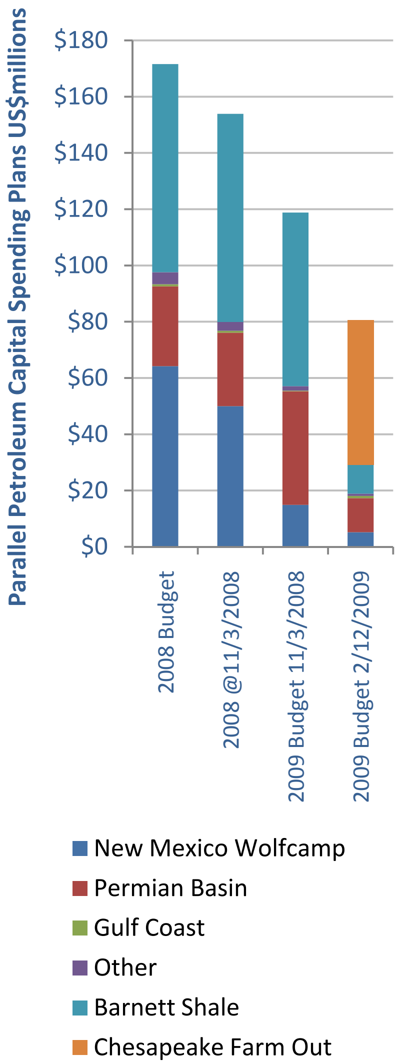
19 February 2009

Parallel Petroleum Barnett Shale Farm Out

Expected capital spending in 2008 was revised downward in November and 2009 plans were for a 23% cut in spending.



Note: The effect of the farm out is to defer Parallel Petroleum's cash requirements for Barnett Shale operations in 2009 by US$51.5 million.

As part of a planned large cut in 2009 spending, Parallel Petroleum has entered a long-term farm-out agreement with Chesapeake Energy. The agreement involves 25,600 gross (9,300 net to Parallel) acres in the Barnett Shale. The acreage is located in Tarrant County and, therefore, is of relatively high quality. Parallel had previously estimated that per well performance will be strong (3.2 Bcfe EUR and 3.9 Mmcf/d IPR). The companies are already partners with Parallel holding an approximate average 35% working interest (working interest ranges from 34% to 37%). This acreage is part of the original joint venture with Dale Resources (acquired in late 2006 by Chesapeake).

Parameters of the Deal

The agreement encompasses an eight year period beginning in 2009 and ending on 31 December 2016. As Chesapeake pursues its drilling program in each of these years, Parallel will assign all of its working interest to Chesapeake. This assignment is subject to the provision that 50% of the working interest reverts back to Parallel after Chesapeake has recovered 150% of its costs.

All wells drilled in each year of the agreement will be treated as separate projects for purposes of calculating when Chesapeake has recovered its 150% of cost compensation.

Rationale and Impact of the Deal

From Parallel's perspective, this farm out significantly reduces the company's upside potential for an extended period of time. The length of the agreement period alone is a clear indicator of the concessions that Parallel made to Chesapeake. Stretching out through calendar year 2016 drilling on the acreage, the term of the agreement clearly extends well beyond the likely period of financial distress.

As shown to the left, Parallel has cut its planned capital spending very sharply as oil and natural gas prices have fallen. By 3 November 2008, planned spending in 2009 was 23% lower than expected 2008 outlays. At the same time the farm-out was announced, Parallel also reported that planned 2009 spending (before the farm-out's effects) was being cut by 32% (from US$119 million to US$81 million). The effect of the farm-out is to shift another US$52 million in spending from Parallel to Chesapeake, leaving Parallel's budget for 2009 at US$29 million.

Table 1 tracks key financial and operating information for Parallel Petroleum on a quarterly basis through the 3rd quarter of 2008. An essential driver behind the decision to farm-out the company's Barnett shale position is clearly seen in this table. The times interest covered ratio fell from 8.5 in the second quarter to 7.5 by the end of the third quarter. Our estimates (shown in the far right hand column) suggest that this ratio has, since the last quarterly report, fallen to just 2.6 times.

Another key driver behind this deal is apparent from Table 1 and previous capital spending plans. Even at the pre-crash rate of cash inflow reported in the 3rd quarter of 2008 (US$45.8 million per quarter) 2008 spending levels were very close to pre-tax cash inflows. Based on recent oil and natural gas prices, the company's cash inflows are likely to be down by 65% and, at US$15.9 million per quarter are insufficient to fund even the reduced, pre-farm-out 2009 capital budget.

Changing Financial Status of Parallel Petroleum

The table shows selected quarterly financial and operating data through the 3rd quarter of 2008. In the last column are estimates of the likely status of key financial indicators at the time of the farm-out deal.

Table 1

	3/31/2008	6/30/2008	9/30/2008	GES Estimates 2/12/2009
Current Liabilities	$90,234,000	$127,058,000	$81,618,000	**$81,618,000**
LT Debt	$227,505,000	$282,630,000	$308,300,000	**$308,300,000**
Other LT Liabilities	$52,463,000	$75,510,000	$63,602,000	**$63,602,000**
Equity	$233,417,000	$205,589,000	$265,137,000	**$265,137,000**
Interest Expense	$5,570,000	$5,368,000	$6,139,000	**$6,139,000**
Output				
Oil output bbls	247,000	237,000	274,000	**274,000**
Gas output mcf	2,662,000	2,790,000	2,886,000	**2,886,000**
BOE Output	690,667	702,000	755,000	**755,000**
Price				
Oil $/bbl	$93.74	$119.42	$115.19	**$40.21**
Gas $/mcf	$7.80	$9.95	$8.54	**$4.75**
BOE $/boe	$63.59	$79.86	$74.45	**$32.75**
Revenues	$43,917,380	$56,063,040	$56,208,500	**$24,724,949**
Cash Opex				
Lease Opex	$6,979,000	$7,254,000	$7,539,000	**$7,539,000**
Production Taxes	$2,289,000	$2,996,000	$2,836,000	**$1,285,697**
Net Cash Inflow	$34,649,380	$45,813,040	$45,833,500	**$15,900,251**
Interest Coverage Ratio	6.22	8.53	7.47	**2.59**
Nymex 1 Month Crude	$97.75	$123.28	$119.38	**$41.68**
Henry Hub 1 Month Futures	$8.68	$11.42	$9.15	**$5.09**

Note: Data for 2008 are drawn from Parallel Petroleum's quarterly SEC filings. Data in the last column are estimated by GES as an approximation to the likely situation confronting Parallel at the time of their decision to farm out their Barnett Shale acreage.

Time interest coverage drops precipitously. Capital expenditure coverage from operating cash flows also severely constrained.