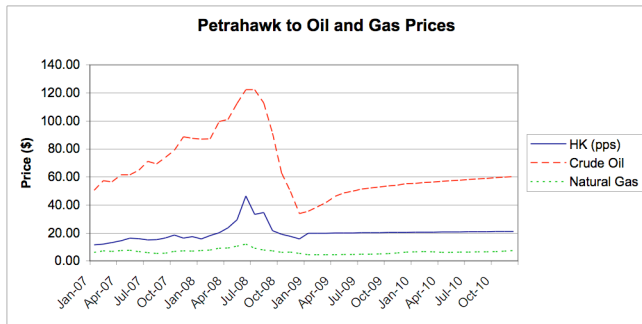


**Ticker: HK (NYSE)**  
**Price: 19.71 USD (Close Jan. 30, 2009)**  
**Industry: Oil Gas and Consumable Fuels**  
**Analysts: C.Carr, V. Hayes, D. Kohtz, R. Sanner**

**HK Investment Thesis**

Our analysis of Petrohawk Energy Corporation recommends a BUY of the company’s DEBT for the following reasons:

- HK has large growth potential from past and future acquisitions, reflected in the large P/E ratios.
- The YTM on the new debt issuance of 12.75% is much higher than the forecasted earnings yield of 2.74%.
- Management is demonstrating smart investing by reducing capital expenditures for 2009 and concentrating approved expenditures on the development of previous acquisitions and high internal rate of return projects.<sup>1</sup>
- In 2007 there was no dividend payout to equity holders.<sup>2</sup> The cash position of the company has weakened since, lowering expectations for dividend payouts to begin in the upcoming year.
- Falling gas prices have hurt many energy corporations in the industry making them susceptible to takeovers.<sup>3</sup> HK is in a position to acquire competitors that are faltering in the current recession.



Average share price each month and projected share prices using a compounding annual growth rate and comparing the HK price to the historical commodity prices and commodity futures prices. Commodity prices found on <<http://www.tradingeconomics.com/Economics/Commodities.aspx?Symbol=CL1>>.

**Free Cash Flow**

The free cash flow of HK is negative for the last seven consecutive quarters and is projected to be negative for the fourth quarter of 2008 and fiscal year 2009. The company has tied up cash in large capital expenditures and the acquisition of One Tec, LLC. According to management’s statements capital expenditures will be pulled back for 2009 from \$1.5 billion to an estimated \$1 billion. Incorporating this into the forecast for 2009

produced a projected free cash flow of (929,880). This projection was arrived at assuming a conservative growth rate in revenues of 12% relative to the annual revenue growth of the last three years. We also assumed gross and operating margins to decrease due to the projected decrease in natural gas prices in the markets.

Current Market Debt/Equity	46.59%
Current Book Debt/Equity	38.51%
New Debt/Equity (market)	44.80%
New Debt/Equity (book)	54.20%
Issuance Expected Yield	10.5%
YTM on Issuance	12.75%
Debt Rating on New Notes	B
Forecasted 2008 P/E	36.56
Forecasted 2009 P/E	37.09
Forecasted Earnings Yield	2.74%

**New Debt Issuance**

HK is issuing \$300 million in senior notes that will come due in August 2014. The notes will yield 10 ½ percent. The notes are discounted at 91.279% of face value, and carry a yield to maturity of 12 ¾ percent.<sup>4</sup> The new debt will be used for the following activities:

- Repayment of a portion of outstanding debt that will allow flexibility for 2009 capital expenditures
- Funding upcoming acquisitions
- Expansion of infrastructure
- Make available working capital<sup>5</sup>

**Debt vs. Equity Position**

The risk-reward profile of the debt issuance is a better investment for the APM portfolio. HK has a high YTM on the new debt and a modest recovery rate in default for debt holders (10-30% of principal would be repaid).<sup>6</sup> Given the low risk of the debt and the cash payment to debt holders compared to the lack of dividend payout to equity holders the debt position is a better investment.

<sup>1</sup> Petrohawk Energy Corporation. 10-Q 6 Nov. 2009.  
<sup>2</sup> “Dividends and Returns.” Morningstar.com 30 Jan. 2009  
<sup>3</sup> “Fire Sales Seen for U.S. Energy Sector.” Reuters.com. 20 Jan. 2009.  
<sup>4, 5, 6</sup> “Petrohawk Energy Corporation Prices Senior Notes Offering.” Ameriprise Financial. 23 Jan. 2009.