# Atlas Energy (ATLS) $29.55 December 2014

*Atlas recently sold off a majority of their assets through a complex transaction. New Atlas offers investors a >40% distribution and plenty of growth options. The stub is a true orphan security that nobody knows what to do with. The Cohen brothers are once again left with a blank slate to create shareholder value for the patient investor.*

| **Ticker**: | **ATLS** | **Current Price**: | **$29.55** |
|---|---|---|---|
| **Action:** | Long | Market Cap (M) | $1,536 |
| **Expected Timeframe:** | 1-3 years | Enterprise Value(M): | $1,676 |
| **Asset Class:** | Common Equity | Target Price: | $38.81 |
| **Target Allocation:** | 2-5% | Benchmark: | S&P 500 |
| **Catalysts: Spin-off** | | | |

*all figures are taken from 12/8/2014 closing prices. Target price assumes a current Targa value of $17.69, $9.12 of cash and a New Atlas stub value of $12.00

## Investment Overview

On October 13, 2014 Atlas Energy LP and Targa Resources announced a transaction that was valued at approximately $7.7 billion. Targa agreed to acquire Atlas Energy LP (Atlas) and Atlas Pipeline Partners (Atlas Pipeline) and all non-midstream assets would be spun off into a new stub entity (New Atlas). The consideration for Atlas Pipeline was $5.8 billion via a combination of Targa stock and cash. Shareholders in Atlas will receive the following:

Table 1. Consideration for Atlas Energy LP Shares Source: Company Filings and Dichotomy Calculations

| | |
|---|---|
| ATLS Current Price (A) | $29.55 |
| TRGP Current Price(B) | $97.81 |
| | |
| Shares of TRGP(C) | 0.1809 |
| *Current Value of TRGP(D)* | *$17.69* |
| Cash (E) | $9.12 |
| | |
| **ATLS Stub (A-D-E)** | **$2.74** |

New Atlas, the Atlas Stub, is the interesting part here and contains a number of non-midstream assets. Following the spin-off New Atlas will have 52 million units outstanding along with $140 million of debt. With a current stub value of $2.74, this implies a pro forma market cap of $142 million and an enterprise value of $282 million.

Table 2. New Atlas Assets Source: Company Filings

| Non-Midstream Interests | | | |
|---|---|---|---|
| **Atlas Resource Partners** | **ATLS E&P Development Sub** | **Lightfoot Capital Partners** | **Arkoma** |
| *GP Interests* | *80% General Partner Interest* | *16% GP Interest* | *Natural Gas Production* |
| *Incentive Distribution Rights* | *8% LP Interest* | *12% LP Interest* | |
| *ARP Common Units* | | *LP Interest in Arc Logistics* | |
| *ARP Class C Preferred Units* | | | |

There is no way around it, New Atlas is complex. The following four segments attempt to break-down each part of New Atlas.

### Atlas Resource Partners

Atlas Resource Partners (Atlas Resource) operates in the USA and currently has ~1.5 trillion cubic feet equivalent of proved reserves and produces ~261 million cubic feet per day(MMcfe/day). This production figure was up from 187.7 MMcfe of daily net production during the year ending December 31, 2013. Atlas Resource expects to distribute $2.40 to common unit holders during 2015. The basic outline for the company can be seen below.

Table. 2. Revenue and Cost Projections for Atlas. Source: Company Filings(1, 2), Dichotomy Calculations

| **Net Production Vol** | **Production** | **Revenue/Costs** |
|---|---|---|
| Natural Gas (mcfed) | 221,500 | $280,136,588 |
| Crude Oil (bbl/d) | 7,190 | $219,133,225 |
| NGL (bbl/d) | 4,409 | $43,450,695 |
| **Total (mcfed)** | **290,964** | **$576,700,000** |
| Well Construction | | $307,400,000 |
| Gathering & Processing | | $9,300,000 |
| Admin & Oversight | | $22,100,000 |
| Well Services | | $27,400,000 |
| **Total Revenue** | | **$943,200,000** |
| | | |
| Production Costs | | ($220,294,664) |
| Well Construction Costs | | ($267,300,000) |
| Gathering & Processing Costs | | ($11,300,000) |
| Well Services | | ($10,033,333) |
| G&A | | ($55,300,000) |

| | |
|---|---|
| **Total Costs** | **($564,227,997)** |
| | |
| Operating Income | $378,972,003 |
| Interest Expense | ($82,675,000) |
| Maintenance CapEx | ($71,300,000) |
| Preferred LP Dividends | ($18,500,000) |
| Amortization of Finance Costs | $12,075,000 |
| Non-Cash Stock Comp | $18,000,000 |
| **Available Cash** | **$236,572,003** |

The assumptions that are used in the available cash calculation are natural gas pricing of $3.83/mcfe, oil at $83.35/bbl and natural gas liquids at $25.90/bbl. Right now about 68% of natural gas and oil is hedged in 2015. The table below shows my estimates for available cash if oil and natural gas drop by 10% and 20%, respectively.

Table 3. Commodity Price Sensitivity. Source: Dichotomy Calculations

| **Action** | **Available Cash** |
|---|---|
| Current Estimate | $236,572,003 |
| Oil 10% Drop | $214,658,581 |
| Natural Gas 10% Drop | $205,445,716 |
| Oil 20% Drop | $192,745,258 |
| Natural Gas 20% Drop | $174,319,428 |

Obviously guessing the exact price of oil and natural gas is a fool's errand. However, the simple sensitivity analysis above shows that Atlas is weighted more towards natural gas. Even with a 20% drop in natural gas prices (and assuming they have no hedges in play) Atlas Resource can still distribute $174 million to common unit holders. There are currently 84.4 million common units, which means after a 20% drop in natural gas prices Atlas Resource could still distribute $2.06/unit. This type of distribution is likely too low because it assumes that there would be zero cost savings from service providers, an unlikely scenario if commodity prices stay where they are. To keep things simple, I will assume that the $2.40/common unit guidance will remain intact. The cash distribution can be seen in the table below.

Table 3. Cash Distribution Policy for ARP Source: Form 10 Atlas Energy Group

| | |
|---|---|
| Distributions | |
| Common LP Units Owned by 3rd Parties | $152,100,000 |
| New Atlas LP Units | $50,400,000 |
| IDR and GP Interests | $17,800,000 |
| Preferred LP Units | $8,800,000 |
| | |
| Total Distributions | $220,300,000 |
| **Distributions to New Atlas** | **$77,000,000** |

At the end of the day, Atlas Resource Partners owns a number of oil and gas producing assets. Through their existing assets and new production Atlas Resources will generate more than $235 million of distributable cash. New Atlas will receive $77 million from Atlas Resources based on assumptions made in October. Even after the commodity sell-off I believe the distribution is safe given the hedging program and fact that natural gas is the majority of revenues, not oil.

### Development Subsidiary

The Development Subsidiary has had capital contributions of $93.7 million and currently has operations in Marble Falls (Fort Worth Basin TX- 13 wells) and the Mississippi Lime area (Oklahoma – 2 non-operated wells). They also own 53 undeveloped drilling locations in the Eagle Ford formation.

New Atlas expects to receive $4.7 million in cash distributions from the Development Subsidiary. Ultimately the goal will be to spin this out, either through a spin-off or an IPO, either future event should be accretive for New Atlas owners.

### Lightfoot Capital

Lightfoot Capital acts as an incubator for MLPs. New Atlas will own a 12% LP interest in Lightfoot and a 15.9% GP interest in Lightfoot. Lightfoot, in turn, owns a 40.3% LP interest in Arc Logistics Partners LP (ARCX). Arc Logistics is a MLP that owns and operates terminalling, storage, transloading and pipeline assets.

Arc Logistics is the only real asset of Lightfoot for now. The assets that Arc owns can be seen in the graphic below. Right now, Arc contributes very little to Atlas, given that the current distribution is $0.41/quarter, under the $0.4456/Q minimum to receive incentive distributions. As cash flows increase so too should the distributions, which will lead to proportionately higher payouts for Lightfoot and Atlas. I expect cash flows to grow through more acquisitions of terminals and the expansion of Gulf LNG.

Gulf LNG is a liquefied natural gas regasification and storage facility located in Pascagoula, Mississippi. Currently Arc owns a 10.3% interest in Gulf LNG and Lightfoot owns another 9.7%. This in turn means that Atlas owns 1.55% of Gulf LNG via the GP interest and 0.49% via the LP interest in Lightfoot, for a total of 2.04% of Gulf LNG.

There are several other big investors in Gulf LNG including Kinder Morgan (KMI) and GE. Currently the facility can store up to 6.6 billion cubic feet of gas and has 1.5 billion cubic feet of per day peak vaporization send-out capacity. There are plans to expand the facility with two LNG trains capable of exporting 10 million tonnes per year of LNG. Gulf LNG expects the expansion to cost $8 billion.

Even without the expansion, the business is pretty good. There are long-term contracts and predictable revenue streams. In the 9M 2014 period Gulf LNG generated $71.9 million of net income, which is roughly in-line with 2013's figure of $71.027 million during the first nine months. In 2013 Gulf LNG generated $94.89 million of net income and I believe 2014 will be largely the same.

As of September 30, 2014 El Paso Pipeline Partners (which owns 50% of Gulf LNG through their 100% ownership of Southern Gulf) valued their stake of Gulf LNG at $556 million, implying a total value of $1.112 billion for the whole project. This does not seem that excessive given the $94.89 million of net income (P/E of 11.7X), and downright cheap when compared to public comps. While it is tough to nail down an exact value for Gulf LNG, the numbers are quite encouraging. Arc paid $72.7 million for their stake in Gulf LNG. A similar value would put Lightfoot's stake at $68.4 million. New Atlas therefore owns a stake that is worth $22.6 million at today's equity value.

Graphic 1. Arc Logistics Owned Assets

| Location | Capacity | Products |
|---|---|---|
| **Terminals** | | |
| Baltimore, MD[1] | 442 mbbls | Gasoline; Distillates; Ethanol |
| Blakeley, AL[2] | 708 mbbls | Crude Oil; Asphalt; Fuel Oil |
| Brooklyn, NY | 63 mbbls | Gasoline; Ethanol |
| Chickasaw, AL | 609 mbbls | Crude Oil; Distillates; Fuel Oil; Crude Tall Oil |
| Chillicothe, IL | 273 mbbls | Gasoline; Distillates; Ethanol; Biodiesel |
| Cleveland, OH - North | 426 mbbls | Gasoline; Distillates; Ethanol; Biodiesel |
| Cleveland, OH - South | 191 mbbls | Gasoline; Distillates; Ethanol; Biodiesel |
| Madison, WI | 150 mbbls | Gasoline; Distillates; Ethanol; Biodiesel |
| Mobile, AL – Main | 1,093 mbbls | Crude Oil; Asphalt; Fuel Oil |
| Mobile, AL - Methanol | 294 mbbls | Methanol |
| Norfolk, VA[3] | 213 mbbls | Gasoline; Distillates; Ethanol |
| Portland, OR | 1,466 mbbls | Crude Oil; Asphalt; Aviation Gas; Distillates |
| Selma, NC | 171 mbbls | Gasoline; Distillates; Ethanol; Biodiesel |
| Spartanburg, SC[1] | 83 mbbls | Gasoline; Distillates; Ethanol |
| Toledo, OH | 244 mbbls | Gasoline; Distillates; Aviation Gas; Ethanol; Biodiesel |
| **Total Terminals** | **6,425 mbbls** | |
| **Transloading Facilities** | | |
| Chickasaw, AL | 9 mbpd | Crude Oil; Distillates; Fuel Oil; Crude Tall Oil |
| Saraland, AL | 14 mbpd | Crude Oil |
| **Total Transloading** | **23 mbpd** | |
| **LNG Facility** | | |
| Pascagoula, MS[4] | 320,000 $M^3$ | Liquefied natural gas |

More importantly, the Lightfoot stake is likely to get dropped down into Arc sometime in the near future. Arc's CEO, Vince Cubbage, stated in the Q3 2014 conference call Arc believes the asset would be made available for a future drop-down and they "look forward to that." A drop-down is when a parent company sells an asset to a related entity, or "drops-down" the asset. The parent gets the asset ready for this transition and the related entity (usually an MLP) pays cash to the parent. The parent gets cash to acquire/develop more assets and the related asset has an income producing asset that is (typically) accretive to earnings. In this case, a drop-down would provide Lightfoot cash to use in other ways, I speculate that they will invest it in the Gulf LNG expansion if possible.

New Atlas' stake in Lightfoot is not paying large dividends right now. However, there is reason to believe that distributions will increase and Lightfoot will gradually contribute more to New Atlas. If the Gulf LNG expansion project goes through there should be opportunity for Lightfoot to participate, directly benefiting New Atlas. Alternatively, as a Gulf LNG drop-down occurs, New Atlas will benefit from increased distributions as Arc funds the drop-down via a combination of debt and equity. This has already been completed by one Gulf LNG partner. Kinder Morgan dropped down their ownership in May 2014 and received cash for their interest.

### Arkoma

Atlas Energy (Old Atlas) acquired a number of assets in the Arkmoa Basin in July of 2013. For $64.5 million the company purchased 45 Bcf of proved reserves and average daily production of 5.1 MMcfe in 584 wells. These are long-life coal methane bed assets and they now produce 11.5 million cubic feet per day of natural gas.

During the 12 months ending 6/30/2014 Arkoma produced $16.374 million of revenue and $9.9 million of EBITDA, and approximately $7.5 million of operating income. Based on discussions with management and Dichotomy's estimates, I believe that revenue and profit margins will come in at similar levels next year (as always, assuming natural gas prices stay constant). These assets could be dropped down and New Atlas would receive the proceeds.

### Pro Forma New Atlas

A bet on New Atlas is a bet on two things. First, the company has producing assets that will contribute to a significant distribution (guidance is for an annual distribution of $1.25/share). Second, New Atlas will be able to accumulate and distribute assets either through spin-offs, drop-downs, or via some other form of financial engineering. Both of these factors leave the company materially undervalued compared to the current price.

The table below shows Dichotomy's estimates for cash distributions in three scenarios. The low scenario assumes a 10% drop price in unhedged commodity prices (which is a natural gas price of less than $3.25/mcf and oil below $70.91/bbl), a 10% drop in development subsidiary distributions, and a 10% drop in partnership assets raised in 2015. The mid scenario is simply management's guidance, and the high estimate factors in a 10% increase in Atlas Resource distributions if oil and natural gas prices rise.

Currently the New Atlas stub is trading at $2.74/unit after factoring in the cash and TRGP shares that will be received (Table 1). While there is no perfect estimate for oil or natural gas prices, it is not getting cheaper to extract either commodity from the ground. At a minimum, I believe that New Atlas can distribute at least $0.81 per share. Compared to a stub value (as of 12/8/2014 closing) of $2.74 this distribution in a low scenario would equal a 29% yield. This seems wildly out of line and prices the business for failure in a few years.

Table 5. Distributable Cash Flow. Dichotomy's Calculations

| **2015 Estimates** | **Low** | **Mid** | **High** |
|---|---|---|---|
| ARP Distributions | $53,300,000 | $77,000,000 | $84,700,000 |
| Development Subsidiary | $4,230,000 | $4,700,000 | $4,700,000 |
| Less Interest Expense | -$14,825,000 | -$14,825,000 | -$14,825,000 |
| Less Maintenance CapEx | -$1,600,000 | -$1,600,000 | -$1,600,000 |
| Plus Amort of Deferred Finance Costs | $1,400,000 | $1,400,000 | $1,400,000 |
| | | | |
| Distributable Cash Flow | $42,505,000 | $66,675,000 | $74,375,000 |
| Common Units Outstanding | $52,500,000 | $52,500,000 | $52,500,000 |
| **Max Distribution/Share** | **$0.81** | **$1.27** | **$1.42** |

To further highlight the undervaluation, let's look at the main distribution contributor for New Atlas, Atlas Resources. Currently Atlas Resource offers investors a 19.15% yield. Given New Atlas' financial flexibility, General Partner asset-like nature, and ability to grow, I believe New Atlas should trade at a premium to Atlas Resource. However, New Atlas has plenty of upside, even if it only re-rates to Atlas Resource's yield. The pro forma distribution for New Atlas is $1.25/unit, implying a 45.7% yield. If New Atlas trade at the same current yield of Atlas Resources (22.34%), New Atlas would appreciate by more than 104%. I will leave it to readers to imagine arbitrage opportunities.

Finally, in an attempt to flog a valuation horse, a sum of the parts calculation is very encouraging for New Atlas Investors. With 24.7 million Atlas Resource (ARP) common units (closing price of $10.56 as of 12/8/2014), New Atlas owns $260.8 million worth of Atlas Resource. With 52 million New Atlas units, this works out to $5.02 per unit of New Atlas. In their December 2014 presentation, Atlas estimates that their Arkoma production is worth $1.15 per unit, or $59.8 million total. Finally there is $140 million of debt, which is $2.70 per unit of New Atlas. The table below shows these figures and compared to the current value.

Table 6. New Atlas Valuation Sum of the Parts

| | **Value** | **Value Per Unit** |
|---|---|---|
| **ARP Common Units** | $260,832,000 | $5.02 |
| **Arkoma Production** | $59,800,000 | $1.15 |
| **Net Debt** | -$140,000,000 | -$2.70 |
| **Total Current Value** | $180,632,000 | $3.47 |
| | | |
| **Implied Current New Atlas Value** | $142,480,000 | $2.74 |

The table below ascribes zero value to the IDR or GP interests in Atlas Resource that New Atlas owns, zero value to their stake in Lightfoot Capital (which owns shares of a liquid public company), and zero value to any future growth, drop-downs, or spin-offs. This is the truest sense of a margin of safety, heads I win, tails I still win.

The most obvious source of upside to New Atlas is higher oil and natural gas prices. Even if prices remain flat, I believe New Atlas will offer investors attractive returns for several years. Ultimately, New Atlas is a bet on management. While the Cohen brothers pay themselves very well (non-cash stock comp is guided to be $18 million at New Atlas), they get excellent results. The graphic below is from the October 13, 2014 presentation and shows returns generated by Atlas entities.

Graphic 1. Atlas Entities Source: Oct 13, 2014 Targa Transaction Presentation

| | Realized in 2011 | | Partially Realized in 2014 | |
|---|---|---|---|---|
| | Atlas America / Atlas Energy Inc. | Atlas Energy Resources, LLC / Atlas Energy | Atlas Pipeline Holdings / Atlas Energy, L.P. | Atlas Pipeline Partners, L.P. |
| Ticker | NASDAQ:ATLS | NYSE:ATN > NASDAQ:ATLS | NYSE:AHD > NYSE: ATLS | NYSE:APL |
| Date of IPO / Spinoff | 5/14/2004 | 12/13/2006 | 7/21/2006 | 1/26/2000 |
| Price at IPO / Spinoff | $4.55 | $21.00 | $23.00 | $13.00 |
| Price at Sale or Current Price [1] [2] | $46.53 | $53.98[3] | $54.91[4][5] | $37.40 [6] |
| Total Price Change (%) | 923.7% | 157.0% | 138.8% | 187.7% |
| Dividends / Distributions | $0.31 | $4.46 | $19.22[4] | $34.98 [6] |
| **Total Return** | **930.5%** | **178.3%** | **222.3%** | **456.8%** |
| *Compound Annual Growth Rate* | *41.2%* | *27.7%* | *15.3%* | *12.4%* |

The opportunity here lies with the Cohen brothers and their decades of experience and connections. The ability for New Atlas to continue acquiring assets will simply be history repeating itself. New Atlas has guided (in their December presentation) that fundraising of $1 billion for new assets could increase distributions by an additional $0.35 per unit, plus give them upside to new IDRs.

Given the financial flexibility, I believe New Atlas should trade at a significant premium to Atlas Resource. While admittedly crude, I believe a 10% dividend yield is reasonable and assumes very little to no partnership growth. If New Atlas distributes $1.25 annually a 10% yield would value the stub at $12.50, a 356% premium over 12/8/2014's price. Should investors look for a more conservative value, a low estimate for distributions is $0.81/unit (95% of Table 6's low scenario distribution which assumes lower commodity prices than today). A conservative 15% yield would value New Atlas at $5.40/unit, a 97% premium over the current stub value of $2.74.

Table 6. Potential Valuation: Dichotomy Calculations

| | Low Valuation | Mid Valuation |
|---|---|---|
| **Distribution** | $0.81 | $1.25 |
| **Distribution Yield** | 15% | 10% |
| **Implied Share Price** | $5.40 | $12.50 |
| **Upside From Current Stub** | 97% | 356% |

At today's stub value of $2.74, there is a draconian valuation being assigned. If we assume that commodity prices drop 20% (that is, Atlas Resource would receive roughly $2.80/mcf for sold natural gas and $62/bbl for oil), a distribution of greater than $0.40/unit is still attainable. At $0.40/unit, that's a distribution yield of 14.6%. Either Mr. Market is confused, or New Atlas is going out of business in the next year.

New Atlas is less a bet on oil prices and production and more a bet that the Cohen brothers are capable operators and quality asset managers. I believe that anyway an investor looks at this – forwards, backwards, EV/EBITDA, distribution yield, relative value, etc – all show a company that is dramatically undervalued going forward. It would be naive not to examine Targa as well, given that Atlas owners will be receiving a significant number of Targa shares.

### Targa Resources Corp

Targa is a midstream natural gas and natural gas liquids service company in the United States. Targa Resources Corp owns general, limited partner, and incentive distribution rights in Targa Resources Partners. As stated earlier, Targa Resources Partners will be purchasing Atlas Pipeline and Targa Resources Corp will be purchasing Atlas Energy (GP's acquire the GP's, LP's acquire the LP's).

Targa is increasingly moving towards fee-based revenue and the acquisition of Atlas Pipeline will only further increase that. During Q3 2014 their operating margin was approximately 72% fee-based, this is up from 45% as of Q3 2012 (obviously this increases if commodity prices decrease). For the full-year 2015, the company expects that a $5 drop in crude would decrease EBITDA by $3 million, a $0.05 per gallon drop in natural gas liquids would cause a $12 million reduction in EBITDA and a $0.25 drop in natural gas would cause a $5 million decrease in EBITDA. For a company that expects to generate $925-$975 million of EBITDA in FY 2014. A significant portion of their production was hedged and overall, the company should be close to their guidance.

Going forward, investors should see increased distributions from Targa (either the GP or the LP) thanks to a significant capital spend program. In the past two years more than $2.5 billion has been spent on new projects and the company expect to spend another $2 billion+ from 2015 onwards. A vast majority of this will be primarily fee-based. Thanks to this capital spend Targa Resources Corp has grown their dividend by more than 29% in the past year. This rapid dividend growth does not include Atlas Pipeline's contribution to Targa Resources Partners.

In the Q3 2014 presentation, management of Targa expects Targa Resources Corp to see 35% dividend growth in 2015. The inherent leverage at the general partner is clear here because the 35% dividend growth depends on only 11-13% distribution growth at Targa Resources Partners. I believe that Targa represents an attractive investment by itself given the large capital pipeline, rapidly increasing dividend distribution and attractive financial flexibility offered with the General Partner (Targa Resources Corp). Investors in New Atlas will need to decide whether they want to hedge out their exposure to Targa (shorting Targa Resources Corp) or simply be given shares once the spin-off is executed. The tough decision, whether to own Targa or not own Targa, is part of the reason New Atlas is available at such a discount.

## Why New Atlas is Available and Risks Involved

Oil almost hit $105/bbl in July of 2014 and after that, it was all downhill. Atlas and Targa had the misfortune of announcing their transaction on October 13, 2014. As far as oil prices go, things only got worse, with a full on "puke" occurring in November. I have tracked the spread for New Atlas and it expanded quite a bit each and every day a major down move occurred in oil prices (more than 3%). While it is impossible to know the exact reason this happened I will propose several theories for the wide spread.

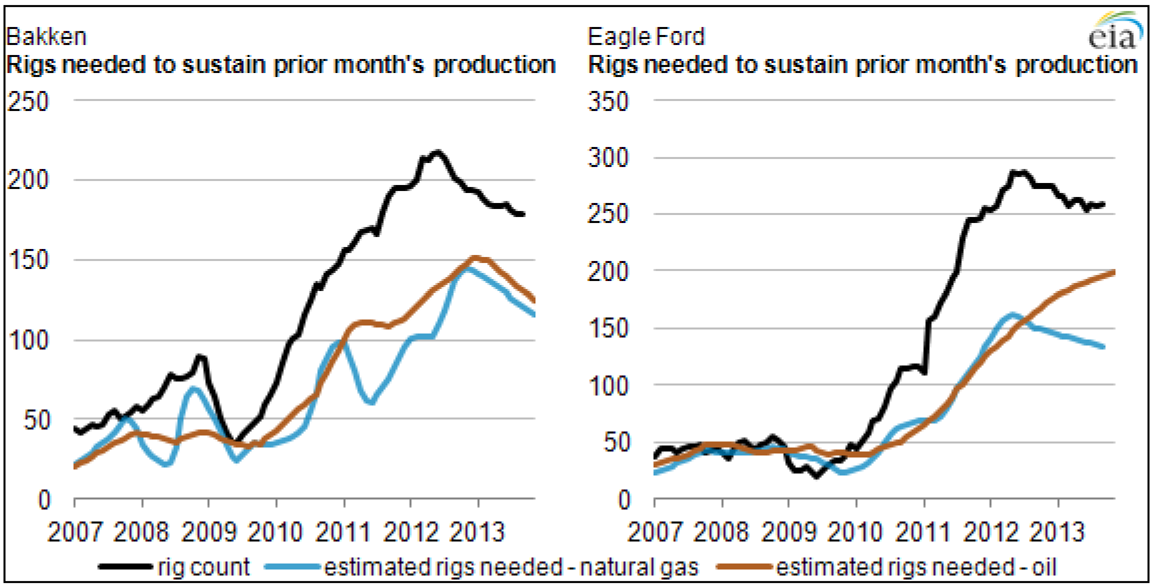
1. Hedge funds have been shutting down left and right during 2014, with nearly 1,000 expected to shut down this year, second only to 2008. Many of these funds are macro/commodity based and live or die based on the price of oil and oil companies. When investors want all their money back, a fund needs to liquidate regardless.
2. New Atlas is very complex with a number of moving pieces. It is a classic special situation where most investors do not know what they are receiving until a brokerage statement arrives in the mail.
3. New Atlas is not the Old Atlas. New Atlas has 52 million units outstanding. The stub value as of 12/8/2014 is $2.74, implying a market cap of $142.5 million. Meanwhile, after the transaction is completed investors will own (unless hedged out – which requires an enormous amount of capital) a considerable portion of Targa. Do these investors understand Targa? Do they even want to own Targa? There are many considerations for Old Atlas owners that, when coupled with a plunge in oil prices, make it easier/more convenient to simply move on.

While I believe there has been forced selling by owners of Atlas and investors can buy with a margin of safety, there are risks involved. The obvious risk is that oil/natural gas prices can keep going down. Oil has been in a multi-year bear market that began in 2007 and natural gas pricing (at least in the USA) is a fraction of what it was only a few years ago. The ability to extract shale oil has changed the global oil and natural gas landscape.

With oil prices as low as $49/bbl for Bakken based crude, many shale oil plays are hitting a point of questionable profitability. While many E&P companies have actively hedged at prices well above today's price, these will slowly erode if oil stays low. As those hedges go away, so too does excess profitability. Higher cost producers will gradually start to curtail production and eliminate expansion programs. This should start to reduce overall production in shale regions. I believe that oil and gas production will ultimately start to wane if oil prices continue to stay low. This is good for low cost extractors like Atlas.

Atlas is less concerned about oil and more concerned about natural gas prices, given that the majority of their distribution from Atlas Resources is generated from natural gas sales. Longer-term there are several events that should help natural gas prices stabilize. First, many of the shale plays exhibit dramatic decline rates after first coming online. In order for shale gas to continue contributing to gas supplies, more rigs need to come online, as can be seen in the graphic below.

Graphic 2. Rigs needed to Sustain Production in various plays. Source: EIA




Looking out further there are a number of initiatives that should help gradually pick up excess natural gas slack. These include natural gas fueling, LNG exports, and increased electricity production with natural gas. Again, I make no claim to predict a rise in natural gas prices, simply a claim that there is plenty of demand potentially out there.

The other risk with an investment in Atlas involves two operational aspects of the company. First, as noted earlier, the Cohen brothers pay themselves well and this level may impact the distribution. In the pro forma financial statements SG&A was listed at $9 million. However, I believe that this is simply a pro rata calculation and materially understates the true level.

In the 2013 Atlas Resource 10-K, G&A expenses are broken down for Atlas, Atlas Resource, and Atlas Pipeline. For the 2013 fiscal year, Atlas incurred G&A of $39.05 million. Many of these costs are fixed and include executive officer salaries and audit costs, to name two. New Atlas has $18 million of non-cash stock compensation that would be included in the G&A cost. Backing that $18 million out from the $39 million 2013 figure, cash G&A is roughly $21 million. This is $11 million more than the pro forma G&A figure.

In a worst case scenario, all of this $11 million must be deducted from distributable cash. Going back to Table 5, I calculated that a maximum distribution under a low, mid, and high scenario was $1.05, $1.27, and $1.42 respectively. Deducting $11 million for extra G&A would lower distributions by $0.21 per year ($11 million divided by 52 million units). Thus a maximum distribution would be $0.84, $1.06, and $1.21 per year under each scenario. Even under the low scenario (a situation that would need lower oil/natural gas prices and all of the SG&A from old Atlas), the $0.84/yr distribution would still be a pro forma yield of 30.6% yield.

New Atlas could have trouble raising enough new money to build out their assets. If the oil glut continues Atlas Resources could have trouble raising partnership proceeds. In 2015 Atlas expects to raise $275 million from partnership proceeds. In the Form 10 Atlas estimates that raising 10% less funds would result in $5.5 million less cash available for distribution.

Finally, the merger could be cancelled. In today's rapidly collapsing commodity price environment, anything is possible. I do not think that is likely though. Financing is already in place and the parties are contractually prohibited from terminating the merger due to industry issues. As is customary in mergers, there would also be significant costs to terminating the merger. First, there would be upfront costs. There is a $53.4 million termination fee and a $17.8 million expense reimbursement to Atlas if the merger is terminated.

Second, Targa would need to backtrack from their guidance. Given the importance of distributions, and perhaps more importantly, distribution growth, management of Targa is highly incentivized to make sure this merger goes through. The fee-based revenue that Atlas Pipeline offers provides Targa with an income stream that will not be immediately impacted by the commodity sell-off.

## Conclusion

The pending Targa and Atlas transaction has created confusion for existing shareholders and when coupled with the recent commodities swoon, offers an attractive investment opportunity for patient, long-term investors. New Atlas owners have the opportunity to own an orphaned security that potentially yields more 25% on a pro forma basis. Going forward investors will be able to take advantage of the Cohen brothers' ability to build out the Atlas Empire via acquisitions, drop-downs, and spin-offs.

Fair value for the New Atlas stub is between 97% to more than 300% above today's price after factoring in distributions and likely fair value scenarios. More patient investors could see their initial investment grow even more as both old and new assets are monetized. The Cohen brothers successfully navigated the financial crisis and should continue to do so, regardless of oil and natural gas prices.

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