



**Proven Performance**

**September 8, 2006**

# Who Is Meritage?

## Principals & Key Employees

### Tom Corley

- Manager and Principal of Meritage Energy Partners I (2001-present)
- Senior Executive with Basin Exploration (1996 -2001), St Mary Land (1993 -1996) & General Atlantic Resources (1983-1993)
- Colorado School of Mines 1983 BSc Petroleum Engineering
- Responsible for Acquisitions, Reservoir, Operations, Geotechnical

### Sam Winegrad

- Manager and Principal of Meritage Energy Partners I (2001-present)
- Senior Executive with Basin Exploration (1995-2001), General Atlantic Resources (1985 -1995)
- Colorado University 1980 BSBA - Land Mgmt
- Deal Negotiation, Contracts, Finance, Administration

# Track Record

- ❑ Meritage Energy Partners (4.5 Years)
  - ❑ Start-up w/ Quantum July 2001
  - ❑ Applied conservative but successful business plan
  - ❑ Utilized \$1.6 million equity, built through acquisitions
  - ❑ Sold for \$61.5 million returning 23:1
- ❑ Basin Exploration (5 Years)
  - ❑ Restructuring of financially challenged public company 1995 - New management team & strategy
  - ❑ Increased Enterprise Value \$50 million (1995) to \$415 million (2000)
  - ❑ Share Price \$3.50 (1996) to \$24.00/share at exit
  - ❑ Merged w/ Stone Energy in 2001
- ❑ General Atlantic Resources (10 years)
  - ❑ Start-up (1981) - \$12 million seed capital
  - ❑ Growth Through Acquisitions & Exploration Programs
    - ❑ Institutional Investors
  - ❑ Several Cycles of Build/Sell, IPO & Merger
    - ❑ \$110 million sale ('88), IPO \$115 million ('93), UMC Merger ('94)

# Meritage Energy Partners I



- Formed July 2001
  - Tom Corley & Sam Winegrad
  - Quantum Energy Partners, LP
- Equity Capitalization
  - Total Equity Commitment \$16.0 Million (\$1.6 Million drawn)
- Banking Relationship – Wells Fargo
  - Revolving Credit Facility - \$25 Million

# Meritage I Business Plan



- Acquire/Exploit strategy (80% of budget)
  - Long lived, stable assets
  - Aggregate \$50 – 75 MM in assets
  - Rockies, Mid-continent regions
  - Oil or Gas, Strong preference for operations
  - Small deals (<\$10 Million/transaction)
    - Below “radar-screen”
  - Hedge/Leverage aggressively
  
- Early-stage exploration (20% budget)
  - Continuous-type plays (basin-centered gas, CBM)
  - Generate or acquire prospect, build lease position
  - Manage risk through sell/carry, retain significant equity, operations

# Meritage I Performance

## Reserves, Production, Cash Flow

- 8.0 MMBOE “risky” reserves
- Operated approx. 2000 boepd (gross)
- Net Daily production = 1300 boepd
- Approximate 2005 NCF = \$1,000,000 per month
- Acquired in seven transactions
- Long-life, stable production, with upside

# Meritage I Exit Sale to Citation Oil & Gas

- ❑ Cash Transaction
- ❑ \$61,500,000 Purchase Price
- ❑ Effective 1/1/06 (closed 01/03/06)
- ❑ Market Metrics
  - ❑ \$7.69/boe
  - ❑ \$49,200/boepd
  - ❑ 61 months current cash flow

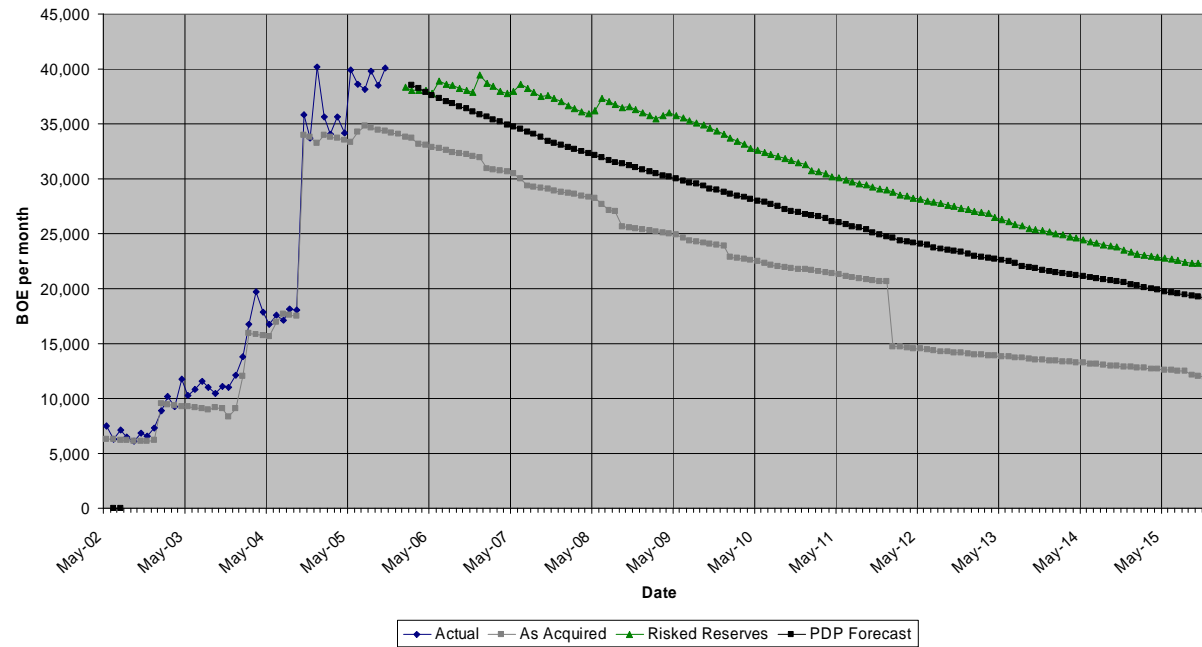
# Meritage I Returns to Investors

- ❑ \$61,500,000 Gross Purchase Price
  - ❑ \$60,800,000 Net Closing Amount
- ❑ -\$23,000,000 Debt Payoff & Hedge Unwind
- ❑ -\$2,000,000 Other Closing & Unwind Costs
- ❑ \$36,000,000 Distributed Capital (est.)
- ❑ \$1,600,000 Invested Capital
- ❑ ROI=22.5:1

<b>Meritage Energy Partners</b>				
<b>Acquisition Returns*</b>				
	<b>As Acquired</b>		<b>Actual- Hedged</b>	
	<b>IRR</b>	<b>ROI</b>	<b>IRR</b>	<b>ROI</b>
<b>Tom Brown</b>	15%	2.3	67%	4.4
<b>Pendragon</b>	39%	1.9	100%	18.3
<b>Westech</b>	15%	1.5	100%	5.1
<b>Merit</b>	17%	2.2	100%	4.4
<b>Advantage</b>	14%	2.3	88%	3.0
<b>Dominion</b>	13%	1.6	100%	3.5
<b>Quicksilver</b>	13%	1.5	100%	2.4
<b>Lewis &amp; Clark</b>	22%	2.3	100%	4.9

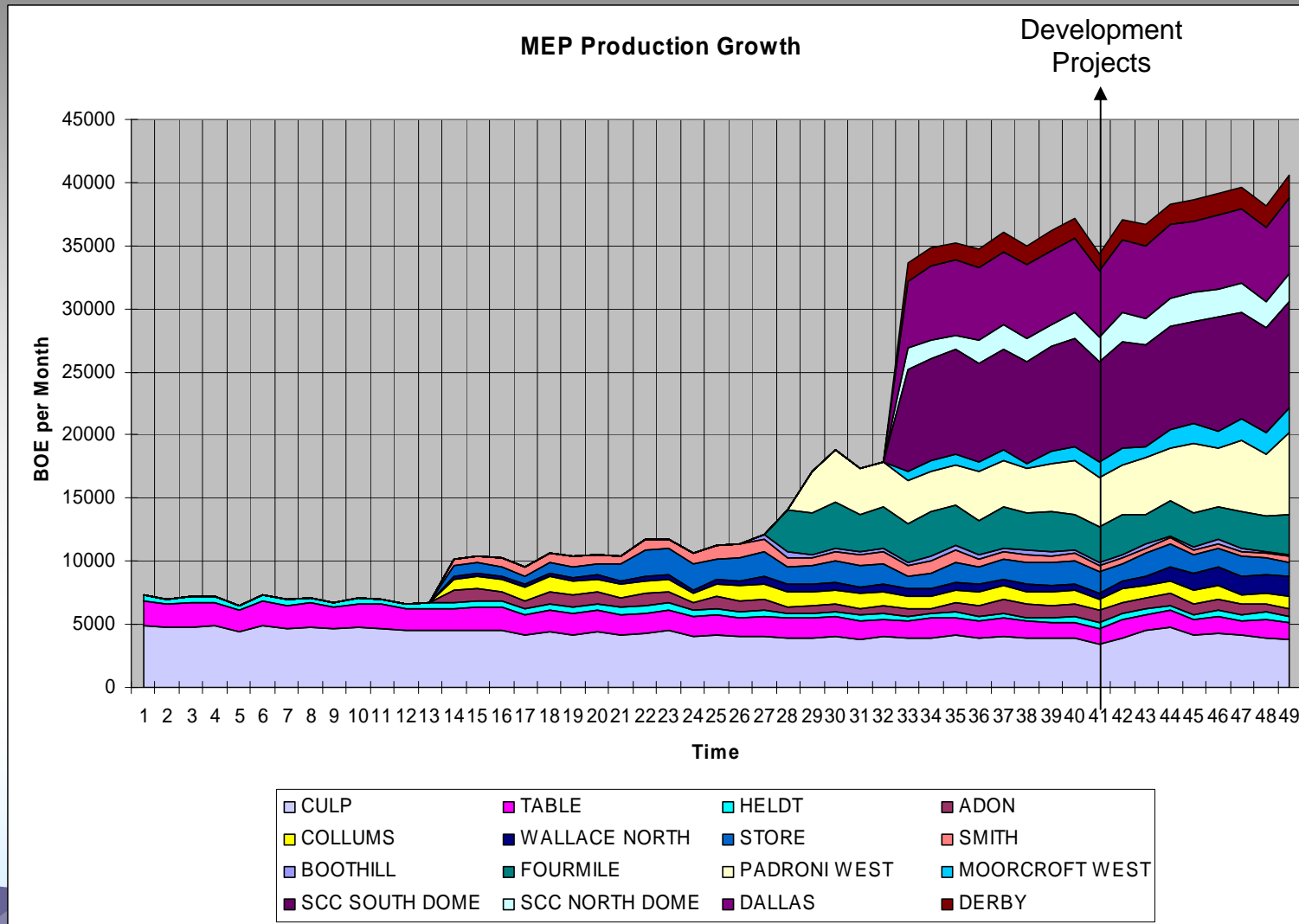
**\*Project Acquisition  
Returns before leverage  
and G&A**

**Meritage Performance  
Projected vs Actual Volumes**



<b>Meritage Energy Partners As Acquired vs. Realized Data</b>				
	<b>Reserve</b>			
	<b>Volumes</b>	<b>Net Daily*</b>	<b>Reserve Cost</b>	<b>IRR</b>
	<b>MBOE</b>	<b>BOPD</b>	<b>\$/BOE</b>	<b>%</b>
<b>As acquired</b>	4,935	1,108	4.04	15.6
<b>Realized (ITD + Risked Forecast)</b>	9,053	1,292	2.20	100+
<b>* as of 1/01/06</b>				

# Production Growth



## Value Added – Development Projects

- Development drilling in three fields (8 wells)
- Recompletion of existing or new zones (22 wells)
- Mechanical work to increase production (12 wells)
- Numerous acid jobs and other stimulation projects
- Unitized field and initiated waterflood

# Value Added - Price vs Performance Comparison

## Methodology & Results

- Performed rigorous analysis to bifurcate returns between price run-up and raw property performance (i.e. value added through exploitation)
- Price run-up accounted for 48% of value increase
- Exploitation projects added 52% to property value

## Case Histories - Pendragon

- \$430,000 Purchase Price (\$305,000 @ Closing)
- Small Negotiated deal
- Three Fields in Wyoming
- Upside Projects Identified
  - Initiate Waterflood (formed unit, drilled well)
  - Fracture Stimulate Gas well (successful)
- Sale Value (with INCF) = \$6,345,000
  - After \$450,000 capital invested

## Case Histories- Quicksilver

- \$8,300,000 Purchase Price (\$6,904,000 @ Closing)
- Largest deal – Negotiated – Closed October 2004
- Three Fields in Wyoming
- Upside Projects Identified
  - Re-activate Steamflood
  - Add-pay & Recompletions
  - Increase Lift projects
- Sale Value (with INCF) = \$17,996,396
  - After \$8.3 million hedge loss
  - After \$1.4 million capital investment

# Next Steps

- Assess Market Trends
- Develop Business Strategy
- Formation and Funding of Meritage NEWCO
- Execution of Business Plan

# Macro Trends

- Product Prices

- Short term – more than ample supply in the face of recovering demand. Large crude & nat. gas inventories have been pressuring the front-end of the curve. Lack of refining infrastructure, switch to clean gas and MTBE phase-out have recently boosted front-end of the oil curve.
- Physical markets are dislocated from the financial markets, creating wide regional basis differentials, a reflection of near term excess supply, especially relative to infrastructure.
- Long Term - prices supported by geopolitical instability, weather and consumption growth i.e. China and India. Infrastructure will come.
- Result is price contango through 2007(oil), 2008 (gas), a sharp reversal to the historical backwardation. Supportive of hedging the out years. The roll is inverted.

# Macro Trends

- Upstream Investment Opportunities
  - Intense competition for resource plays, including CBM, shale oil/gas, basin centered gas and tight gas sands. Record prices, especially opportunities heavily weighted towards future drilling opportunities. Early movers rewarded. Late entrants get squeezed.
  - Less competition for conventional assets, especially those with a large PDP component.
  - Canadian royalty trusts and U.S. based MLP's are coming into the U.S. market, filling a need for low risk, income generating investments with attractive yields relative to "risk free" investments. Cheaper capital gives them a competitive advantage, but may also present an excellent exit opportunity and could result in new valuation metrics for long-lived properties.

# Investment Thesis

- Build On Proven Success/ Current Trends
  - Building reserves/volumes with conventional producing assets where competition is thinner and valuations are cheaper. Valuation arbitrage will exist with advent of MLP's and royalty trusts. Current prices support aggressive hedging
  - Exposure to resource plays is important. The best risk/reward profile is in early stage positions. Taking drilling risk creates exposure to spiraling drilling / service costs and cycle time risk, as well as product price risk. Also very equity capital intensive.

# Meritage II Business Plan

- ❑ Acquire/Exploit strategy (80% of budget)
  - ❑ Long lived, stable assets
  - ❑ Aggregate > \$150 Million
  - ❑ Target Basins w/ good attributes, but are “out of favor”
  - ❑ Oil or Gas, Strong preference for operations
  - ❑ Bread and Butter deals (\$15 - \$50 MM)
  - ❑ Larger deals (>\$50 MM) - strategic
    - ❑ Focus on solid long-life assets that provide option value
    - ❑ Establish core positions
  - ❑ Small Deals (<\$15 MM) – bolt on, opportunistic
  - ❑ Hedge/Leverage aggressively
  
- ❑ Early-stage exploration (20% budget)
  - ❑ Resource play focus (basin-centered gas, CBM, shale gas)
  - ❑ Generate or acquire prospect, build lease position
  - ❑ Manage risk through sell/carry, retain significant equity, operations

# Formation and Funding

- Meritage Energy Company, LLC (MECO) formed effective July 1, 2006
- Initial equity raise of \$17.2 MM completed Sept. 2006
- Targeted Small initial raise (\$12-20 MM)
- Wells Fargo (lead), Financial Investors + Successful O&G Executives

# Deerfield Acquisition

- Starter Kit
  - Long life oil properties
  - Predominately 100% working interest and operated
  - Multiple physical markets for the production
  - Base Case (PDP only) returns  $>15\%$  IRR
  - Upside potential through drilling and field work, as well as exploration
  - Closed 9/7/06