

Contango Oil and Gas Company

AMEX: MCF

Kenneth R. Peak  
Chairman, President, CEO, Chief Financial Officer,  
Secretary and Director

Contango is a Houston-based, independent oil and natural gas Company. The company explores and acquires oil and natural gas properties, primarily in the onshore Gulf Coast and offshore Gulf of Mexico, and owns a 10% interest in an LNG (liquefied natural gas) receiving terminal planned to be built in Freeport, Texas.

[www.contango.com](http://www.contango.com)

Phone: 713-960-1901

Kenneth R. Peak, Chairman, President, CEO, Chief Financial Officer, Secretary and Director, spoke with *Wall Street Reporter Magazine* on September 18, 2006.

**WSR: Start off with Contango's recently reported year-end financial results, and bring us up to date on their assets and operations.**

**MCF:** We reported our year-end financials last week. We are a June 30 fiscal company. That's why we are reporting our year-end at this point in time. In the press release, we focused on bringing everyone up to speed on the amount of cash flow we had in 2005 and what we did with that money; we said we had a cash inflow of USD\$50 million and an outflow of USD\$46 million. The bulk of the money was spent, USD\$25 million of that USD\$45 million was spent in the

offshore and another USD\$10 million was spent in the onshore; of the USD\$10 million, the bulk of that was spent in the Fayetteville Shale. We have been focused for the last year on three major investments; our LNG plant at Freeport, Texas, more than half complete - we are a 10% owner of that plant - the other investors are Dow Chemical, Cheniere, and a private individual. We have two long-term contracts with ConocoPhillips at 1 billion cubic feet gas a day and Dow Chemical at 500 million cubic feet a day. Since 2005, we have been very focused on Fayetteville Shale. We said in our press release that we had 44,000 net mineral acres; of those net mineral acres to our group, Contango has a 70% working interest. We have 30,000 net mineral acres to Contango, and we are in 60 wells at this point in time. The bulk of those are with a third-party operator, and 15 of them are with the Alta Group, where we are operating. We have just this weekend started our fifth well so we now have two rigs running in the play, and within the next two weeks we will be tracking our very first well. We are excited about that. I am looking forward to the results. In the meantime, we continue to receive six to eight AFEs unmarked from an independent third party

operator. We also have offshore wells where in 2005, we drilled two successful wells out of four, and we are currently drilling one of our major exploration wells.

**WSR: For fiscal year 2007, the capital expenditure budget has been set at USD\$58.3 million. How will this amount be allocated between onshore and offshore activities?**

**MCF:** We are allocating USD\$13 million of that for offshore. That leaves USD\$40 to \$45 million for our onshore efforts, which will be going to the Fayetteville Shale. We are going to be drilling from six to eight wells a month in the Fayetteville Shale. We believe this will be a huge resource play. Southwestern Energy is the 900,000-pound gorilla in the play with 900,000 net mineral acres. Our acreage is nearby, contiguous, and in many cases surrounded by them. We are in four counties; Van Buren, Cleburne, Conway and Faulkner, and we consider those four counties the heart of the play. We will be spending money both on integrated wells, where we are integrated by the third party operator into their wells as well as the wells with Alta, which is the operator for our group. The third party company integrating us is moving to 18 to 20 rigs by year-end. We

anticipate we will be in hundreds of wells as this play gets developed over the next five to seven years.

**WSR: Will Contango be looking to raise additional financing to fund its offshore exploration and Fayetteville Shale development programs?**

**MCF:** We are calling for a capital budget of USD\$58.3 million; in my press release, I indicated we have USD\$10 million of cash and another USD\$10 million of unused debt capacity. Of the USD\$58.3 million - we've already spent USD\$8 million, and that is why we are down to USD\$10 million in cash. We are looking for USD\$30 million, which is USD\$50 million minus the USD\$20 million we have in our pocket. We will be looking to fund USD\$30 million over the remainder of this fiscal year. We are kind of in a foot race in creating value out there in order to create a hydrocarbon borrowing base or conventional bank debt of sufficient magnitude to fund most of, if not all of, the USD\$30 Million. By far, the cheapest source of capital for Contango is traditional bank debt, where you give the bank a first mortgage on your proven production and they give you money at, for example, LIBOR plus 2. We think we are

going to be able to get a pretty good piece of that, and perhaps all of our needs financed, but certainly a good piece of that USD\$30 million. As I look at our capital opportunities, our fallback decision would be some kind of mezzanine debt, and that's typically a LIBOR plus six coupon where the banks take a second mortgage and do an over-advance against your production, a fallback from that; certainly something we would look at would be another property sale. We have had a recent discovery, Grand Isle 72, which we expect to come on production by November. That is an alternative. Finally and least desirable would be doing a Series E Preferred Stock issuance. We have done a Series A, B, C and D of preferred stock. We would certainly look at that, and then finally selling common would be the least desirable of all the alternatives, but we have so many exciting opportunities in front of us, we will go get the capital on the best available terms in the marketplace.

**WSR: Regarding the investment in the LNG terminal in Freeport, is the project proceeding on time and on budget, and when is the facility anticipated to start operating?**

**MCF:** It is on time and on budget, that is the good news. It is an USD\$800 million project, and we are well past the halfway point. We are looking for a first quarter 2008 start-up, which three to four years ago when we were starting this seemed like infinity. But in September 2006, we are less in a year-and-a-half away, but things have been going very well. We have been very fortunate that we avoided the hurricane season on the Texas coast so far, which has allowed us to get a lot of very important things done on the project. Next year, we will be in much better shape in terms of hurricanes. The plant is being built to withstand 200 miles-per-hour winds. The managers of the project raised USD\$383 million in December 2005 on a non-recourse basis. Contango's net investment in the project is USD\$3 million, and I don't think we will have to put any more equity into the project. We are also having discussions about expanding the plant, which will happen, hopefully between 2009 and 2011. We're very excited about that, about Fayetteville, and the offshore of Gulf of Mexico is by far the riskiest thing we do, but it also has the ability to succeed and have a major impact on the company's value creation.

**WSR:** In terms of any limiting factors here, does the company have sufficient physical infrastructure and skilled field personnel in place?

**MCF:** We only have six employees. Myself, a controller, a treasurer, an accountant, my secretary, and then on the offshore side, we have a president of Contango Operators, the company where we operate, At one point this summer, we were operating three wells offshore in the Gulf of Mexico, three wildcat exploration wells in the offshore Gulf of Mexico with just one person. The way we do that and the only way you could do it with just one person is that we do turnkey with ATDI, a wholly-owned subsidiary of Global Marine/Santa Fe, and they are the general contractor. We have one individual with over 30 years' experience in the industry managing our offshore efforts. We could get bigger, but I don't see any need to have more than six people. It's not that we are working 24 hours a day or that we are some kind of super humans, it's that we have outsourced everything. The Alta management is managing our Fayetteville Shale, the Freeport management is managing the construction of our LNG plant, we have outsourced our prospect generation to two partially-owned subsidiaries,

Republic Exploration and Contango Offshore Exploration, and we've outsourced the drilling of the wells to ADTI. It's more just managing our managers, which comes down to be what our job is.

**WSR: Will the company look to enter into additional alliances or joint ventures in the future?**

**MCF:** I am very happy with what we have, and we have a full plate. We have the ball exactly where we want it; it is just a matter of execution, but you can tell from the capital that we spent both last year and this year that we are not idea-constrained but rather capital-constrained. I don't see us wanting to begin anything else. We have got so many opportunities right in front of us. Our challenge is to execute on what we've got.

**WSR: Do investors fully appreciate the potential of the company, given the current level of interest?**

**MCF:** We are not well-followed - 99.99% of the investing public doesn't know or care about Contango. I go around speaking at the IPAA Seminars, most recently at the Enercom

Seminar at Denver. There are a number of very sophisticated institutions that know about us. I have a piece of paper here with fewer than 20 names on it that own 70% of our stock. We have a very loyal and knowledgeable group of sophisticated shareholders, and I am very happy with our shareholders. The kind of shareholder I have been trying to encourage to invest in the company is someone with a three to five-year time horizon. Fayetteville Shale will certainly be that. LNG has certainly been that and will continue to be that. It is a 35 to 50-year annuity once we complete it with expansion opportunity, and the offshore. Some of the wells and ideas we are working on are ideas formed two and three years ago. The quarter-to-quarter focus and year-to-year focus are not my prime horizons, and I am the largest shareholder in the company. I am trying to create value on a sustained basis, and it's not something that happens quarter-to-quarter or year-to-year. It's long-term brick-by-brick value creation.

**WSR: In conclusion, give us a few of the key reasons why Contango represents a good long-term investment plan.**

**MCF:** We have three very high-quality ideas. Two of them, the LNG and the Fayetteville Shale, are on the low end of the risk spectrum, built-in anchors to the company's value. One of them, the Offshore Exploration Program, is extremely high risk, but also high reward. We have been in business seven years. We've raised USD\$30 million capital, we have USD\$10 million of debt, and we created a company with USD\$200 million market cap, so there has been serious value creation. We've had significant profits over that time frame, even when natural gas prices were low. We have the same number of shares outstanding today as we had five years ago. There are very few companies that could say that in our business. My focus has not been on getting big but on being profitable and creating value. We have a management team and a Board that own well over 20% of the company and is focused on creating value per share.

**END**