766	269.6	7%	1408	1604	4.10x	21.39x	3.59x	-	
Antero Resources Corporation (NYSE:AR)	\$26.27	15,333	547.0	31%	4078	2956	3.76x	28.03x	5.19x	12.11x	
Range Resources Corporation (NYSE:RRC)	\$27.09	7,890	355.1	30%	2208	2963	3.57x	22.22x	2.66x	13.38x	
<b>25th Percentile</b>		7,890	355.1	28%	2,208	1,626	3.8x	22.2x	3.6x	11.5x	
<b>Average</b>		32,598	517.9	26%	6,892	2,579	4.3x	52.0x	13.1x	12.2x	
<b>Median</b>		15,333	547.0	30%	4,078	2,956	4.1x	28.0x	5.2x	12.7x	
<b>75th Percentile</b>		52,849	570.3	31%	10,575	2,963	5.0x	92.7x	21.7x	13.4x	
<b>Coterra Energy Inc. (NYSE:CTRA)</b>	<b>\$29.67</b>	<b>26,463</b>	<b>634.2</b>	<b>26%</b>	<b>6995</b>	<b>2893</b>	<b>3.78x</b>	<b>41.73x</b>	<b>9.15x</b>	<b>7.12x</b>	
<b>% of Premium / Discount to Average</b>					1.49%	12.15%	(11.78%)	(19.78%)	(30.28%)		

Source: Cap IQ, CME Group, Yahoo Finance

As easy as 1,2,P

## NAV – 1P

1P – Proven Reserves



- Less Reserves → Same Production → Reserves Depleted Faster
- Standard Discount Rate = WACC (4.51%), less risk associated with removal

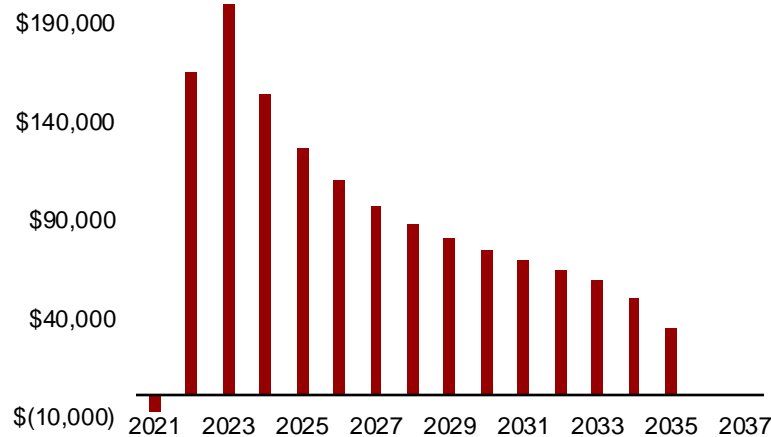
## NAV – 2P

2P – Proven & Probable Reserves



- More Reserves → Same Production → Reserves Depleted Slower
- Higher discount rate (15%) to account for additional riskier reserves

### UFCF Forecast



### Bridge to Equity - NAV WACC

Enterprise Value	31,862.81
add: Cash & Cash Equivalents	1,059
less: Total Debt	- 3,420
less: Preferred Shares	- 11
less: Minority Interest	-
<b>Equity Value</b>	<b>29,491</b>
FD Shares Outstanding	795.6
<b>Implied Share Price</b>	<b>37.07</b>
Upside	24.93%

Source: Cap IQ, CME Group, Yahoo Finance



As easy as 1,2,P – Or is it?

## NAV – 1P

1P – Proven Reserves



- Less Reserves → Same Production → Reserves Depleted Faster
- Standard Discount Rate = WACC (4.51%), less risk associated with removal

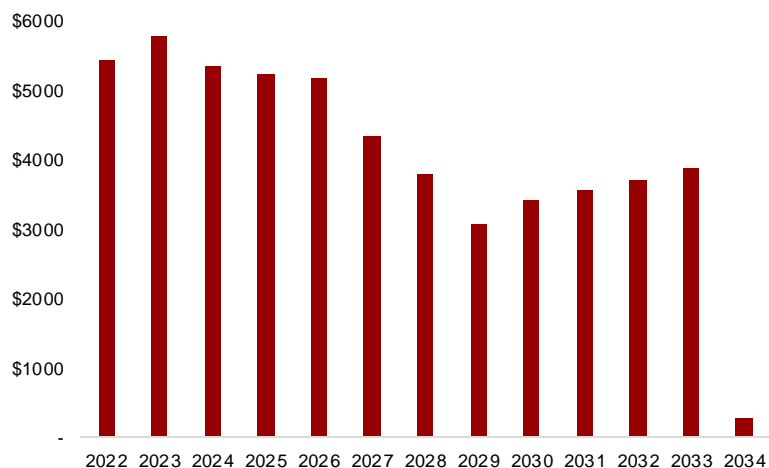
## NAV – 2P

2P – Proven & Probable Reserves

*Historical non-disclosure of 2P - “Only proved reserves in accordance with definitions of Rules 4-10(a) (1)-(32) of Regulation S-X of the SEC have been evaluated for this report.”*

- Higher discount rate (15%) to account for additional riskier reserves

### UFCF Forecast

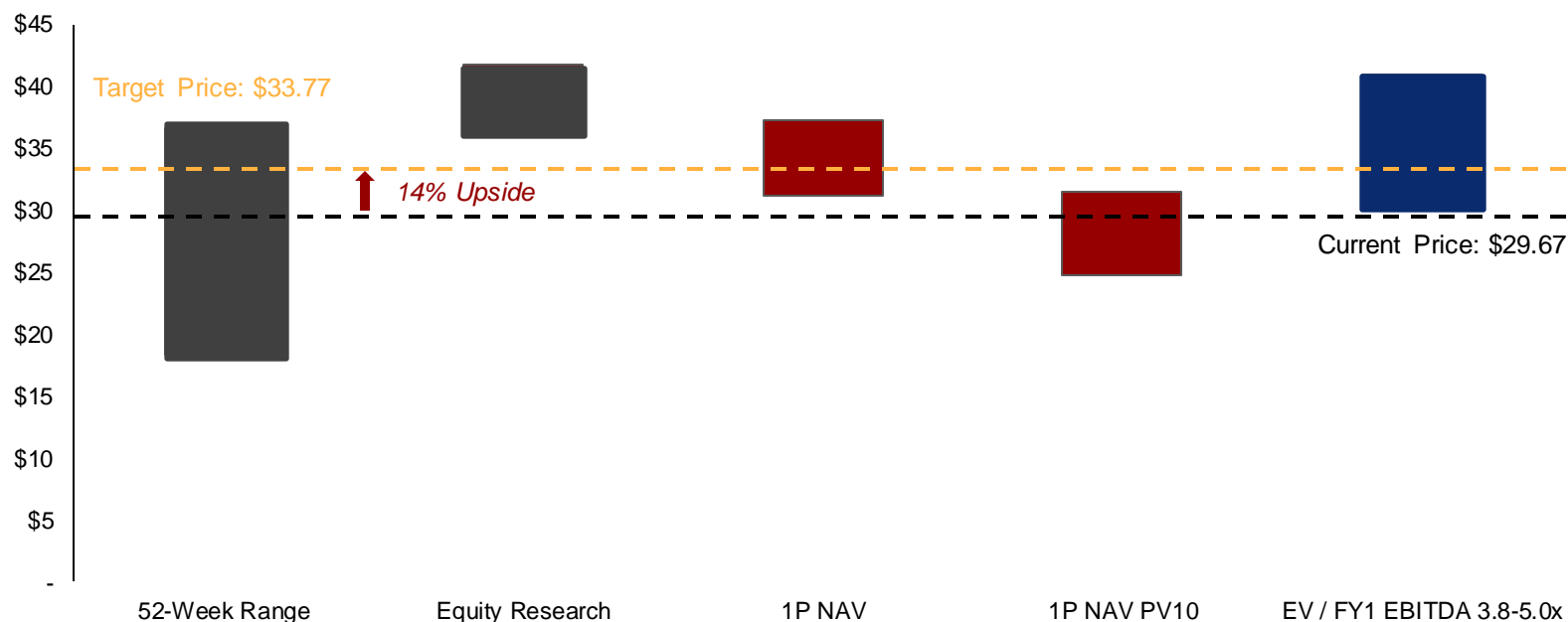


Source: Cap IQ, CME Group, Yahoo Finance

### Bridge to Equity - NAV WACC

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FD Shares Outstanding	795.6
<b>Implied Share Price</b>	<b>37.07</b>
Upside	24.93%

Recommended HOLD with a price target of \$33.77, for an implied upside of 14%



Football Field					
Valuation	Low	High	Average / Base	Weight	
52-Week Range	\$ 18.39	\$ 36.55	\$ 27.47	-	
Equity Research	\$ 36.04	\$ 41.72	\$ 38.88	-	
1P NAV WACC	\$ 31.19	\$ 37.26	\$ 34.23	50%	
1P NAV PV10	\$ 24.74	\$ 31.55	\$ 28.15	15%	
EV / FY1 EBITDA	\$ 30.08	\$ 40.98	\$ 35.53	35%	
<b>Target Price</b>				<b>\$ 33.77</b>	

Source: Cap IQ, CME Group, Company Filings

# Desautels Capital Management

Honours in Investment Management

## Risks and Catalysts

Section VI



Near to Medium Term Catalysts: *Signs of Theses Materialization*

Q4 2022

H1 2023

H2 2023

Russian crude export ban

Freeport LNG fixed

Further special dividends

Calcasieu Pass LNG Complete

Risk Considerations: *Signs to Exit*

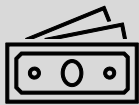
INTERNAL

EXTERNAL

Federal Acreage



Dividend Suspension



Warmer Winter



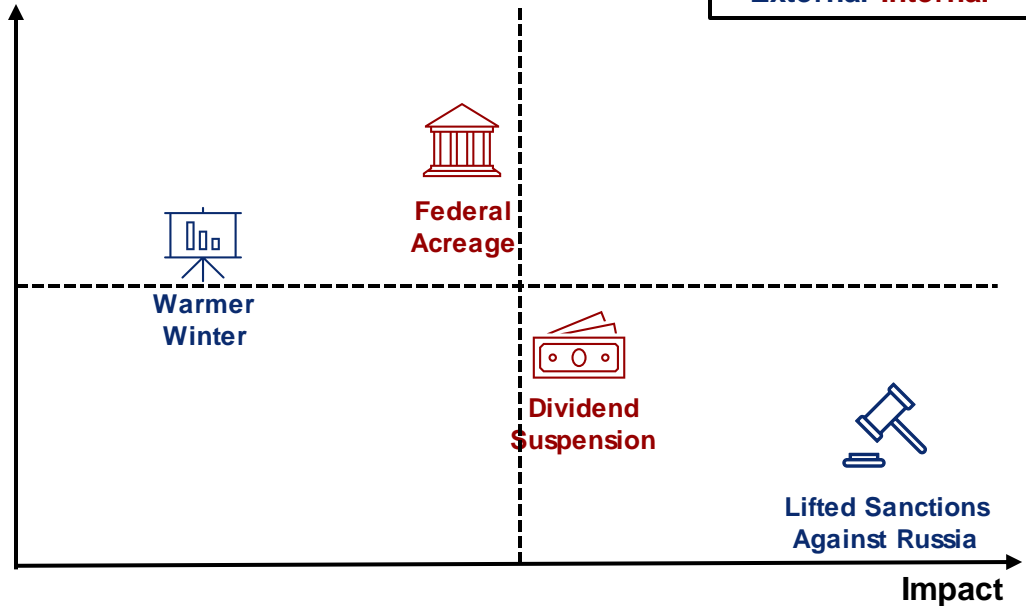
Lifted Sanctions Against Russia



Likelihood vs Impact Matrix

Likelihood

External Internal



Source: 1: EnergyGlobal, 2: CNN

# Desautels Capital Management

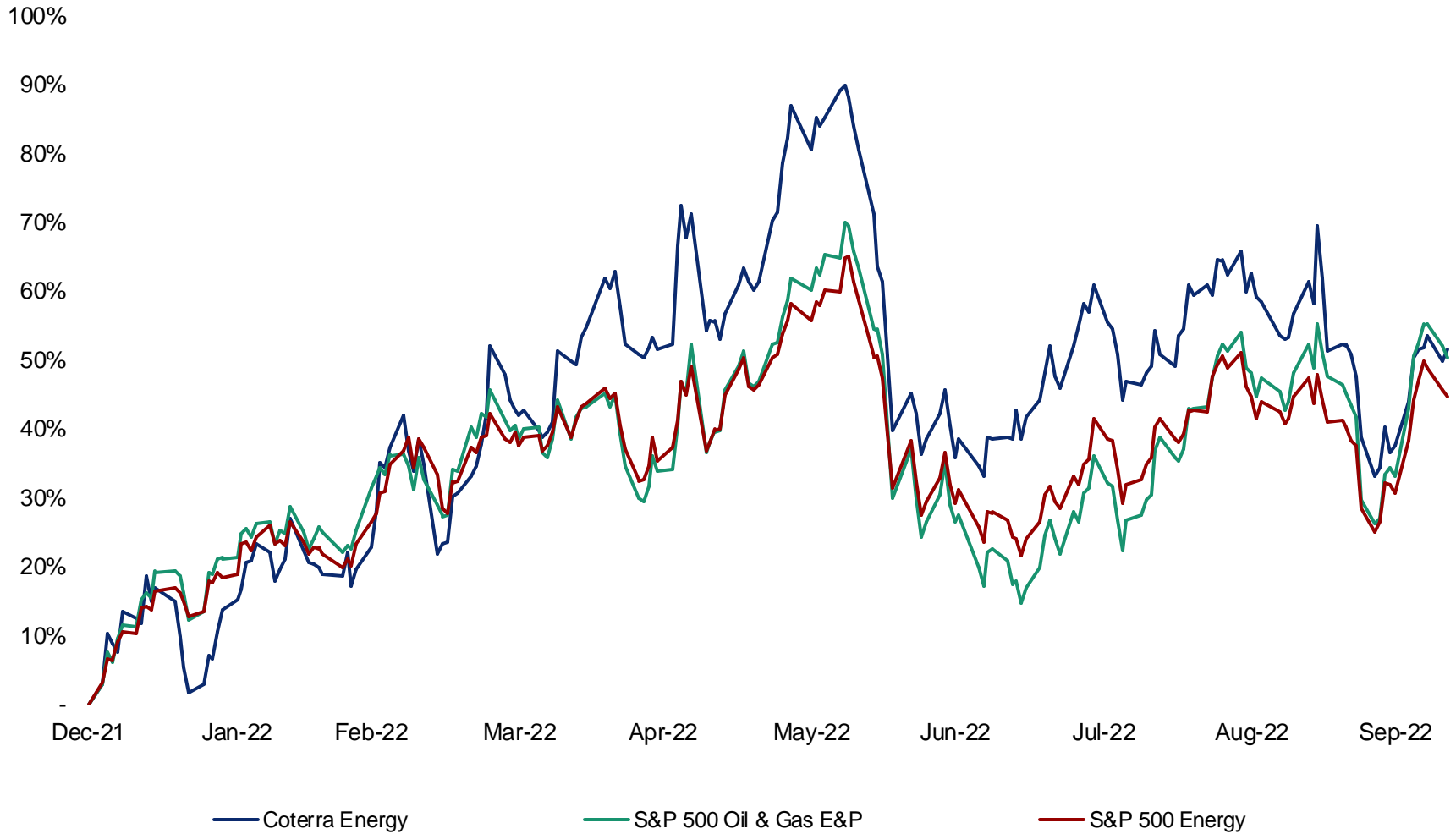
Honours in Investment Management

## Appendix

Section X

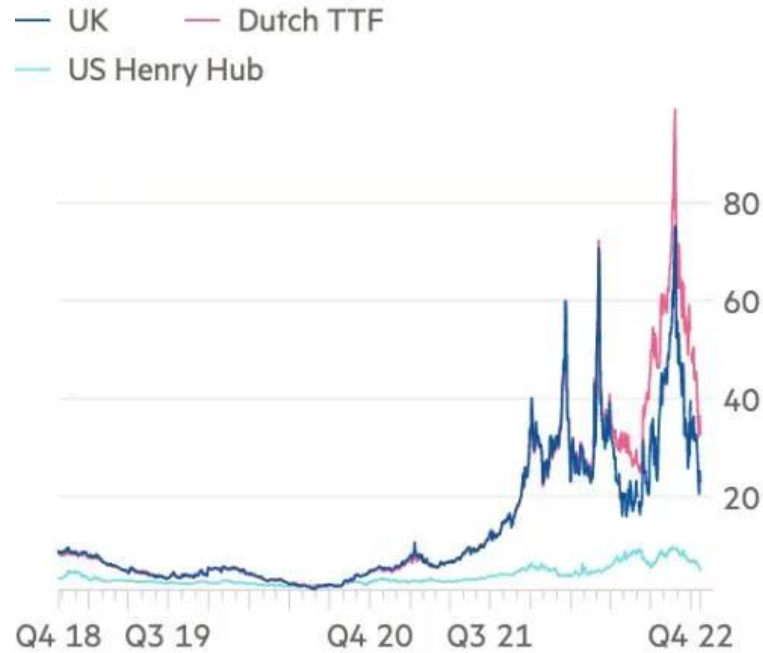


Coterra has consistently outperformed both the E&P and Energy index



## Natural gas prices cool

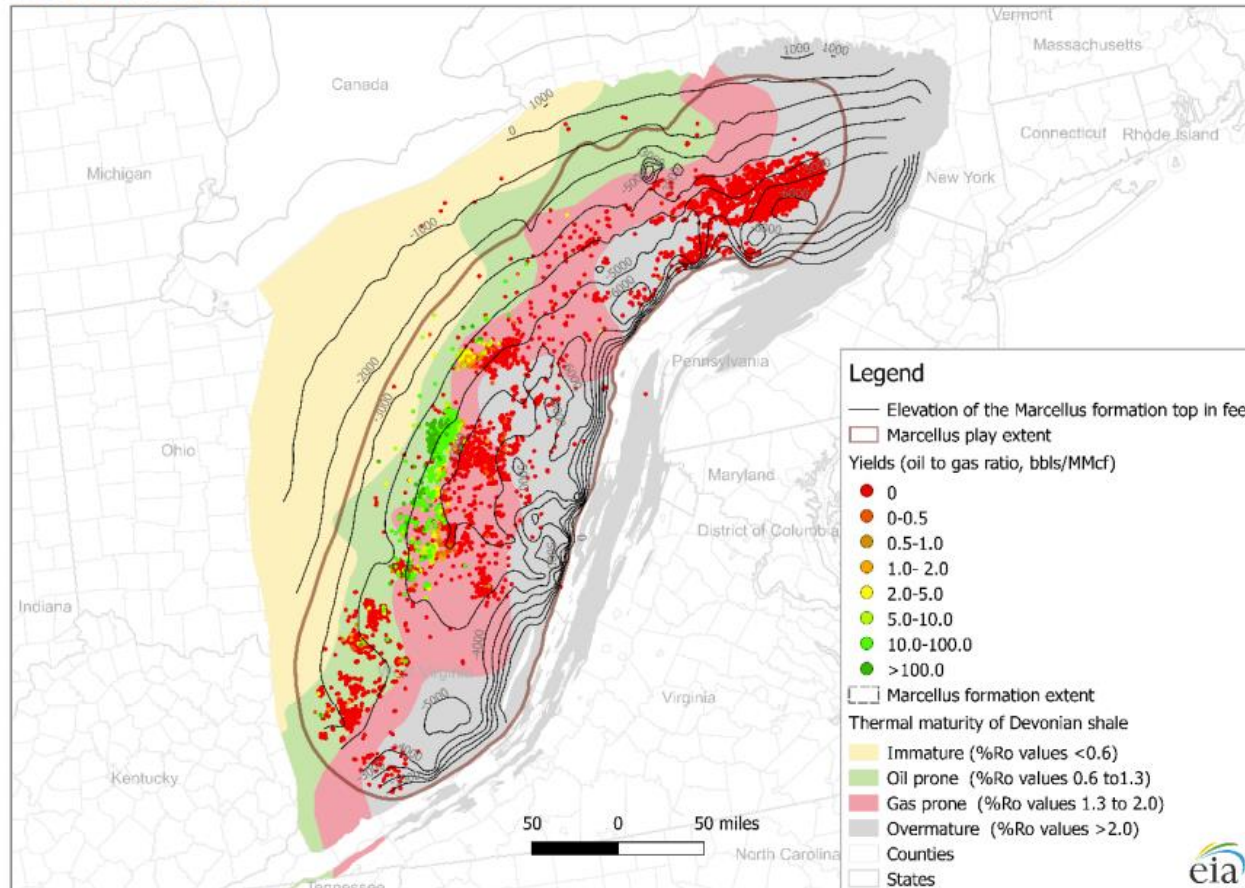
UK, Europe and US natural gas price benchmarks, \$/mn Btu



Source: Reuters Eikon  
© FT



**Figure 6. Initial Yields (oil-to-gas ratios, barrels per million cubic feet (bbls/MMcf) of Marcellus wells as of December 2016**



Source: U.S. Energy Information Administration based on DrillingInfo Inc., and U.S. Geological Survey.



## Largest Liquids Producers in Q3/22 (mmB/d)

