

- Investors have the opportunity to invest in Comstock Resources (NYSE: CRK) before CRK screens well and attracts institutional capital.
- Comstock launched an exercise in financial engineering that will transform CRK from a ~\$100 million market cap company with an over-levered balance sheet to a ~\$600 million market cap company with an investable balance sheet.
- 2016 was a transition year for Comstock that set the stage for CRK to outperform in 2017. CRK will grow EBITDA from \$85 million to \$185 million (assuming \$3.00 natural gas) on the back of a 40% increase in gas production in 2017 over 2016.
- Comstock will fully fund its drilling plan through cash flows (assuming \$3.00 natural gas) and trades for a 30-60% discount to peers despite growing production and EBITDA faster than peers.
- Comstock should trade for \$17 within the next 12-18 months as CRK becomes fully understood and appreciated.



Shares Outstanding	13.5	Stock Price	\$ 9.56
Market Cap (m)	\$ 129	Cash (m)	\$ 53
Enterprise Value (m)	\$ 1,213	Debt (m)	\$ 1,137

Seeking Alpha users that have read my prior articles know that I do very deep diligence on the companies that I own. I published my first Seeking Alpha article in February 2016 recommending that investors buy MeetMe (NASDAQ: MEET). I recommended buying MeetMe at \$3.20 with a \$5.70 target price and later increased my price target to \$8.00 when the stock was \$5.00. MeetMe reached my \$8.00 price target in August 2016, and **investors that bought MEET on my initiation and sold when MEET reached my price target made 150% profit in 6 months**. You can read my [initiation report](#), [user usage analysis article](#), [Skout acquisition analysis article](#), and [bear thesis rebuttal](#) in the preceding links. I thought it would take MEET 18-24 months to reach my price target, and I don't think investors should expect this recommendation to be as successful as quickly as my MEET recommendation. My goal when I publish on Seeking Alpha is to only recommend stocks that I am highly confident will be successful with realistic price targets. I'm ready to stick my neck out on my second recommendation.

**I recommend that investors buy Comstock Resources, Inc. (NYSE: CRK) with an initial target price of \$17.00, ~75% higher than current levels, over the next 12 months.** Comstock launched an exercise in financial engineering that will create investor interest by allowing CRK to radically transform itself from a \$130 million market cap company to a \$640 million market cap company with a drastically reduced debt load proforma for a mandatory debt conversion at \$12.32. Investors will be able to better understand CRK's valuation and leverage assuming the convertible debt converts, which will reduce Comstock's leverage from 6.0x to 3.0x. Management should be able to renegotiate better terms on its remaining \$700 million in senior secured debt. Further, Comstock is accelerating its drilling plan from drilling 6.5 net wells in 2016 to 17.1 net wells in 2017. New wells are adopting completion techniques proven by Chesapeake in the Haynesville and various Appalachian operators that are improving recoveries greater than costs. **The result is Comstock should increase production by ~40% and more than double EBITDA in 2017 versus 2016.** I want to own CRK before it screens well, and the stock becomes an obvious BUY for institutional investors.

Nobody performing a simple screen wants to own CRK right now. After digging deeper, I can see why [T. Rowe Price purchased a 12% position in CRK in October 2016](#). Currently, CRK has a ~\$130 million market cap, 13.5 million shares outstanding, \$1.1 billion in debt, and analyst consensus of ~\$175 million in 2017 EBITDA. You are probably questioning my long recommendation after reading that sentence. CRK is my favorite long position, and I believe **CRK will attract investment consideration from small cap growth, GARP, and value investors in the very near future.** The current small market cap and large debt load deter many institutional investors from purchasing CRK; however, the surface level balance sheet metrics do not accurately reflect CRK's prospects and catalysts.

Comstock's management completed a massive (and near miraculous) restructuring in September 2016 to bring the company back from the brink of bankruptcy. How bad was it? CRK's \$700 million of senior secured bonds were trading for \$31.50 (on \$100 par value) in February 2016. The ~\$700 million of senior unsecured bonds that reached a bottom of \$7.00 (on \$100 par) in February 2016 were prognosticating that CRK was going belly-up and assets were not going to be sufficient to repay unsecured debt holders. CRK's cash interest payment was ~\$117 million/year, and the company was not generating enough cash to service its massive debt load.

During the first 9 months of 2016, CRK contacted its bond holders with the goal of reducing and restructuring its \$1.3 billion in debt. At December 31, 2015, CRK had \$700 million of senior secured 10% coupon debt due in March 2020, \$376.1 million of senior unsecured 7.75% coupon debt due April 2019, and \$194.4 million of senior unsecured 9.5% coupon debt due June 2020. **All this debt required cash interest payments** and resulted in ~\$117 million in annual cash interest burden. Conversely, Comstock is estimated to generate ~\$90 million of EBITDA in 2016 and was not generating enough cash to service its debt. Comstock needed to restructure its debt or go into bankruptcy to improve its investment prospects. Comstock's management chose the more difficult path and started the process of restructuring. CRK began buying unsecured bonds in Q1'16 and **retired \$237 million of unsecured senior notes for approximately twenty-five cents on the dollar** by the end of Q2'16.

# Balance Sheet

(\$ in millions)

June 30, 2016

Cash and cash equivalents \$ 67

**Revolving Credit Facility**

10 % Senior Secured Notes due 2020 \$ 700

7¾ % Senior Notes due 2019 \$ 288

9½ % Senior Notes due 2020 \$ 175

**Total Debt \$ 1,163**

**Total Net Debt \$ 1,096**

Available Credit Line \$ 50

**Total Liquidity \$ 117**

**Retired \$237 million in long-term debt for \$46 million and 13.7 million shares (2.7 million as adjusted for the reverse stock split) of common stock generating annual interest savings of \$20.6 million with total interest savings to maturity of \$83.0 million.**

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Management contacted nearly every debt holder and negotiated a deal to restructure the unsecured debt. The unsecured debt holders agreed to roll their senior unsecured debt into senior convertible bonds with PIK ("Payment-in-Kind") only interest. PIK interest allows Comstock to pay convertible bond holders interest through additional bonds rather than making a cash payment to cover the coupon. For example, the \$275 million of 7.75% coupon convertible bonds will accrue \$26.86 million of coupon payments after 12 months. At the end of 12 months, the new debt balance will be \$301.86 million and continue to grow until maturity in April 2019 unless the stock trades above \$12.32 for 15 consecutive days and causes a mandatory conversion of convertible debt into equity. This PIK interest structure allows CRK to avoid making cash payments on its debt until maturity. In addition, CRK restructured the \$700 million of senior secured debt to give the company the option to PIK interest expense. The result of the restructuring is the following:

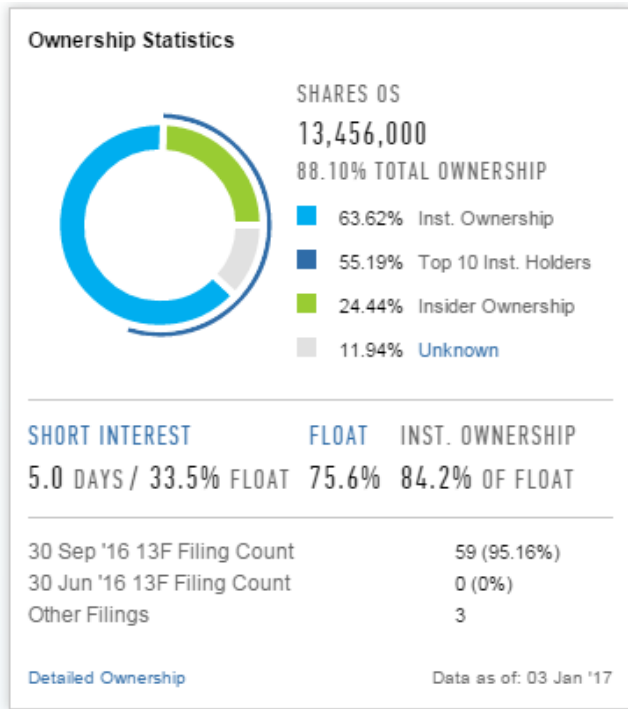
	Prior to Restructuring	Proforma for Restructuring
Tranche	Senior Secured	Senior Secured
Principal	\$700 Million	\$697 Million
Interest %	10.00%	10.00%
Interest Payment	Cash Only	Cash with PIK option
Tranche	Senior Unsecured	Convertible Unsecured
Principal	\$275 Million	\$271 Million
Interest %	7.75%	7.75%
Interest Payment	Cash Only	PIK Only
Mandatory Conversion	NA	\$12.32
Tranche	Senior Unsecured	Convertible Unsecured
Principal	\$175 Million	\$170 Million
Interest %	9.50%	9.50%
Interest Payment	Cash Only	PIK Only
Mandatory Conversion	NA	\$12.32

Many investors consider PIK interest to be a negative. If a company PIKs 100% of its interest payments, the debt balance can balloon, and a company can find itself facing an unserviceable debt load. Comstock's convertible unsecured debt will PIK, but the senior secured debt does not have to PIK. Comstock's 2017 CAPEX plan should allow CRK to avoid paying PIK interest on the \$700m in senior secured debt. CFO Roland Burns stated that "we don't believe we'll need to" PIK interest on the senior secured debt "where gas prices are now" on Comstock's Q3'16 earnings call. Importantly, natural gas was \$2.81 on November 8, 2016 when CFO Burns made that statement versus \$3.32 on January 3, 2017. The flexibility to PIK senior secured interest payments should help CRK preserve cash if necessary.

Why does any of this matter? Excellent question. Many institutional managers have mandates that restrict them from owning certain types of stocks. Some institutional investors cannot own companies with less than a \$500 million market cap. Other investors cannot own companies with debt-to-EBITDA leverage over a certain number. I believe that 5x debt-to-EBITDA (Comstock's current ratio is 6.0x based on consensus) is too high for many institutional managers. CRK is going to be much more investable for many institutional investors when CRK trades above \$12.32 for 15 consecutive days. At \$12.32, the \$450 million of convertible debt will have a forced conversion and convert into equity in the form of ~37 million shares (if it all converted today). Proforma for the conversion (which I assume occurs in the middle of 2017), CRK will have 52 million fully diluted shares outstanding, a \$640 million market cap, \$700 million in debt, and a \$1.34bn enterprise value. Consider that CRK could generate ~\$200 million and ~\$280 million in 2017 and 2018 EBITDA, respectively, and CRK will be able to nearly completely fund its drilling plan and pay interest on senior secured debt with cash generated from operations. **CRK becomes more than just investable, CRK becomes attractive at 6.4x and 4.6x EV/2017 and EV/2018 EBITDA, respectively, with peers trading at 8x and 6x EV/2017 EBITDA and EV/2018 EBITDA, respectively.** Note that this relative valuation discount is based on CRK moving 29% higher (to \$12.32) from \$9.56 on Tuesday, January 3.

I would like to evaluate what CRK's valuation would look like today (\$9.56 stock price) if all the convertible bonds converted into equity rather than valuing CRK at \$12.32 (the convertible bond forced conversion price). CRK would have ~52 million shares outstanding, a \$497 million market cap, \$700 million in debt, and a \$1.15 billion enterprise value. Assuming CRK is able to achieve \$200 million and \$280 million in 2017 and 2018 EBITDA then **CRK is currently trading for 5.7x and 4.1x 2017 and 2018 EBITDA, respectively.** In my opinion, 4.1x EV/EBITDA is too cheap for an exploration and production ("E&P") company growing production 40%, growing EBITDA by more than 100%, and drilling within cash flows. Generally, I assume that E&Ps are going to spend all the cash they generate, and then some. When I have invested in companies that are drilling within cash flows, I have made money and generally found stocks that other investors want to own.

Often times, converts act as a ceiling on stock prices; however, CRK's converts could actually help drive institutional interest. Institutional investors only represent 65% of the total ownership in CRK even after T. Rowe became the largest holder. The amount of shares that could come to market should give institutional investors a chance to buy sizeable positions in CRK.



Source: FactSet

T. Rowe Price Associates announced that it became the largest shareholder of CRK as of October 31, 2016 in a November 2016 13G filing. At September 30, 2016, T. Rowe only owned 113,100 shares of CRK, which means that one of the largest institutional managers in the world bought 1.4 million shares in October, when the average price was \$8.74. Notably, CRK's volume did not appreciably increase until October 18, 2016 when the stock closed at \$8.68. My best guess would be that T. Rowe purchased the majority of the 1.4 million shares it bought over the course of 7 trading days between October 18, 2016 and October 26, 2016 when CRK traded more than 1.16 million shares a day (versus the current 30 day average of 800k shares a day). Notably, CRK's average price between October 18 and October 26 was approximately \$9.75. Therefore, investors today are getting a chance to buy stock at a similar price (\$9.56) to the potential average price when the largest shareholder was likely buying the majority of its shares.

A new institution looking to buy CRK as the stock approaches the \$12.00 level could theoretically buy a 1.4 million share chunk at a negotiated price with a convertible bond holder. I think some convertible debt shareholders bought their position when CRK's unsecured bonds were trading for pennies on the dollar versus \$85 at the close on December 31, 2016. I might consider leaving 5-10% on the table to ensure liquidity if I was sitting on a 10 bagger in less than 1 year. Potentially, MacKay Shields (owns \$110 million of convertible debt), PointState (owns \$110 million of convertible debt) or other convertible bond owners could consider converting some of its convertible debt below the \$12.32 forced conversion price.

"But, Greg, why will the stock be able to absorb 37 million shares if that all comes to market at the same time? I don't understand how the stock can digest that many shares at once." It's a totally fair question. I expect that CRK will be volatile around the forced conversion price, but I can say that investors will want to own an E&P company focused on the Haynesville that is trading for ~4.6x 2018 EV/EBITDA at \$12.32 (or 4.1x 2018 EV/EBITDA at \$9.56 today) and drilling within cash flows. CRK is at the front end of a massive change in its perception. **Comstock is changing from a micro-cap E&P driller with a toxic balance sheet to a small cap operator with an investable balance sheet delivering 70-100% IRRs at \$3.00 natural gas.** The universe of investors that will be able to buy CRK is going to increase significantly after the debt conversion.

My article has treated CRK as a widget thus far. In my opinion, this widget is cheap on a relative and absolute basis, but being cheap isn't enough to merit an investment. The Comstock strategy has shifted away from its South Texas Eagle Ford acreage and towards its Haynesville asset, in which extended reach laterals are delivering 70% and 100% rates of return at \$2.50 and \$3.00/[mmbtu](#) natural gas prices versus NYMEX spot of \$3.32 on January 3, 2017. Comstock's Haynesville wells are delivering

IRRs that rival returns of any other natural gas driller. Capital goes where it is treated best, and capital is flowing to the Haynesville. Several private Haynesville focused companies (Covey Park, Indigo Minerals, and Vine Oil & Gas) are lining up to go public this year, and I believe they are targeting high single-digit to low double-digit forward EBITDA multiple range. The fastest growing, best operated gas producers trade for 10-11x 2017/EV/EBITDA. These soon-to-be-public peers will help generate excitement for the Haynesville, and CRK is going to look relatively too cheap after the convertible bonds convert to stock.

Investors should consider Comstock's assets before making an investment in Comstock.

### Comstock Resource's Assets

#### *The Haynesville*



Comstock is focusing 100% of its 2017 CAPEX plan on its Haynesville acreage (denoted by blue squares in the map above). Therefore, my article will focus on Comstock's Haynesville acreage, but investors should note that Comstock has an attractive acreage position in the Eagle Ford as well. The Haynesville shale in southwestern Arkansas, northwestern Louisiana, and eastern Texas ("ArkLaTex") is estimated to be the second largest recoverable gas formation in the United States behind the Marcellus formation in the Appalachians. Comstock Resources owns 67,000 net acres in the Haynesville and Bossier Shale. Comstock has drilled 12 wells since 2015 in the Haynesville, 1 in the Bossier, and planned to drill 3 more Haynesville wells in Q4'16.

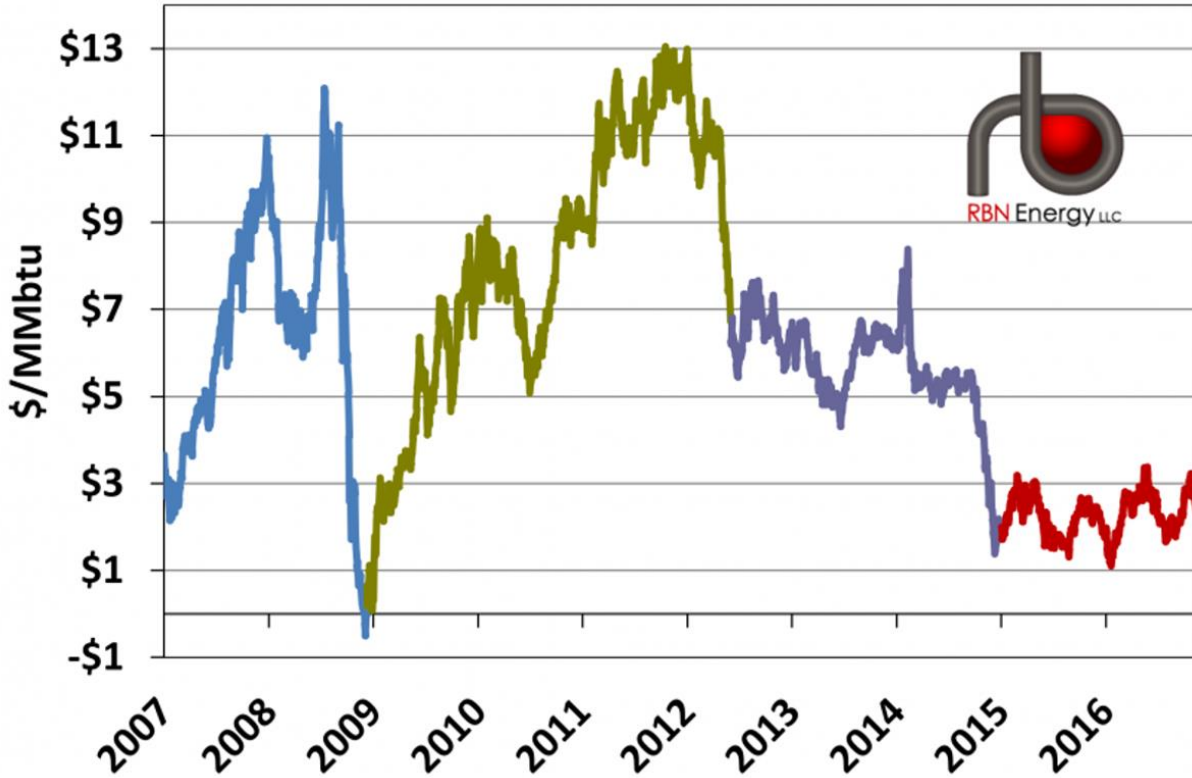
#### **Macro – Why Haynesville, Why Now?**

Comstock created wealth in the [Haynesville](#) in 2008, 2009, and 2010 before discontinuing drilling in 2012 when the commodity experienced extreme pressure. Natural gas went from \$13 in 2008 down to \$1.90 in 2012. Concurrently, oil was much more resilient after the Great Recession, and Comstock devoted its CAPEX budget to its Permian (sold in 2013) and Eagle Ford acreage.

Drilling in the Marcellus took off in 2011, and the Marcellus remained highly profitable through most of 2014 because it is a relatively shallow "wet gas" play. Conversely, the Haynesville is a "dry gas" play requiring significantly deeper holes. For those less familiar, "wet gas" not only contains methane ("dry gas") but also contains compounds like ethane, propane, butane, isobutane, and condensate, which are also known as natural gas liquids or "NGLs". NGLs can be separated from natural gas and sold separately. "Wet gas" operator profits were padded by NGL revenue and combatted low natural gas prices. The "frac spread", the difference between NGL prices (based on Mont Belvieu) and natural gas prices (based on Henry Hub), [was negative](#)

in 2008 (NGLs were actually worth negative value) and increased from approximately \$3 in early 2009 to as high as \$13 in 2011. In other words, Mont Belvieu NGLs (assuming 42% ethane, 28% propane, 11% normal butane, 6% isobutane, and 13% natural gas) were worth \$13 in addition to Henry Hub natural gas, which was worth ~\$4.00 in 2011. The frac spread vacillated between \$5-7 from 2012 to 2014, which was still nicely profitable for natural gas producers. Therefore, Marcellus “wet gas” attracted more capital than dry gas basins from 2012 to 2014 because the high frac spread and shallow shale depth boosted IRRs and NAVs through late 2014.

**Natural Gas: Henry Hub, Frac Spread Based on Mont Belvieu NGLs**

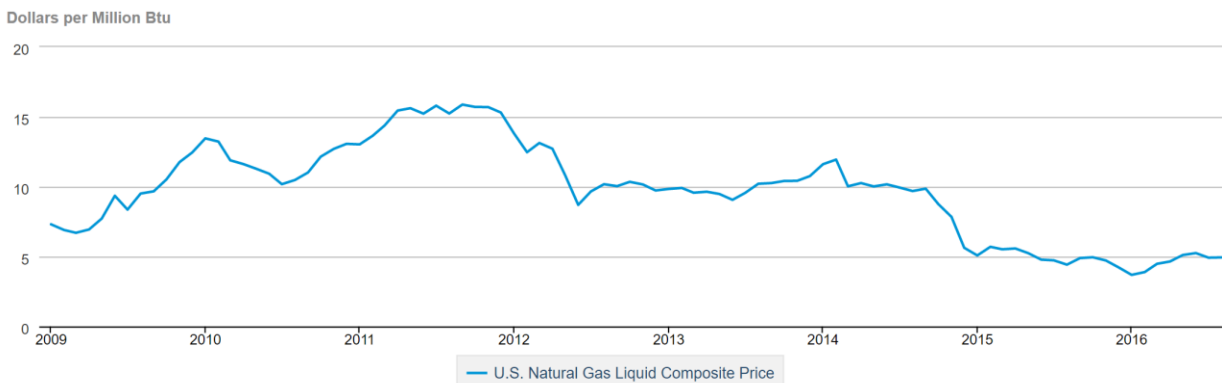


SOURCE: RBN Energy

The US shale boom resulted in a significant amount of NGL production that overwhelmed the petrochemical industry and caused prices to trade 50% lower in 2015 versus 2014. NGLs are a derivative of crude oil and are generally correlated with crude oil prices. NGL prices have hovered around \$5 since the beginning of 2015. Unfortunately for “wet gas” producers, “wet gas” needs to be processed and purified regardless of NGL pricing for the resulting methane to enter pipelines.

**U.S. Natural Gas Liquid Composite Price**

DOWNLOAD



Source: EIA.gov

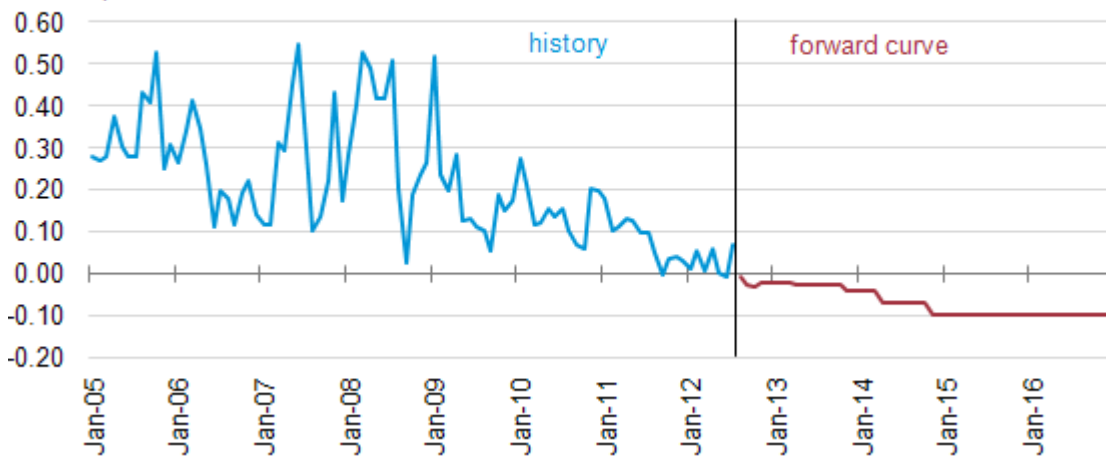
During the 2012-2014 NGL shale boom, many producers signed up for “take-or-pay”, or firm transportation and processing contracts, to entice midstream companies to build new gas processing plants and pipeline infrastructure. These firm transportation and processing contracts require that producers pay midstream companies for a specific volume of ethane extraction and transportation regardless of NGL spot prices. A producer may have agreed to a 50MMcf/day take-or-pay contract when gas was \$4 and a basket of NGLs were \$10 in 2014. Unfortunately, many producers were not able to economically drill their resource when natural gas was \$2 and a basket of NGLs was \$5 earlier in 2016. However, a producer that entered into a 50MMcf/day firm contract still had to pay for 50MMcf/day of capacity regardless of whether the producer delivered that natural gas.

Alternatively, producers may have entered into percent-of-proceeds, or “PoP”, contracts in which the processing plant takes some percentage of the NGL profits. PoP contracts required gathering and processing companies to share in commodity risk by taking, for example, 70% of the proceeds from NGL sales and giving 30% to the producer. “Wet gas” producer returns are heavily exposed to NGL prices in firm commitment and PoP contracts.

During the Marcellus heydays, Marcellus nat gas was actually earning a premium to Henry Hub gas prices. The Marcellus is geographically closer to the large northeast market serving New York and Boston. The Marcellus saw massive discoveries and production increases beginning in 2011/2012. The lack of pipeline infrastructure resulted in too much gas and not enough offtake capacity. As a result, Marcellus natural gas lost its premium pricing and is now trading for a ~\$0.50 discount to Henry Hub pricing.

**Difference between the TCO Appalachia and Henry Hub natural gas price, January 2005 - December 2016**

dollars per million British thermal units



Source: EIA.gov

The NGL price decline and offtake issues in the Appalachian basin have significantly impacted Marcellus producers’ ability to drill for natural gas profitably. As a result, “dry gas” basins like the Haynesville have become relatively more attractive versus “wet gas” basins. The Haynesville is currently delivering better IRRs than Marcellus wells. See Keybank’s comparison of Haynesville and Marcellus well economics below.

**Figure 2. Haynesville vs. Marcellus Economics**

Haynesville 7,500'	Original	New	Marcellus
EUR (Bcf)	15.5	18.6	16.3
1st Year Bcf	3.9	4.8	3.2
Well Cost (M)	\$8.10	\$8.50	\$6.00
IRR	62%	86%	72%
PV-10	\$6.6	\$9.6	\$6.8
Gathering & Transport & Basis:		(\$0.45)	(\$0.90)

Source: Keybank Capital Markets, Inc. Estimate; RICE; RRC

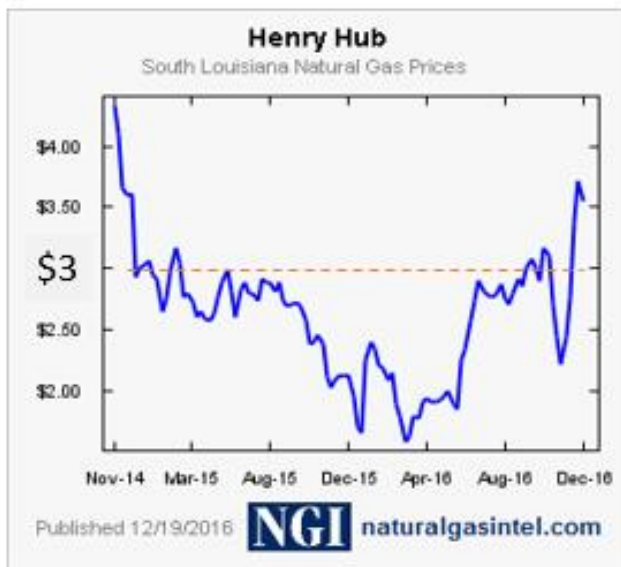


On November 9, 2016, Keybank published updated internal rate of return (“IRR”) and PV-10 (Present value of approximated oil and gas operating profit discounted back by 10%) projections that compare Haynesville and Marcellus wells. Clearly, the new Haynesville completion methods in addition to cheaper gathering, processing, and transportation (“GP&T”) costs and better basis pricing have made the Haynesville’s IRRs and PV-10’s more attractive than RICE or RRC’s Marcellus wells.

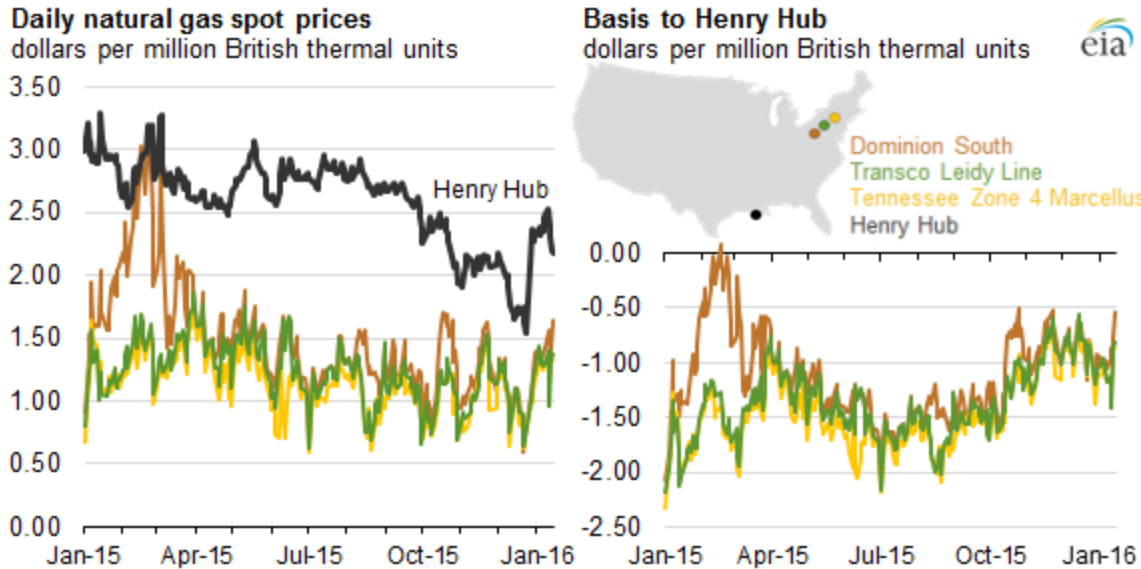
The Haynesville/Bossier shale (Comstock’s primary asset) has several advantages versus the Marcellus that I believe will lead to more investor interest in the Haynesville shale over the next 6 to 12 months. Rather than engaging in an overly obtuse discussion of every distinction, investors should focus their attention on one primary advantage: **the Haynesville enjoys better pricing than the Marcellus due to its geographic proximity to the Gulf of Mexico and existing GP&T infrastructure.**

### *Basis Differential Advantage*

What is the approximate basis differential in the Haynesville versus the Marcellus? Perryville receives a significant amount of Haynesville natural gas. Perryville nat gas pricing is about \$0.10 less than Henry Hub, the official delivery location for NYMEX futures contracts, according to [NGI](#). Data from [NGI](#) indicates that Marcellus region price points (based on 3 primary pipelines – Dominion South, Transco Leidy Line, and Tennessee Zone 4 Marcellus) are still about \$0.50 below Henry Hub pricing.



Therefore, Haynesville producers are experiencing an approximate \$0.40 gas pricing premium to Marcellus producers. To nail the point home, let's use \$3.00 NYMEX in an example. Marcellus natural gas producers are getting paid ~\$2.50 (\$0.50 less than NYMEX) per million British thermal units ("Btu") while Haynesville producers are receiving \$2.90. A \$0.40 premium on a \$3 commodity is meaningful and flows directly to operating profit. So, why exactly does Haynesville nat gas trade for a \$0.40 price premium to Marcellus gas? **Infrastructure.** The large investment in the Utica and Marcellus shale led to a bolus of gas that has been hard to absorb. That is evidenced by the \$1.50 Marcellus basis differential to Henry Hub through most of 2015.



Source: EIA

Although dry gas in the Marcellus can meet pipeline specifications, wet gas still needs to be processed to separate NGLs from methane. Low NGL prices have created little incentive for producers to spend precious capital developing wet gas resources, and drilling in "wet gas" parts of the Appalachian has slowed in 2016. Don't forget that Marcellus NGL transport fees are "very high since production must be **trucked** to Mont Belvieu" and ethane (the light end of the NGL market) "**transportation differentials are so high that recovered ethane often becomes a net cost**" according to the [EIA's March 2016](#) study. The combination of low NGL prices and high transport costs is hitting Appalachian "wet gas" producers with a double whammy. Even worse is that the Appalachian doesn't have much storage capacity with only [5-14 million barrels of NGL storage capacity](#) compared to 200 million barrels in Mont Belvieu, Texas according to Marc Halbritter, SVP of Business Development at Blueracer Midstream/Caimen Energy. Marcellus producers do not have an option besides paying the expensive transport fees associated with Marcellus NGLs.

Natural gas pipeline infrastructure was the biggest hole in my knowledge when I began researching Comstock. I have learned enough to become dangerous, but [RBN Energy](#) does a fantastic job explaining the natural gas market from all angles. If you find yourself saying "I wish I could find a concise source to teach me about natural gas processing fundamentals", [look no farther](#). Investors wanting to understand northeast gas pipeline infrastructure should read [this article detailing current northeast takeaway capacity](#) and [this article discussing the REX pipeline ramp](#).

Let me attempt to summarize what I have learned and my conclusion. Limited offtake capacity has caused Appalachian operators to incur \$0.75-\$1.25/Mcfe GP&T costs. New processing and offtake capacity has been constrained under Obama but is coming online in the Marcellus. Improved offtake capacity should continue to shrink the spread between Henry Hub and Marcellus gas prices. Marcellus gas production significantly outstrips processing and transportation ("P&T") capacity, and production will continue to grow but likely at a slower rate than P&T capacity expansion. Conversely, the Haynesville went through an infrastructure build out boom in the 2000s and then again in 2011-2012. Some industry sources have indicated that the Haynesville pipeline infrastructure is only 40% utilized right now. Therefore, Haynesville midstream companies will afford small producers attractive GP&T contracts because incremental revenue is basically 100% margin.

“Greg, that was a lot of macro mumbo-jumbo to me.” Fine. Let’s take a look at actual data from producers. Once again, I’m solely focused on determining the effective natural gas price that producers receive. The cost to bring that gas out of the ground is a separate discussion in my mind. Let’s examine other natural gas producers.

Companies with More than 60% of 2016 Production from Gas								
	COG	RICE	RRC	SWN	REXX	GPOR	XCO	CRK
Time Period		3Q'16	3Q'16	FY 2016	FY 2016	FY 2016	FY 2016	FY2016
Primary Basins	Marcellus	Marcellus / Utica	Marcellus / Utica	Marcellus / Fayetteville	Marcellus	Utica	Marcellus / Utica	Haynesville
Acres in Primary Basins (000's)	200	200	795	720	313	184	201	67
% 2016 Sales Gas	96.0%	100.0%	67.0%	90.0%	61.0%	86.0%	~65%	87.0%
% 2016 Sales NGLs	0.0%	0.0%	29.0%	8.0%	34.0%	8.0%	NA	1.0%
Primary Basin Basis (\$ per Mcf)	NA*	(0.45)	(0.68)	(0.83)	(0.95)	(0.61 - 0.66)	(0.50 - 0.60)	(0.10)
GP&T	0.70**	0.77 - 0.83	1.00	NA	NA	NA	1.00 - 1.05	0.27
Production and Ad Valorem	0.06**	0.03 - 0.05	0.05	0.10	0.10	NA	0.15 - 0.20	0.06

\* COG does not provide its differential. SVP of Marketing Jeff Hutton commented that the differential may get wider in 2017.

\*\* Includes limited Eagle Ford production costs

Operators have different reporting methodologies. So, the table above is directionally accurate but likely not a perfect comparison. Marcellus and Utica producers are experiencing ~\$0.90 GP&T costs and approximately \$-0.50 to \$-0.60 basis differentials. For example, Exco Resources (NYSE: XCO) is guiding to \$1.00 – 1.05 in gathering and transportation costs while Rice Energy (NYSE: RICE) is guiding to \$0.80 in gathering and transportation costs in 2016. Therefore, XCO’s effective natural gas price at \$3.00 NYMEX is only \$1.45 (\$1.55 reduction from basis differential + GP&T).

Rice Energy’s Marcellus asset produces drier gas (more methane and less NGLs) than other Marcellus producers. Therefore, comparing Rice’s effective gas price is a truer comparison to Comstock. RICE’s effective natural gas price at \$3.00 NYMEX is only \$1.75. In Q3’16, Rice Energy incurred basis differential costs of \$0.45/Mcfe, gathering and compression costs of \$0.45/Mcfe, and firm transportation costs of \$0.35/Mcfe for a total effective cost of \$1.25.

Finally, let’s compare Appalachian producers to Comstock. Comstock’s geographic proximity to Henry Hub/the Gulf of Mexico allowed Comstock to earn -\$0.44 basis differential including gathering and transportation cost in 3Q’16. Comstock believes its 2017 differential including gathering and transportation will be \$0.37/Mcfe. To complete the example, CRK’s effective natural gas price at \$3.00 NYMEX is \$2.63 (\$0.10 basis differential + \$0.27 GP&T). Remember that Exco receives \$1.45/Mcfe and Rice Energy earns \$1.75/Mcfe. Therefore, **Comstock is earning a ~\$1.00 effective natural gas price PREMIUM to its Marcellus peers due to CRK’s proximity to Henry Hub/the Gulf of Mexico and Louisiana’s existing pipeline and processing infrastructure.**

Some investors may argue that Comstock’s relative basis advantage will decrease as Marcellus infrastructure comes online. That is fair; however, I would answer that argument by pointing out that the US became a natural gas exporter for the first time ever on September 1, 2016. Exported gas is largely going to Mexico, and the Haynesville will have a nice geographic advantage versus the Marcellus.

Haynesville operators, specifically Comstock, have a GP&T pricing advantage over Marcellus operators that is likely sustainable for at least 18-24 months as more processing and transportation capacity comes online. Investors should invest their capital like they own every basin in the US, and the Haynesville is delivering sustainably better returns than the Appalachian basin over the next 18-24 months barring a massive increase in NGL prices.

## So, Why CRK?

I am amazed that some investors solely consider initial production (“IP”) rates and Estimated Ultimate Recoveries (“EURs”) before making their investment decision. That level of analysis would be like analyzing a tech, retail, or healthcare stock while completely ignoring costs and solely focusing on revenues. The devil is in the details when analyzing E&Ps, and the details are in the costs line.

Natural gas producers have five basic costs when bringing natural gas out of the ground: 1) well costs (aka Finding and Development or “F&D” costs), 2) basis differential – the price difference between NYMEX and the gas price the producer receives, 3) lease operating expenses (“LOE”), 4) GP&T costs, and 5) production taxes. I would like to examine Haynesville operators’ production costs when determining why CRK is the best way to play the Haynesville.

The Haynesville really has two public investment vehicles, Chesapeake (NYSE: CHK) and Comstock. **Comstock earns a \$0.87 effective price premium to Chesapeake when considering basis, GP&T costs, LOEs, and production taxes.** The \$0.87 price premium contributes directly to Operating Income. **Importantly, Comstock’s price advantage potentially exists across the entirety of the Haynesville.** I’ll expound on this point later. CRK and CHK have different reporting metrics, therefore calculating CRK’s cost advantage is not straight forward. However, investors can reasonably calculate CRK and CHK’s costs on an apples-to-apples basis based on public data.

First, investors should understand how to calculate Chesapeake’s basis, GP&T costs, and LOEs. Chesapeake provided a significant amount of data about its recent CA 1H well at CHK’s October 2016 investor day that allows investors to calculate Chesapeake’s GP&T and LOE costs as a standalone entity. I believe that the following table is an accurate summary of Chesapeake’s CA 1H well.

	CHK CA 1H Well	Source
Cost Per Lateral Foot (\$)	\$ 1,250	2016 Analyst Day
Lateral Length (feet)	10,000	2016 Analyst Day
Well Cost/F&D (\$)	\$ 12,500,000	Pinnacle Calculation
Year 1 Estimated Recoveries (Bcf)	9.3	2016 Analyst Day
Natural Gas Price (NYMEX)	\$ 3.00	2016 Analyst Day
Year 1 Estimated Recoveries (\$)	\$ 27,900,000	Pinnacle Calculation
Year 1 Cost Recoveries	100%	2016 Analyst Day
Year 1 Costs	\$ 27,900,000	Pinnacle Calculation
<b>Year 1 Basis + LOE + Tax + GP&amp;T</b>	<b>\$ 15,400,000</b>	<b>Pinnacle Calculation (Yr. 1 Costs minus F&amp;D)</b>
Basis Differential (\$/Mcf)	\$ (0.10)	Pinnacle Estimate
Basis Dollar Cost (\$)	\$ (930,000)	Pinnacle Estimate
LOE (\$/Mcf)	\$ 0.19	2016 Analyst Day
LOE (\$)	\$ 1,767,000	Pinnacle Calculation
Ad Valorem taxes (%)*	2.0%	<a href="http://www.lmoga.com">http://www.lmoga.com</a>
Ad Valorem taxes (\$/Mcf)*	\$ 0.06	Pinnacle Calculation
Ad Valorem taxes (\$)*	\$ 558,000	Pinnacle Calculation
GP&T (\$)	\$ 12,145,000	Pinnacle Estimate
GP&T (\$/Mcf)	<b>\$ 1.31</b>	Pinnacle Calculation

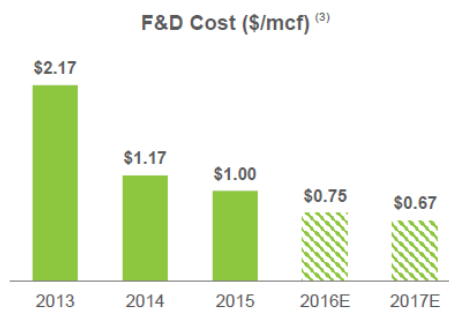
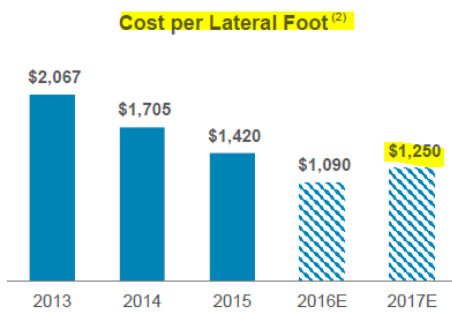
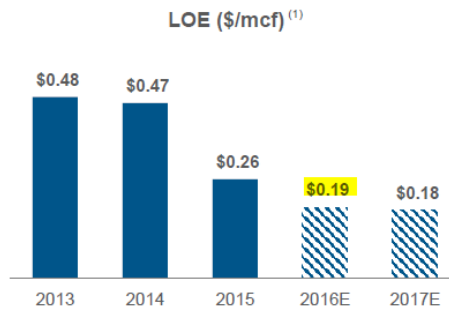
\*The Louisiana Constitution exempts the oil and gas contained in the earth from ad valorem taxes; however taxes are assessed on other associated revenue.

Let's walk through the inputs in my table and make sure that my calculation is reasonable. CHK guided to drilling costs of \$1,250 per lateral foot on a go-forward basis, which is an increase from 2016 costs per lateral foot.

## OPERATIONAL PERFORMANCE

### GULF COAST

- Leading drilling performance founded on a culture of continuous improvement
- Record-setting productivity delivers more reserves per dollar invested
- Ultra-high density, large volume frac jobs and XL laterals significantly improve capital efficiency
- Relentless pursuit of value drives low production costs and greater efficiency



(1) Data represents operated net lease operating expenses excluding taxes / net equivalent volume.

(2) Average cost per foot of wells drilled and/or completed within the time period.

(3) Data represents average net D&C / net EUR, grouped by TIL year.

On Chesapeake's October 20, 2016 analyst day, Jason Pigott, Chesapeake's Executive Vice President of Operations and Technical Services, highlighted that the increase in Haynesville drilling costs are associated with increased proppant loading. The \$1,250 cost per lateral foot assumption appears to be based on 3,000 pounds of proppant per lateral foot.

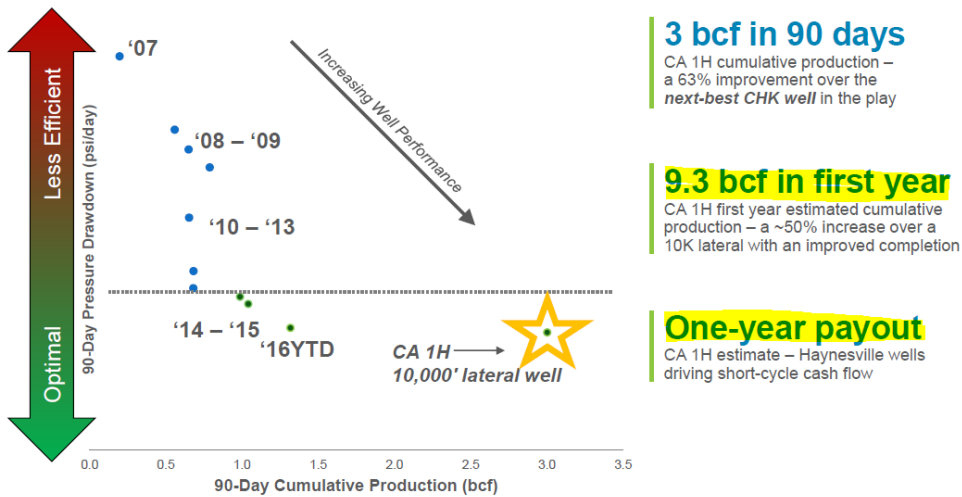
When we look at the capital front, our investment on a dollar per foot, we've taken that down from \$2,000 a foot to just about \$1,000 a foot in 2016. We show here an increase in 2017, and the reason for that is in 2016 about half the year we were pumping these 1,700 pound per stage job, half the year we've transitioned to the 3,000 pound per foot jobs. And that's why you see an increase in 2017, because we're all in on the 3,000 pound per foot job. So, that drives an increase in your costs on a per foot basis. But we're focused on maximizing EUR from these wells and minimizing F&D.

Chesapeake's most successful Haynesville well (CA 1H) to date is a 10,000 foot lateral that used 3,000 pounds of proppant per lateral foot in southern Caddo parish. We can assume based on EVP Pigott's commentary that the well cost was approximately \$1,250 per lateral foot \* 10,000 feet = \$12.5 million.

CA 1H delivered a massive 3 Bcf of natural gas in the first 90 days of production (30 MMcf/day) and is expected to produce 9.3 Bcf of gas in the first year of production and pay for all drilling costs in 1 year. The two data points highlighted in the picture below give investors the important information needed to understand true GP&T costs for Chesapeake's CA 1H well.

## DRAWDOWN MANAGEMENT

RECORD PRODUCTIVITY WITH RESPONSIBLE DRAWDOWN



➤➤ *Prioritizing long-term value over short-term gains*

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Lastly, CHK is assuming a \$3 natural gas price when calculating its rate of return (“ROR”). Investors should also use \$3 NYMEX to calculate CHK’s operating costs because CHK’s assertion of a “one-year payout” is based on \$3 NYMEX.

	CHK CA 1H Well	Source
Cost Per Lateral Foot (\$)	\$ 1,250	2016 Analyst Day
Lateral Length (feet)	10,000	2016 Analyst Day
Well Cost/F&D (\$)	\$ 12,500,000	Pinnacle Calculation
Year 1 Estimated Recoveries (Bcf)	9.3	2016 Analyst Day
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Year 1 Costs	\$ 27,900,000	Pinnacle Calculation
<b>Year 1 Basis + LOE + Tax + GP&amp;T</b>	<b>\$ 15,400,000</b>	<b>Pinnacle Calculation (Yr. 1 Costs minus F&amp;D)</b>
Basis Differential (\$/Mcf)	\$ (0.10)	Pinnacle Estimate
Basis Dollar Cost (\$)	\$ (930,000)	Pinnacle Estimate
LOE (\$/Mcf)	\$ 0.19	2016 Analyst Day
LOE (\$)	\$ 1,767,000	Pinnacle Calculation
Ad Valorem taxes (%) *	2.0%	<a href="http://www.lmoga.com">http://www.lmoga.com</a>
Ad Valorem taxes (\$/Mcf)*	\$ 0.06	Pinnacle Calculation
Ad Valorem taxes (\$)*	\$ 558,000	Pinnacle Calculation
GP&T (\$)	\$ 12,145,000	Pinnacle Estimate
GP&T (\$/Mcf)	<b>\$ 1.31</b>	Pinnacle Calculation

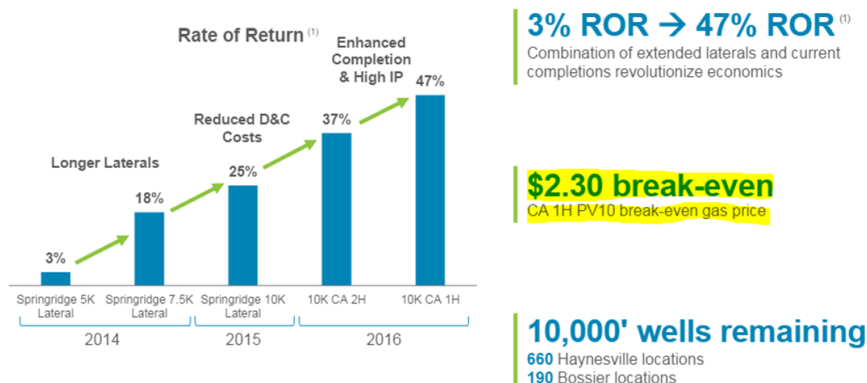
\*The Louisiana Constitution exempts the oil and gas contained in the earth from ad valorem taxes; however taxes are assessed on other associated revenue.

Therefore, I calculate Chesapeake's LOE (\$0.19/Mcfe), production taxes (\$0.06/Mcfe), and GP&T (\$1.31/Mcfe) expenses to equal approximately \$1.56/Mcfe for the CA 1H well, which is notably CHK's best Haynesville well to date.

Alternatively, investors can cross check this calculation by referencing Chesapeake's \$2.30 break-even gas price at its CA 1H well. F&D (\$0.67/Mcfe) + LOE (\$0.19/Mcfe) + production taxes (~\$0.06/Mcfe) + basis differential (\$0.10/Mcfe) = \$1.02/Mcfe. The only remaining variable is GP&T. \$2.30 minus \$1.02 in all other costs = \$1.38 in GP&T/Mcfe, which is in the same ballpark as my \$1.31 estimate.

## NEW TECHNOLOGY DRIVES VALUE CREATION

LONGER LATERALS AND BIGGER COMPLETIONS



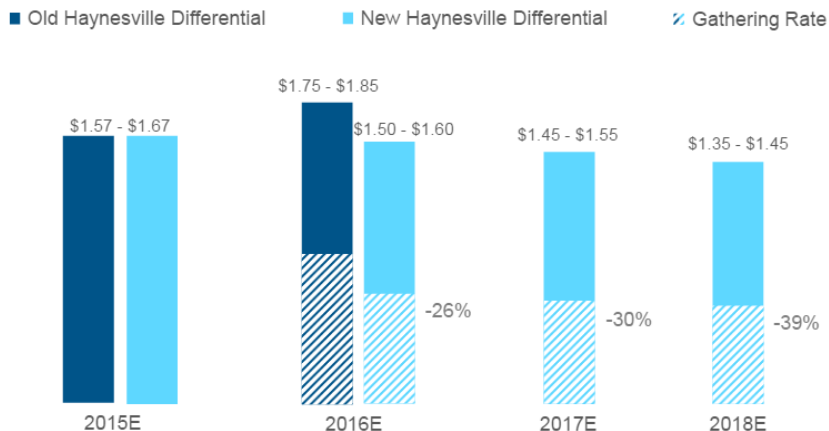
<sup>(1)</sup> Assumes \$3.00 flat price deck

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Lastly, investors can further cross reference Chesapeake's GP&T by referencing the September 8, 2015 Barclays presentation in which Chesapeake disclosed estimated Haynesville differentials (basis differential + production taxes + GP&T) of \$1.50-\$1.60 in 2016. My assumption that basis differential and production taxes total about \$0.16/Mcfe would imply that Chesapeake expected 2016 GP&T to be around \$1.39/Mcfe.

## HAYNESVILLE GAS DIFFERENTIALS <sup>(1)</sup>



- ~\$0.40/mcf improvement from 2016E Old to 2018E New total differential
- Improved gathering rate and increased capital allocation increases CHK's expected annual EBITDA ~\$200 mm per year

<sup>(1)</sup> Includes basis differentials. 2015E MVC is included as anticipated; 2016E Old including MVC as previously projected.

7 | Barclays CEO Energy-Power Conference 9/8/2015



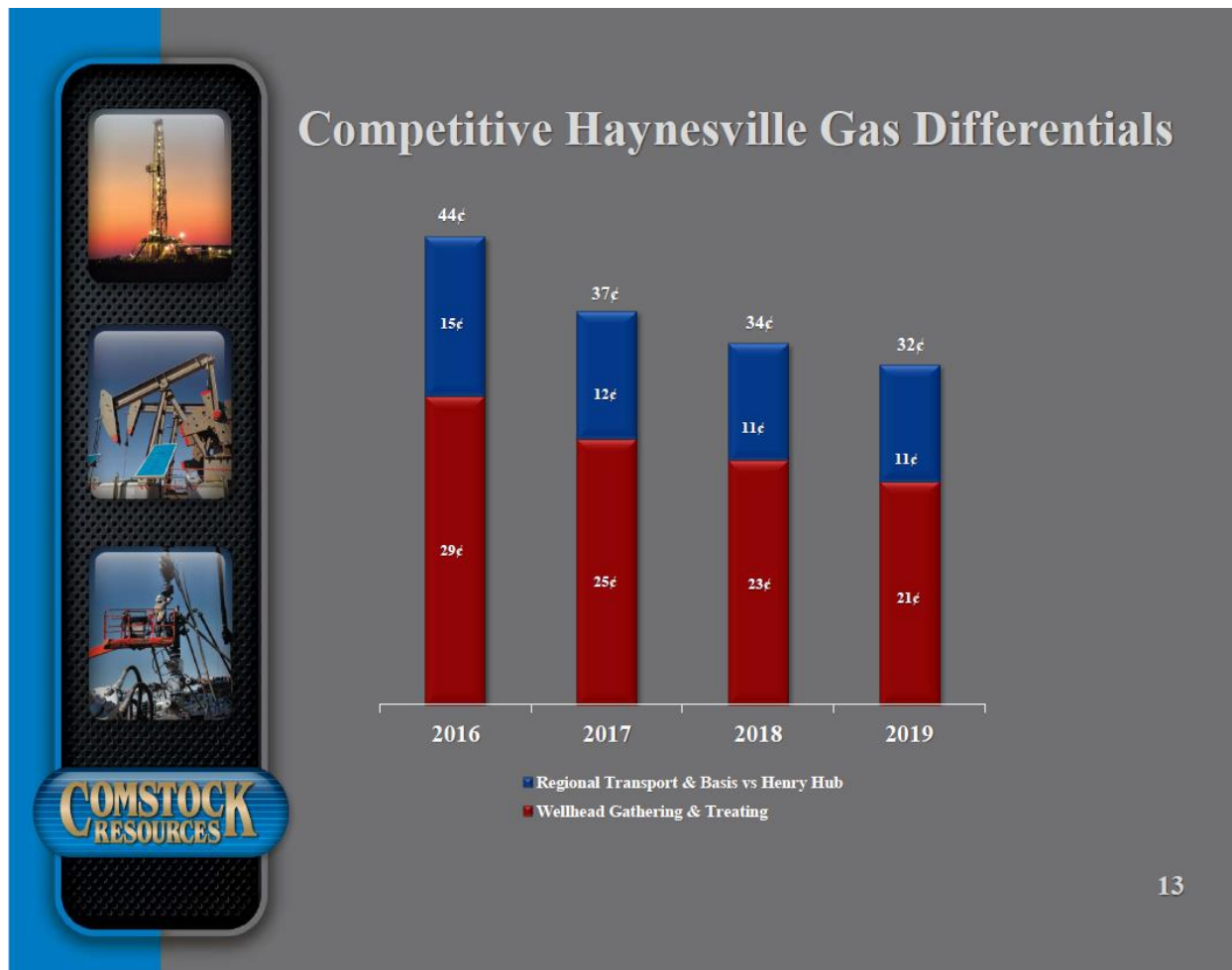
Chesapeake's \$1.50-\$1.60 Haynesville gas differential estimate is pro-forma for a renegotiated fixed fee gas gathering agreement with Williams that was signed in September 2015.

In September 2015, we entered into new fixed-fee gas gathering agreements with subsidiaries of The Williams Companies, Inc. (Williams) in our Haynesville Shale operating area and our dry gas Utica Shale operating area. The fixed-fee provisions will be effective beginning in January 2016, replacing the previous fee structures that have applied. We expect that our gas gathering fees, when the new fee structure is effective, will be lower in both operating areas. Under the Haynesville Shale agreement, we expect to meet our existing minimum volume commitments (MVC) because of the consolidation of two Williams gathering systems and a projected increase in our Haynesville Shale volumes. Inclusive of previously expected MVC shortfall payments, we expect reductions in our Haynesville gas gathering rates of approximately \$0.20 per mcf in 2016 and 2017 and approximately \$0.30 per mcf in 2018 and beyond. Under the Utica Shale agreement, we estimate a gathering rate reduction of approximately \$0.25 per mmbtu. We are dedicating an additional 50,000 net acres in the Utica Shale to Williams and will be subject to a new MVC of 250,000 mmbtu per day beginning in mid-2017. We expect to meet this Utica Shale MVC with approximately one rig per year.

Three different approaches each calculated a \$1.31-\$1.39/Mcfe estimate for Chesapeake’s GP&T costs. LOEs and production taxes bring Chesapeake’s operating cost to ~\$1.60/Mcfe. Conversely, **my calculation for Comstock’s LOE, production tax, and GP&T expenses is only \$0.73, or \$0.87 better than Chesapeake. A \$0.87 cost advantage on a \$3.00 commodity is significant and positions Comstock as the best positioned Haynesville producer.**

Let’s take a breath before we move on to examine CRK’s operational costs.

Investors should understand Comstock’s basis, and GP&T costs. The picture below depicts Comstock’s basis differential and GP&T costs. I believe that Comstock sends most of its nat gas to Perryville and receives a -\$0.10 differential to NYMEX. Therefore, GP&T costs would be expected to be \$0.27/Mcfe in 2017 assuming that the -\$0.10 differential is constant in 2017.





Comstock's December 2016 investor presentation provides enough data to perform a similar 10,000 foot well economic assessment.

	CRK 10k Lateral	Source
Cost Per Lateral Foot (\$)	\$ 1,080	Pinnacle Calculation
Lateral Length (feet)	10,000	December 2016 Investor Presentation
Well Cost/F&D (\$)	\$ 10,800,000	December 2016 Investor Presentation
Year 1 Estimated Recoveries (Bcf)	6.2	Pinnacle Estimate (25% of EUR)
Natural Gas Price (NYMEX)	\$ 3.00	Pinnacle Assumption
Year 1 Estimated Recoveries (\$)	\$ 18,600,000	Pinnacle Calculation
Year 1 Cost Recoveries	114%	Pinnacle Calculation
Year 1 Costs	\$ 16,318,000	Pinnacle Calculation
<b>Year 1 Basis + LOE + Tax + GP&amp;T</b>	<b>\$ 5,518,000</b>	<b>Pinnacle Calculation (Yr. 1 Costs minus F&amp;D)</b>
Basis Differential (\$/Mcf)	\$ (0.10)	Pinnacle Estimate
Basis Dollar Cost (\$)	\$ (620,000)	Pinnacle Estimate
LOE (\$/Mcf)	\$ 0.46	3Q'16 Earnings Release
LOE (\$)	\$ 2,852,000	Pinnacle Calculation
Ad Valorem taxes (%)*	2.0%	<a href="http://www.lmoga.com">http://www.lmoga.com</a>
Ad Valorem taxes (\$/Mcf)*	\$ 0.06	Pinnacle Calculation
Ad Valorem taxes (\$)*	\$ 372,000	Pinnacle Calculation
GP&T (\$)	\$ 1,674,000	Pinnacle Estimate
GP&T (\$/Mcf)	<b>\$ 0.27</b>	Pinnacle Calculation

\*The Louisiana Constitution exempts the oil and gas contained in the earth from ad valorem taxes; however taxes are assessed on other associated revenue.

I calculate that Comstock incurs GP&T costs at approximately \$0.27/Mcfe. My assessment also leads to several other conversations about well cost, recoveries, and commodity price assumptions, but I want to focus on GP&T costs. Basis differential, finding and drilling ("F&D") costs, LOEs and ad valorem taxes should be largely uniform across a basin. GP&T costs can vary widely between operators and change extremely slowly.

The most obvious question is.....**why are Comstock's GP&T costs \$0.27/Mcfe when Chesapeake is paying ~\$1.35 for gas of similar composition to travel on the same pipeline?** That's the money question, and the answer tells you why Comstock is the best positioned Haynesville producer. Period.

Large producers generally enter into long term GP&T contracts to entice midstream companies to build infrastructure to take oil and gas from the wellhead to pricing hubs. For example, I believe a lot of the Marcellus GP&T contracts are ~10 years in duration. So, takeaway contracts signed in 2012 do not come up for renewal until 2022. Attractive GP&T contracts can be a long term sustainable advantage.

*Why does Comstock's operational pricing advantage apply across the entire Haynesville play?*

Shell (LON: RDSB), Encana (NYSE: ECA), and Chesapeake had large Haynesville acreage positions in the 2008-2012 time period; however, each has exited or sold a considerable portion of their acreage. Shell sold its Haynesville acreage (107,000 net acres) in August 2014 to Vine Oil & Gas (a Blackstone Energy Partners backed entity), and Encana sold its Haynesville acreage (112,000 net acres) in August 2015 to GeoSouthern. Chesapeake recently divested 119,500 net acres in the Haynesville through two transactions in December 2016. Chesapeake's [first transaction](#) divested 40,000 net acres in the core (78,000 net acres in total) for \$450 million. Chesapeake's [second transaction](#) divested 41,500 acres to Covey Park Energy for \$465 million. In total, that's

about 350,000 net acres in the Haynesville acreage that has traded hands in the last two years. Why do these guys want to sell? I have two theories.

First, large producers may have signed firm GP&T contracts to entice midstream companies like Energy Transfer and Williams to build processing and pipeline infrastructure to take gas from the wellhead to the pricing hub. A significant amount of Haynesville pipeline infrastructure (Energy Transfer Tiger 42", Regency 36" and 42", and Enterprise Acadian 42") was contracted and built in the 2009-2012 timeframe when gas primarily traded between \$4.00 and \$5.00. Gas spent much of 2012 south of \$3.00, and I believe Shell, ECA and CHK's Haynesville GP&T contracts were so expensive that drilling the Haynesville was not as attractive as other basins.

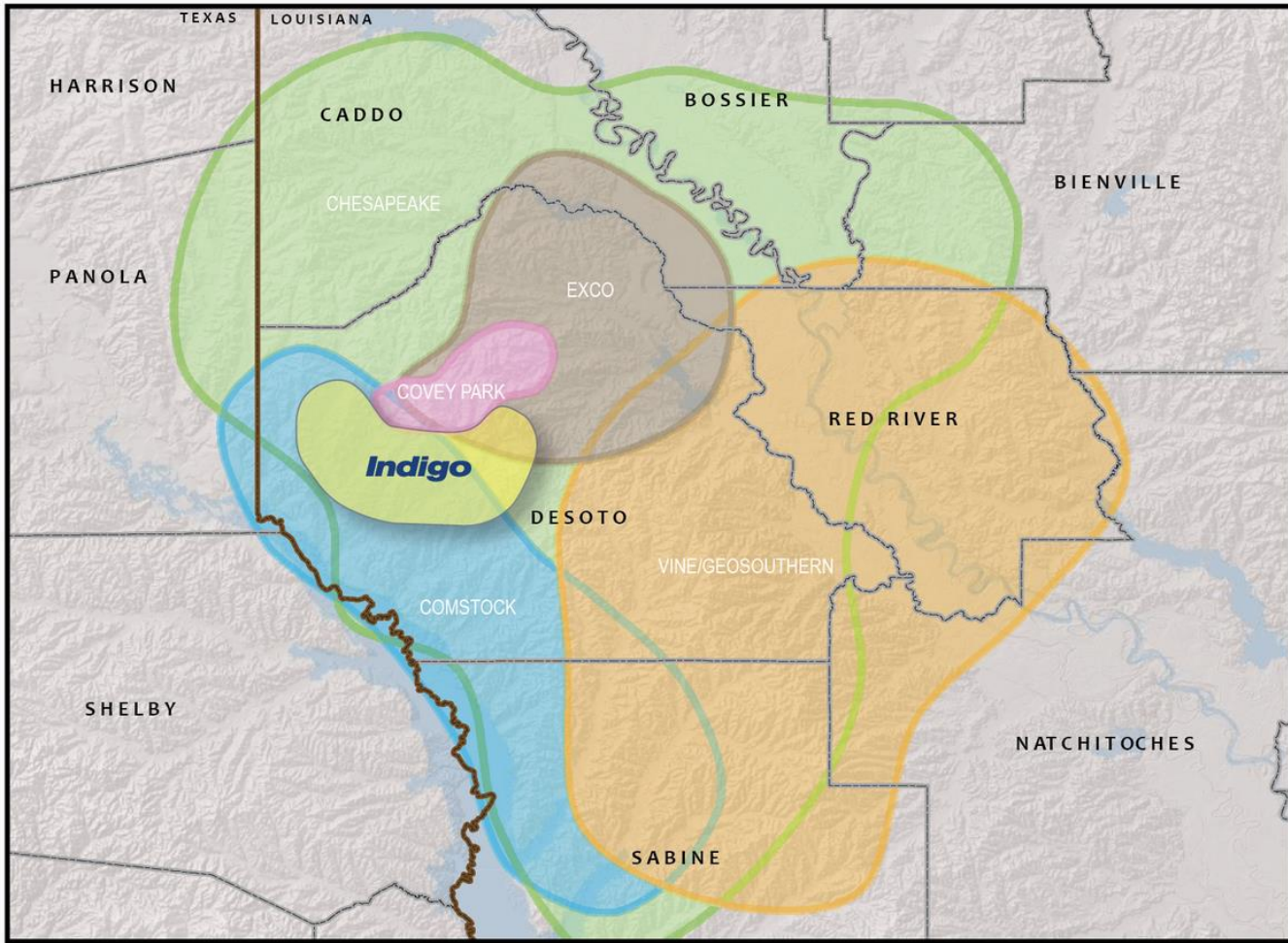
Second, [Shell's divestiture](#) seemed to be a strategic decision to exit the Haynesville (with relatively good timing right before the oil crash in October 2014) and focus capital on the NGL rich Appalachian. Encana and Chesapeake's divestitures seem more complicated to me. Encana sold all of its Haynesville acreage in an effort to concentrate on its core assets, but ECA still retained marketing and transport contracts its Haynesville acreage for 5 years. I believe Encana's Haynesville GP&T contracts were struck at lucrative prices considering that ECA [had to reduce the 5 year GP&T obligation by \\$480 million](#) to get the divestiture done. Additionally Encana retained attractive marketing and transport contracts for the next 5 years.

Chesapeake's GP&T contracts are the most peculiar to me. Let's look at Chesapeake's recent history in the Haynesville. Chesapeake Energy Corporation formed a wholly owned subsidiary named Chesapeake Midstream Operating, LLC. ("CMO"). Chesapeake Energy Corporation signed GP&T contracts with Chesapeake's Haynesville acreage. Chesapeake formed a 50/50 joint venture with Global Infrastructure Partners ("GIP"), a private equity fund, in September 2009 underneath CMO before taking CMO public in July 2010 under the ticker CHKM. Williams acquired GIP's ownership before eventually acquiring 100% of CHKM in June 2014. Let me boil this down. **Chesapeake management is not stupid. Management likely noticed that Wall Street is willing to pay more for a midstream company than an E&P company, and Chesapeake's management signed expensive GP&T contracts between Chesapeake Midstream Operating and Chesapeake the E&P driller. This would have inflated midstream earnings while putting pressure on E&P earnings.** In other words, I believe Chesapeake's management used the E&P as a piggy bank and extracted as much value as it could. This was 100% value arbitrage, and Chesapeake was able to create a lot of value for shareholders through the ultimate sale of Chesapeake Midstream Operating, LLC. However, that story is over. Done. Kaput. That business is owned by Williams. Now CHK is stuck with long term GP&T contracts that suck the profitability out of its Haynesville natural gas producer.

I believe that Shell, Encana and Chesapeake signed long term and very expensive GP&T contracts on pipelines that were built in the 2011-2012 timeframe. These contracts were probably 10 year contracts, and are unlikely to change materially. **Importantly, the ~350,000 acres sold by Shell, Encana and Chesapeake likely retain the punitive GP&T contracts that the operators previously signed.** Said a different way, the [41,500 net acres that Chesapeake sold to Covey Park](#) on December 20, 2016 for \$465 million is probably encumbered by ~\$1.35/Mcfe GP&T contracts that probably don't expire for at least 5 years. If Covey Park was willing to pay \$11,200/net acre for acreage with \$1.35/Mcfe GP&T contracts, what should Comstock's 67,000 net acres with \$0.27/Mcfe GP&T contracts be worth?

I would argue that Comstock's Haynesville acreage should be worth significantly more than \$11,200/acre provided that Comstock is making 33% more margin (\$1.08 in lesser GP&T costs on a \$3.00 commodity) than Chesapeake. I estimate that Comstock produces 215 MMcf/day of gas in 2017, which equates to approximately 78 Bcf of total production in 2017. **Comstock's \$1.08 GP&T price advantage versus Chesapeake results in \$85 million of incremental revenue with nearly 100% EBITDA contribution margins.** Helllllooooo. Time to wake up. I'm assuming that approximately half of Comstock's 2017 EBITDA comes from a GP&T pricing advantage that is sustainable for at least ~5 years due to the long term nature of GP&T contracts. Comstock's GP&T contract advantage makes Comstock one of the lowest cost shale gas producers in the country.

## Haynesville Operators (prior to the recent Chesapeake transactions)



Source: [www.IndigoMinerals.com](http://www.IndigoMinerals.com)

Covey Park ([218k net acres in the Haynesville/Bossier shales](#)), Indigo Minerals ([151k net acres in the Haynesville](#)), and Vine Oil & Gas ([107k net acres acquired from Shell in 2014 for \\$1.2bn](#)) have acquired a total of ~475,000 net acres in the Haynesville according to public information. A large chunk of that acreage likely came from the 350,000 acres sold by Shell, Encana, and Chesapeake which is likely burdened with expensive GP&T contracts. A material amount of recent entrants' production is going to be subject to expensive GP&T contracts even if these companies bought some acreage that isn't burdened by firm transportation contracts. Each of these three companies is considering an IPO in 2017 according to [Forbes](#), but Comstock seems positioned to deliver the best returns of any Haynesville operator. Consider that Chesapeake now owns 255,000 acres proforma for recent divestitures, and there isn't a behemoth Haynesville position concentrated in one company's hands. In fact, Covey or Indigo could likely become the largest Haynesville operator with a Comstock acquisition and market themselves as "THE way to play the Haynesville" on their IPO. **Comstock is likely a very attractive target to one of the 3 private companies before they go public.** Comstock's 67,000 net acres in the Haynesville could receive interest from Covey Park, Indigo Minerals, or Vine Oil & Gas prior to their respective IPOs. I think Cabot Oil & Gas (NYSE: COG) also makes sense as a potential acquirer. Range Resources (NYSE: RRC) has a large acreage position in the Appalachian basins and recently acquired Memorial Resources for \$3.3 billion in a move that diversified some of Range's reliance away from the Appalachian basin. Cabot could find Comstock attractive for similar reasons. Cabot could enter the Haynesville buy acquiring Comstock and add Comstock's bolt on Eagle Ford acreage that appears to match well with Cabot's acreage. I don't believe that CRK would sell its Haynesville acreage without selling the entire company. We will dig into valuation shortly to understand what Comstock is worth.

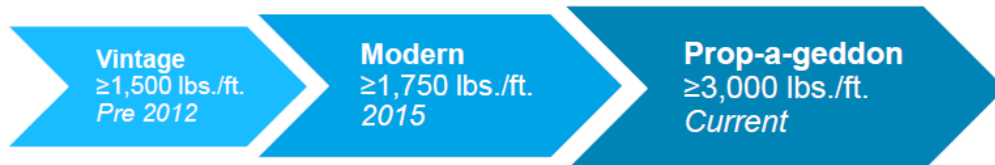
## CRK's Expected Financial Results

I concluded that I would prefer to own Haynesville over Appalachian acreage, Comstock is the best positioned Haynesville operator, and Comstock has fundamental and financial engineering catalysts to drive increased institutional awareness. Investors are going to dive into Comstock's numbers before making an investment.

Improved completion techniques should create excitement in Comstock. Chesapeake is testing a massive 5,000 pound of proppant per lateral foot, which Chesapeake is calling "Prop-a-geddon". Side note - I really want one of the Prop-a-geddon coffee mugs that management gave to attendees at the October 2016 analyst day. IN addition, Chesapeake is testing tighter frac spacing and perforation cluster spacing (down to 10 feet from 85 feet pre-2012). Note that Comstock dramatically slowed drilling in the Haynesville around 2012. These changes are potentially big evolutionary leaps in completion techniques for Comstock.

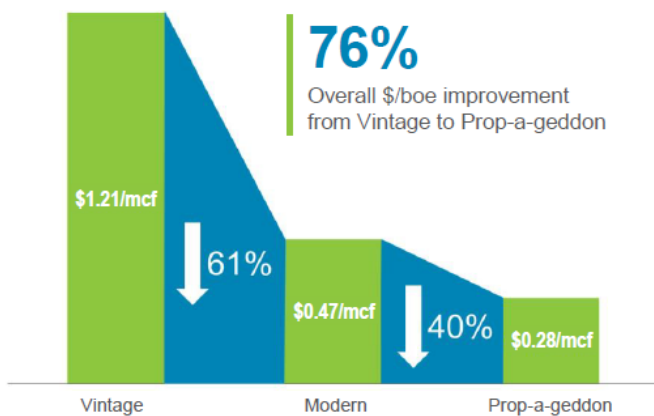
## HAYNESVILLE COMPLETION OPTIMIZATION

### IT'S A WHOLE NEW BALL GAME

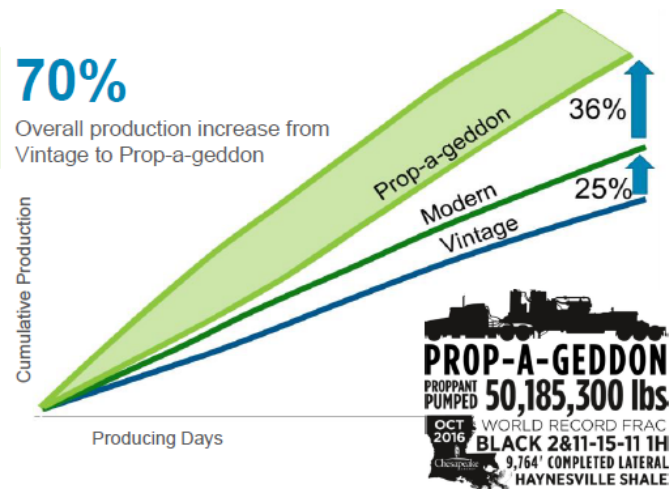


#### More Productivity for Your Dollar

Gross Completions Capital / Gross EUR



#### Proven Results from Optimization



Unlocking additional opportunities and expanding the core with completion technology

Source: Chesapeake October 2016 Analyst Day

Comstock is following suit by increasing proppant from 2,800/lateral foot to 3,800/lateral foot and shorter stage lengths of about 150 feet versus 250 feet previously, which indicates 50 frac stages on a 7,500 foot lateral versus 30 frac stages previously. The result can be seen in the graphic below. Well costs on a 7,500 foot well increased by \$400,000 and EURs increased by 3.1 Bcf from 15.5 Bcf to 18.6 Bcf. I assume that 25% of EURs are recovered in the first year, so the improved completion techniques could bring 0.775 Bcf (3.1 Bcf \* 25%) more out of the ground in year 1. Extracting 0.775 Bcf more in year 1 equates to about 20% more in year 1. Investors should note that the initial decline on new wells is actually flatter and IP rates are about 10% higher.

Therefore, I think a 20% increase in year 1 recoveries is not unreasonable. An additional 0.775 Bcf of year 1 recoveries equates to \$2.3 million (at \$3 gas) for an additional \$400,000 of F&D cost. I would say that is a good investment.

## Haynesville Well Economics

<i>Original Completion Design -</i>	<b>4,500' L</b>	<b>7,500' L</b>	<b>10,000' L</b>
<b>Estimated Well Costs (\$ millions)</b>	\$6.3	\$8.1	\$10.3
<b>24 Hr. IP (Mmcf per day)</b>	15	20	24
<b>Decline B Factor</b>	0.99	0.99	0.99
<b>Initial Decline (%)</b>	73	67	64
<b>Proppant (Pounds per lateral ft.)</b>	2,800	2,800	2,800
<b>EUR (Bcf)</b>	9.0	15.5	20.7

<i>New Completion Design -</i>	<b>4,500' L</b>	<b>7,500' L</b>	<b>10,000' L</b>
<b>Estimated Well Costs (\$ millions)</b>	\$6.5	\$8.5	\$10.8
<b>24 Hr. IP (Mmcf per day)</b>	17	22	26
<b>Decline B Factor</b>	0.99	0.99	0.99
<b>Initial Decline (%)</b>	72	65	61
<b>Proppant (Pounds per lateral ft.)</b>	3,800	3,800	3,800
<b>EUR (Bcf)</b>	11.2	18.6	24.8

**COMSTOCK**  
RESOURCES

10

Source: Comstock December 2016 Investor Presentation

New well completion designs are leading to improved well economics. Improved well economics are leading to accelerated drilling. Comstock guided to drilling 17.1 net wells in 2017 versus 6.5 net wells in 2016. The result is that Comstock guided to 200 – 230 MMcf/day of natural gas production in 2017 versus ~150 MMcf/day in 2016. Comstock guided to 2,200 – 2,800 barrels of oil/day in 2017. An investor assuming a flat \$3 gas and \$50 oil price deck could see upside to current consensus of \$175 million in EBITDA. Notably, Comstock has a ~0.10/mmbtu and a ~\$3/barrel negative price differential to gas and oil. I believe that CRK's current consensus is pricing in ~2.75/mmbtu NYMEX and \$45/barrel pricing for gas and oil in 2017 assuming moderately improved LOEs and GP&T year-over-year. Comstock has hedged [~25% of its 2017 gas production at \\$3.32](#). Therefore, I think the street is pricing in conservative commodity assumptions that have set the bar appropriately high to merit my "new favorite long" label.

Management provided EBITDAX (EBITDA + CAPEX) guidance in its recent investor presentation at \$3.00 and \$3.75 NYMEX natural gas. Comstock believes it can deliver \$185 million and \$233 million in 2017 EBITDAX at \$3.00 and \$3.75 gas, respectively.



Assume that Comstock generates \$200 million in 2017 EBITDAX, which equates to ~\$3.14 gas. Calculating FCF is straight forward. Comstock announced that its 2017 CAPEX plan will cost \$142.9 million. Cash interest is ~\$70 million assuming that Comstock pays all senior secured interest with cash rather than PIK. Remember that Comstock does not pay cash interest on the convertible debt. Comstock does not pay cash taxes. Comstock had a \$558.7 million U.S. federal net operating loss (“NOL”) and a \$957.7 million state of Louisiana NOL at December 31, 2105. Therefore, Comstock’s cash uses are \$213 million versus potentially \$200 million in EBITDAX, and Comstock is nearly completing funding its drilling plan with cash flows. Investors that dig into Comstock’s numbers will find that expectations are set attractively. The last step is valuation.

## Valuation

My \$17 price target is based on 8.0x and 5.3x my 2017 and 2018 EBITDAX (EBITDA + CAPEX) estimates, respectively. My valuation is assuming 52 million fully diluted shares outstanding after adding shares from the convertible debt conversion. I assume 37 million shares proforma for the \$450 million of convertible unsecured debt with an 81.2 shares per \$1,000 par value conversion. I also assume that the convertible debt PIKs until May 2017 and adds ~\$19 million in convertible debt which would represent 1.5 million additional shares. I also assume \$3.00 NYMEX natural gas.

CRK is the cheapest natural gas producer relative to its organic production growth rate. Companies that trade for the cheapest valuation in their respective comp groups are often experiencing some sort of degradation in their businesses. While CRK's relative discount was fair in the beginning of 2016, CRK should not trade for a 2-turn EBITDA discount to peers proforma for the debt restructuring and conversion. Balance sheet leverage will be palatable following the debt conversion. Production should grow ~40% in 2017 over 2016, and EBITDA could more than double in 2017 from \$85 million to ~\$200 million assuming that commodity prices stay flat at \$50/barrel and \$3/mmbtu. Management has hedged approximately ~25%, or 50MMcf/day, of its 2017 production at \$3.32, and management is de-risking the model by continuing to hedge production on its way to hedging ~110 MMcf/day, or 50% of total production. Natural gas has risen more than 100% from the lows in February 2016, and **CRK is arguably the best positioned natural gas derivative publicly listed stock** due to its favorable GP&T contracts. CRK still trades for a 30-60% discount to peers despite the improvement in Comstock's fundamentals.

**The best natural gas producers trade for 10-11x EV/2017 EBITDA. My price target would increase from \$17 to \$25 if I applied a 10x 2017 EBITDA multiple to Comstock.** Comstock could earn that multiple if the convertible debt converts, natural gas prices remain above \$3, NGL prices do not skyrocket, and Comstock executes on its 2017 drilling plan. Comstock will be a reasonably levered natural gas producer drilling within cash flows while growing production and EBITDA faster than any other natural gas producer.

My top investment ideas have a common theme in that they appeal to growth, GARP, and value investors simultaneously. These stocks get the benefit of a uniquely significant amount of eyeballs considering an investment at the same time. CRK is at the front end of screening well for all three of these investor groups.

### *The Case for Growth Investors*

Comstock's guidance implies that natural gas production will grow ~40% in 2017 on a 2-rig program, and EBITDA will grow by more than 100%. Comstock ran a 6-rig program before the crash in 2014, and Comstock could easily add a third rig in 2018. **No other natural gas producer is expected to grow production organically as quickly (potentially a 35% two-year CAGR) as Comstock. Comstock should be able to organically grow EBITDA faster than any other natural gas producer in 2017.** Growth investors are going to look for natural gas derivatives with natural gas making a 2-year high on December 28, 2016 and testing \$4.00. Applying an 8x EBITDA multiple, a multiple in line with its peers, is fair given its growth characteristics and would imply a ~\$17 stock price.

### *The Case for GARP Investors*

CRK will grow production 40% while fully funding its drilling plan with cash on its balance sheet with gas at \$3.00. **Natural gas production peers trade for a 30-60% premium to Comstock based on 2017 and 2018 consensus EV/EBITDA, Price/Cash Flow per Share, and EV/Daily Production.** GARP investors will find Comstock's relative valuation discount attractive while considering its attractive growth rates and ability to self-fund its drilling. Valuing CRK at peer average multiples implies a \$17 stock price.

### *The Case for Value Investors*

I expect that value investors will value Comstock based on the value of its assets. **The combination of self-funding its 2017 and 2018 drilling plans along with trading for a 15% asset value discount to precedent transactions will attract value investors.** I am only giving CRK value for its Haynesville and Eagle Ford acreage. I give zero value to CRK's 87,500 Tuscaloosa acres.

Haynesville – [Indigo Mineral spent \\$375 million](#) on 25,000 acres, or \$15,000/acre, in April 2016 (when gas was less than \$2) in the Haynesville/Cotton Valley that I believe was not burdened by expensive GP&T contracts. Some of Comstock's Haynesville acreage spreads into the Cotton Valley. Therefore, \$15,000/acre appears to be a fair comparison to Comstock given the lack of expensive GP&T contracts and geographic dispersion. I could argue that Comstock deserves a slight premium to \$15,000/acre because Comstock has more acreage. Valuing Comstock's 67,000 acres at \$15,000/acre implies a \$1 billion value.

Eagle Ford – Comstock owns 19,000 net acres in the Eagle Ford. [Carrizo Oil & Gas \(NASDAQ: CRZO\) recently bought 15,000 acres for ~\\$12,067/acre](#) in LaSalle, Frio and McMullen counties (the same counties as Comstock’s acreage). Ascribing a similar value per acre to Comstock’s acreage implies a \$230 million valuation. \$230 million is a fair valuation for CRK’s Eagle Ford acreage today, but I do not expect management would entertain an asset sale at that valuation.

A precedent transaction approach values Comstock’s acreage at \$1.25 billion, and I assume \$700 million in debt, \$50 million in cash, and 52 million shares proforma for the convertible debt conversion. Importantly, gas prices are up ~80% from April 2016 when Indigo bought Haynesville acreage at \$15,000/acre. Unencumbered Haynesville acreage could sell for more than \$15,000/acre in today’s gas world. Therefore, with a potentially conservative \$11.50 implied asset value, CRK is trading for approximately 15% discount to its asset value.

Lastly, I believe value investors could also value Comstock’s proved developed and undeveloped reserves. Investors will have to wait until the end of 2016 reserve report comes out, but Comstock could see a meaningful increase in proved developed reserves. I believe Comstock’s proved developed reserves could increase from \$373 million in 2015 to ~\$500 million in 2016 based on Comstock’s 2016 CAPEX plan and increased gas prices. Comstock has stated that it has 700 potential Haynesville and Bossier locations and 250 Eagle Ford locations based on spacing in line with competitor’s spacing. I think the Cotton Valley may also have 50-100 locations. Therefore, Comstock could have a total of 1,000 locations. Comstock’s liquidity has improved significantly which could allow Comstock to include a significant amount of PUDs in its reserve that were excluded previously because Comstock did not have 5 years of liquidity to drill its resource. I believe that Comstock currently recovers all costs within the first year of drilling a Haynesville well, and actually generates ~\$2 million in EBITDA per Haynesville well in the first twelve months. Remember that these wells could produce gas for decades (obviously at lower production levels evidenced by the decline curve). I don’t believe that valuing PUD locations at \$1 million per location is outrageous. Assuming \$1 million per location plus \$500 million in PDP reserves, and investors could arrive at a \$1.5 billion Enterprise Value, or \$16.25 stock price.

#### *Valuation Summary*

Growth, GARP, and value valuation methodologies come up with a \$16.00 – \$17.00 price target. I believe that the early stages of discovery will see Comstock attract value investors before GARP and growth investors begin to see the picture. I am adopting a \$17.00 price target in my initiation.



Conclusion - What inning are we in?



Smart money invested in innings 1-3, institutional money invests in innings 4-6, and retail money invests in innings 7-9. The “smart money” hit a grand slam when the bonds moved from \$7 to \$67 in 6 months before restructuring into a PIK only security. The stock tripled from \$3 to \$9 since February 2016. Smart money has already made a fortune in CRK over the last year, and CRK is at the very beginning of attracting institutional investor interest. The institutional stage of investment in CRK should last into late 2017/2018, and astute investors are going to want to get involved now in front of a wave of institutional money flowing into CRK. Evidence that institutional money is pouring into CRK can be found in recent 13G filings.

T. Rowe Price Associates announced that it became the largest shareholder of CRK as of October 31, 2016 in a November 2016 13G filing. My best guess would be that T. Rowe purchased the majority of the 1.4 million shares it bought in October 2016 at approximately \$9.75. I am excited to have the opportunity to play T. Rowe's hand with them by buying at a similar price (\$9.56) to T. Rowe's theoretical average price. I think T. Rowe has made an extremely astute investment, and investors should absolutely follow suit. Why? CRK is about to appeal to small cap growth, GARP, and value criteria simultaneously.

Generalists have the latitude to invest capital in many sectors, and many generalists were caught on the wrong side of the oil trade in 2014. That wound was deep and painful. I believe it takes two years for generalists’ wounds to heal before they consider investing following big collapses like the 2014 oil crash. Well, two years have passed, and generalists will be looking at energy’s outperformance in 2016 and saying “I need to get in again”. The wound has healed, and generalists will be ready to come back. Generalists will be the incremental energy buyer in 2017.

Comstock is levered to the Haynesville, which I believe is the best natural gas asset in the United States because of its proximity to the Gulf and existing infrastructure. CRK is going to be on a ton of institutional manager’s radars, and I believe CRK is going to test \$17 over the next 12-18 months, but the majority of the move could happen over the next 6 months.

## Risks

### *Commodity Risk*

CRK's performance is going to be largely determined by the price of natural gas. The biggest risk to my long recommendation is a protracted sell-off in gas. Absent a large correction in gas prices, I feel confident that CRK will deliver strong returns in 2017. Natural gas, like oil, is volatile and negative price movements could impact CRK's stock price. Natural gas traded as low at \$1.68 and as high as \$3.93 in 2016; gas was up ~55% in 2016. Notably, gas is trading at 2 year highs after working off unfavorable dynamics including high inventory levels as a result of above average winter temperatures and oversupply from the ramping Marcellus producers. Low prices in February 2016 accelerated gas use versus coal, and oil production declines led to a decrease in associated gas production. On December 29, 2016, natural gas inventories were down 237 billion cubic feet, the largest draw since 240 billion cubic feet in Jan 2014, which was the largest draw ever. Further, nat gas stocks are down to 3.36 Tcf from 3.77 Tcf a year ago. The natural gas market seems much healthier today than a year ago, but a prolonged correction in gas prices below \$2.75 - \$3.00 could cause CRK to miss my 2017 revenue and EBITDA estimates, but CRK could still be attractive given my bullish view on the Haynesville.

My thesis gets derailed if gas prices average less than \$2.40 in 2017. Remember CRK has hedged 25% of 2017 production at \$3.32. Therefore, the remaining 75% of Comstock's production would have to earn \$2.09 for CRK to average \$2.40 gas in 2017. At \$2.40 average natural gas, Comstock can still fully fund its CAPEX plan with cash from operations, but Comstock will not be able to pay senior secured interest payments with cash. Therefore, Comstock will PIK interest on the \$700 million of senior secured debt. Every month that CRK PIKs interest on the \$700 million of senior secured debt adds ~450,000 - 500,000 shares to my shares outstanding calculation. Although PIK'ing interest on the \$700 million in senior secured debt is not ideal, CRK could arguably still be worth 8x 2017 EBITDA which would equate to ~\$9.00. A 6% loss versus my recommendation price of \$9.56 is not very painful.

Average natural gas prices below \$2.40/mmbtu could cause Comstock to reduce its CAPEX plan to drill within cash flows. My thesis would be dramatically different in that environment assuming that service costs do not decrease. I would need to analyze CRK's prospects at that time to fully understand Comstock's value. However, my precedent transaction calculation would still value Comstock at \$11.50.

### *PIK Interest*

Comstock's debt will increase approximately from ~\$1.15 billion at September 30, 2016 to \$1.2 billion at September 30, 2017 if Comstock pays all senior secured interest with cash and PIKs interest on the convertible debt for 12 months. Every quarter in which the convertible debt does not convert into equity adds another 900,000 shares to the fully diluted share count. My 52 million share estimate assumes that the convertible debt converts into equity in May 2017.

### *Stock Volatility*

Convertible debt shares could cause extreme volatility in the stock price at conversion. Convertible debt has a mandatory conversion when CRK trades at or above \$12.32 for 15 consecutive days.

### *Hedging*

Management may not hedge its production effectively. Comstock has hedged 50 MMcf/day for 2017 on its way to hedging 110 MMcf/day for 2017. Management guided to 200-230 MMcf/day of production in 2017. Therefore, hedging 110 MMcf/day is approximately half of CRK's expected production. Comstock is exposed to greater commodity risk if management does not take advantage of the recent spike in natural gas prices to hedge out its production. I would prefer to see management complete its hedging program in the short term to decrease near term commodity risk and increase CRK's investment merits.

### *Other Risks*

Other risk factors include 1) higher than expected decline rates in producing well, 2) lesser than expected recoveries from new completion techniques, 3) rising well costs, 4) regulatory changes, and 5) exploration and operational missteps.

## **Disclosure**

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