Cobalt International Energy

Rolling the Dice on Deepwater Subsalt

1. **With no production or proved reserves, Cobalt is looking to raise $1 billion in an initial public offering.**
2. **The company has interests in 2 deepwater subsalt discoveries in the Gulf of Mexico.**
3. **Cobalt identified 132 prospects on its extensive acreage in the Gulf of Mexico and West Africa.**
4. **Cobalt's management has a long, successful track record of identifying deepwater reserves.**
5. **The expected IPO proceeds will fund capital expenditures only through 2011, but first oil is not expected until 2012 in the Gulf of Mexico and 2014 at the earliest in West Africa.**

Looking at the S-1, you may think it is the year 2000 and the company name is Cobalt.com. **Cobalt International Energy, Inc.**, a company with no revenue, much less profits, plans to go public by raising $1 billion. The initial public offering is expected to price 63 million shares at $15 to $17. At the midpoint of the price range and no exercise of the 9.45 million-share overallotment option, a company with no proved reserves would be worth $5.3 billion. Existing shareholders would own 81.1% percent after contributing 55.5% of the capital. Cobalt was created as a limited partnership in November 2005 by private equity firms **First Reserve Corporation; Goldman, Sachs & Co.; Riverstone Holdings LLC; The Carlyle Group;** and **KERN Partners Ltd.** with the not-so-modest objective to assemble a deepwater prospect inventory to rival the supermajors.

The valuation is driven by the company's highly experienced management, working interests in two **Anadarko Petroleum Corp.** discoveries in the Gulf of Mexico (GoM), extensive acreage positions in the GoM and West Africa and large data library. Cobalt's exploration team identified 132 prospects on its acreage; 47 in the GoM and 85 in West Africa. The challenge for investors is to weigh the potentially great rewards waiting to be found, developed and produced versus the perils faced drilling in deep water, including $100+ million dry holes and deepwater drilling rig availability. Results of each well drilled are likely to face intense market scrutiny.

About the author: *Janice Rudd is a former (and possibly future) equity research analyst. While she followed the oil service industry, Janice first recommended deepwater drilling stocks in December 1994 and maintains her belief in the enormous potential of deepwater exploration. She did not have access to Cobalt's management during the writing of this report. Janice does not own shares of any company mentioned in this report.*

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The $1 billion targeted in the IPO is just to get the company through 2011—production is not expected until 2012 at the earliest. Estimated capital expenditures in 2010 are $675 million. On September 30, Cobalt had $267 million of cash on its balance sheet. The limited partnership agreement that created Cobalt International Energy, LP, provides for the partners to put up $1.71 billion; cash of $1.07 billion of was contributed and $186 million guarantees a deepwater drilling rig contract. This leaves $452 million still due. Management believes it will be able to access alternative forms of financing as fields reach the development stage. They would also consider farming out additional interests in their GoM prospects under the right terms.

Estimated capex in 2009 is $675 million.

Cobalt Funds	
	$ millions
Committed under partnership agreement	1,710
Contributed as of Sept. 30, 2009	1,072
Guarantee for rig contract	186
Remaining under agreement	**452**
Cash balance Sept. 30, 2009	**267**

The company is placing big bets that they can find and produce oil below layers of salt in the deep water. The estimated cost to drill wells on the company's GoM prospects runs from $100 million to $210 million. The dayrates on Cobalt's two rig contracts are $500,000 and $510,000. The subsalt targets are deep (below 25,000 feet) and drilling times can be 90 days or more. The company believes it will be able to drill 13 wells over the next four years under its two rig contracts in the GoM. Cobalt has no contracts for rigs in West Africa and the utilization of the most capable deepwater rigs is near 100%. While drilling in these water depths and to these well depths is increasingly commonplace, there is still substantial technical risk, as experienced on *Ligurian #1*, the company's first operated well.

Cobalt has two deepwater rig contracts in the GoM at $500,000 per day and $510,000 per day.

Cobalt Estimated Well Cost			
$ million	**Exploration**	**Appraisal**	**Development**
Gulf of Mexico			
Miocene	100-130	110-140	140-170
Lower Tertiary	140-170	150-180	180-210
	Pre-salt	**Above salt**	
West Africa	45-65	30-50	
Source: Cobalt S-1			

Wagering on people and data to identify high-risk prospects

Cobalt's team attracted the backing of its high-profile private equity investors because its members played a significant role in finding and developing 8 billion of the 17 billion barrel of oil equivalents (boe) of reserves developed in the deepwater U.S. GoM. Chairman and Chief Executive Officer Joseph Bryant was Chief Operating Officer of Unocal and held a number of positions with **BP** (and Amoco) including President of BP Exploration (Angola) Limited. Chief Financial Officer Rodney Gray was CFO of **Colonial Pipeline Co.** after positions at Enron and Transco. General Counsel Samuel Gillespie also came from Unocal with prior positions at **Skadden, Arps** and Mobil. Another BP veteran, James Farnworth, is Chief Exploration Officer. Unocal alumni John Wilkirson and James Painter head Strategy and Planning and the GoM team, respectively.

Cobalt's management team is composed primarily of ex-BP and Unocal deepwater explorers.

Cobalt Management Team Compensation

	2008 Salary	Beneficially Owned Shares	Value @ $16
Joseph Bryant	$412,000	6,260,791	$100,172,656
Rodney Gray	NA	941,761	$15,068,176
Samuel Gillespie	$386,250	4,948,722	$79,179,552
James Farnsworth	$360,500	2,993,956	$47,903,296
John Wilkirson	$350,000	NA	NA
James Painter	$360,500	3,148,626	$50,378,016
	$1,869,250	18,293,856	$292,701,696

Source: Cobalt S-1

Cobalt's first investment was in people, the second in data. Cobalt's team approaches exploration from a basin-wide view, beginning with geology then acquiring prospect specific data. Since its inception, Cobalt has spent $211 million on the acquisition, reprocessing and analysis of geophysical data. Data from each well drilled is tied back to the existing data to plan the next well.

To date, the company has spent $211 million on acquiring and analyzing data.

Data Library

	2-D Line Miles	3-D Square Miles	Well Logs
Gulf of Mexico	78,000	28,000	4,300
West Africa	124,000	2,000	300

Source: Cobalt S-1

Acreage

Cobalt teams with some of the deep water's biggest players.

Cobalt accumulated sizable acreage positions in the Gulf of Mexico and off Angola and Gabon. The company partners with some of the largest operators in these plays, including Anadarko, **BHP Billiton**, **Eni**, Angola's state company **Sonangol** and **Total Gabon**.

Gulf of Mexico

Cobalt's 227 blocks (1.3 million gross acres; 0.6 million net) in the GoM produced 47 drilling prospects in the Miocene and Lower Tertiary, the horizons where 9 of this year's 14 deepwater discoveries were made. Cobalt spent over $600 million in the 2006, 2007 and 2008 GoM lease sales to acquire 113 blocks.

Cobalt spent over $600 million acquiring GoM deepwater leases and now holds 227 blocks.

In April, Cobalt signed alliances with both of its West Africa partners for exploration in the GoM. Cobalt gave Total a 40% interest in its exploratory lease inventory in exchange for a 60% interest in Total's exploratory lease inventory, $280 million up front and funding of $300 million of Cobalt's share of drilling. Sonangol purchased a 25% non-operated interest of Cobalt's pre-Total alliance interests in 11 GoM leases. Sonangol reimbursed Cobalt for its historical cost plus $10.2 million for seismic and exploration costs.

2009 Gulf of Mexico Deepwater Discoveries

Prospect	Operator	Water depth (ft.)	Horizon
Lucius	Anadarko	7,100	Miocene/Pliocene
Buckskin	Chevron	6,920	Lower Tertiary
Santa Cruz	Noble Energy	6,515	Miocene
Shenandoah*	Anadarko	5,750	Lower Tertiary
Heidelberg*	Anadarko	5,000	Miocene
Tiber	BP	4,132	Lower Tertiary
Vito	Shell	4,038	Miocene
Jake	ERT	3,740	
Wide Berth	Mariner	3,700	
Samurai	Anadarko	3,400	Miocene
Winter	Newfield	3,400	
Bushwood I	Mariner	2,700	Lower Tertiary
Pyrenees	Newfield	2,100	
Ewing Banks 998	Walter Oil & Gas	1,000	

* Cobalt has working interest

Sources: U.S. Minerals Management Service, Rudd research

Chevron believes its one discovery will pay for its four $100+ million dry holes.

Miocene

Cobalt has a 9.4% interest in Anadarko's exploration well *Heidelberg #1* that encountered more than 200 feet of net pay in the Miocene horizon. The well is located in 5,200 feet of water in Green Canyon 859 in the Tahiti Basin. Total depth reached 30,000 feet, a deep well even onshore. Cobalt has a 45% interest in adjacent block, where Cobalt believes the majority of the prospect tested by *Heidelberg #1* lies. Anadarko plans to spud an appraisal well, *Heidelberg #2*, before the end of the year.

Heidelberg #1 encountered 200 feet of net pay in the Miocene.

Results of the *Heidelberg #1* support the Cobalt team's view of the reservoir quality and size. Cobalt's first well as an operator, *Ligurian #1*, that further tested the middle- and upper-Miocene horizons, encountered difficulties and was suspended before reaching the target. Cobalt's team is evaluating the drilling data to determine if the well will be sidetracked or relocated. Cobalt has two additional prospects in the Tahiti Basin targeting the Miocene: *Crillo* is drilling and *Firefox* is planned for next year. Exploratory wells targeting the Tahiti Basin Miocene trend have scored an 88% subsalt commercial drilling success rate, including *Tahiti* (450 million boe of proved reserves; on line in May 2009), *Knotty Head*, *Caesar*, *Tonga*, *Friesian* and *Pony*.

Last month Cobalt agreed to swap its interests in two of its Miocene prospects for 60% of **BHP Billiton's** three blocks that are part of its *South Platte* prospect.

Lower Tertiary

Two days after the *Heidelberg #1* discovery was announced in February, Anadarko followed with news that *Shenandoah #1* encountered 300 feet of net pay in Lower Tertiary horizon. The well in Walker Ridge 52 was drilled in 5,750 feet of water to a total depth of 30,000 feet. Cobalt has a 20% working interest in the block. Results support Cobalt's view that the inboard Lower Tertiary would exhibit better reservoir characteristics than the outboard Lower Tertiary fields (**Chevron Corp.**'s *St. Malo* and *Jack* and **Petrobras**' *Cascade*). BP's *Kaskida* is also creating excitement. The exploratory well encountered 800 feet of net pay in the Lower Tertiary in 2006 and the first delineation well, five miles away, discovered hydrocarbons in November. First production from the Lower Tertiary trend is expected in the first quarter of next year at **Petrobras**' *Cascade* and *Chinook* fields using the GoM's first floating production, storage and offloading vessel (FPSO) moored in 8,200 feet of water, a world record. Cobalt expects to spud wells on two inboard Lower Tertiary prospects, *Aegean* and *North Platte* in 2010.

Shenandoah #1 encountered 300 feet of net pay in the Lower Tertiary.

Cobalt's Gulf of Mexico Prospects	
	No. of Prospects
Miocene	
Tahiti Basin[1]	3
Adjacent	22
Total Miocene	25
Inboard Lower Tertiary[2]	25
Total GOM prospects[3]	**47**

[1] Includes the Heidelberg #1 discovery
[2] Includes the *Shenandoah #1* discovery
[3] Three prospects have both Miocene and Lower Tertiary targets.
Cobalt is the operator on 75% of the prospects.
Source: Cobalt S-1

West Africa

Off the coast of West Africa, Cobalt has interests in 2.2 million net acres, the equivalent of 335 blocks in the Gulf of Mexico. If drilling is successful, production could commence between 2014 and 2016. South America's separation from Africa millions of years ago created analogous geology in West Africa and Brazil, where numerous giant fields were found. No exploratory wells targeting subsalt formations have been drilled off Angola or Gabon, but in 1996, a well targeting shallower horizons did find oil under a pre-salt horizon in the deepwater offshore Angola. Given the seismic data and well results supporting large structural closures, widespread sealing salt and rich source rocks, Cobalt's management feels the primary geologic risk is the presence of quality reservoirs. Of the 85 prospects in West Africa, only three were identified using 3-D seismic data, the rest with 2-D. Cobalt's largest prospect has an aerial extent comparable to Petrobras' giant *Tupi* pre-salt discovery offshore Brazil. Brazil's Energy Minister recently suggested production from this field could reach 1 million barrels per day (b/d). Drilling in Brazil's Santos Basin has thus far achieved an 83% success rate.

West Africa's geology in analogous to the prolific fields offshore Brazil.

Cobalt's West Africa Prospects			
	No. of Prospects	**Working Interest**	**Operator**
Angola	46	40%	Cobalt
Gabon	39	21.25%	Total Gabon
Total West Africa	**85**		

Source: Cobalt S-1

Angola

Since Angola's independence in 1975, Cobalt's GoM partner and the state oil company, Sonangol, has controlled the rights to the exploration and development of oil and gas in the country and its waters. In 2007, Cobalt paid signature bonuses of: $4 million for Block 9, $10 million for Block 21 and $10 million for an additional block. Cobalt will cover the costs of a local partner with a 10% interest. Cobalt must convert its contractual rights to a Risk Services Agreement (RSA) for Blocks 9 and 21 before drilling can commence. Cobalt will be the operator on all blocks. Cobalt's prospects are located 30 to 90 miles offshore in water depths of 3,300 to 5,200 feet. The first well, on the *Gold Dust* prospect, is expected to begin drilling in late 2010. Cobalt does not have rights to any gas discovered.

Cobalt paid signature bonuses totaling $24 million for its 3 blocks in Angola.

Although Angola has made major strides from its 27-year long civil war, violence against foreigners is reported in the oil-rich province of Cabinda. In late September, the country reached a preliminary deal with the IMF for up to $890 million in loans.

Gabon

Total Gabon is the operator on the *Diaba* block with a 63.75% working interest. Cobalt paid $2 million for a 21.25% working interest. The remaining 15% is held by the Gabonese government. Total is the largest producer in Gabon at 76,000 b/d, just under one-third of the total. Cobalt's prospects are located 40 to 120 miles offshore in water depths of 300 to 10,500 feet.

Cobalt paid $2 million for 21.25% of the Diaba block.

In June, the president of Gabon for more than 40 years passed away. In August, his son Ali Ben Bongo was declared president amid election fraud allegations from the opposition. Violent protests led to several deaths. Since France was accused of aiding election fraud, Total evacuated its staff from Port Gentil during the protests. Gabon is sub-Saharan Africa's fourth largest oil producer, but many of its 1.4 million citizens live in poverty while the late president was one of the world's richest men.

Not the first small company to bet big on deep water

Cobalt is by no means the first small exploration and production (E&P) company to compete with the majors exploring in deep water.

In mid-2007, **Kosmos Energy** discovered *Jubilee* off Ghana in 4,330 feet of water. In addition to *Jubilee*, Kosmos has other discoveries offshore Ghana and undrilled acreage in off Cameroon and Morocco. In July, Kosmos secured a $750 million project finance facility to fund its share of the Phase I development costs. Since then, rumors have been flying naming **ExxonMobil**, BP**, China National Offshore Oil Company** (CNOOC) and state-run **Ghana National Petroleum Company** (GNPC) as potential buyers with a price tag of $4 billion. Kosmos' partners--Anadarko, **Tullow Oil PLC**, **Sabre Oil & Gas** and the **Ghana National Petroleum Company** (GNPC)--have preemptive rights to purchase the stake and GNPC must approve any deal. Last week, **China Development Bank** signed a financing agreement with GNPC to fund oil and gas development, a move that may enable GNPC to finance the purchase price. The *Wall Street Journal* reported that Kosmos' private-equity founders (**Blackstone Group LP** and **Warburg Pincus LLC**) will quadruple their initial investment in Kosmos made about five years ago.

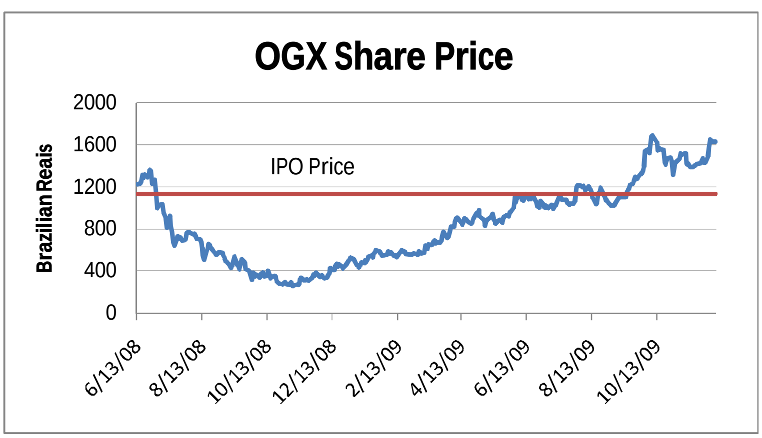
Kosmos may get $4 billion for its stake in the Jubilee field offshore Ghana.

Earlier this year **Devon Energy Corp.** announced it was searching for a partner in its deepwater GoM assets. After the results of *Kaskida* were announced, Devon's management decided to sell all GoM and international assets to focus onshore North America. Devon's GoM interests include four Lower Tertiary discoveries (*St. Malo*, *Jack*, *Cascade* and *Kaskida)*, a Miocene discovery (*Mission Deep)* and over 1 million net acres in the deepwater GoM, 94% of which is undeveloped.

Devon is selling its GoM and international assets to focus on low-risk onshore plays in North America.

OGX raised $3.6 billion by going public in Brazil in July 2008 without having drilled a well. Like Cobalt, the company has experienced management (former Petrobras) and lots of highly prospective acreage, but in Brazil. Unlike Cobalt, the IPO was made under sky high oil prices (over $130 per barrel) and estimates of reserves on undrilled prospects were available to potential investors. After a string of discoveries, the stock is now 44% above its offering price. Shares traded below the offering price for 14 of the 18 months, including a low of just 22% of the IPO price.

OGX investors have had a bumpy ride during the company's 18 months as a publicly traded company.



Impact of deepwater discoveries

With market capitalization of $3.7 billion and long-term debt of $2.5 billion, **Plains Exploration and Production Co.** operates onshore and offshore in the U.S. At the end of 2008, the company had proved reserves of 292 million boe. In the first nine months of 2009, Plains earned $88 million on revenue of $819 million generated from oil and gas production of 82,622 barrels of oil equivalent per day (boe/d). Plains owns 33.3% of the *Lucius* deepwater discovery announced last week, which boosted the stock 5%. Plains operates the Miocene discovery *Friesian* and has other GoM deepwater interests.

Plains has an enterprise value of $6.2 billion and earned $88 million in the first nine months of 2009.

For an idea of the impact a deepwater discovery can have on a stock, $30 billion market-cap Anadarko's value increased $3 billion on the five days it announced GoM discoveries. BP's announcement of the giant *Tiber* discovery added $6.4 billion to its market cap the first day. Shares continued to climb, and nine days after the announcement, shares were up 9% and $14 billion had been added to BP's market cap.

A deepwater discovery can add hundreds of millions or even billions to a company's value.

Market Appetite for E&P

U.S. investors haven't seen an oil and gas IPO since May 2008, when Anadarko-backed master limited partnership **Western Gas** and **Pioneer Natural Resources Co.** spinoff **Pioneer Southwest Energy Partners LP** priced**.** The next most recent IPOs were in November 2007, when **Quest Energy Partners LP**, **Approach Resources Inc.** and **SandRidge Energy Inc.** made their debuts. All four E&P companies that went public in the last 25 months operate in established basins onshore North America. Gulf Coast and south Texas producer **Crimson Exploration Inc.** recently filed to raise $166 million

The last E&P IPO in the U.S. was 19 months ago.

Only 31 companies went public in the U.S. in the first nine months of 2009, but 21 IPOs priced during October and November. Three companies succeeded in raising more than $1 billion: **Banco Santander Brasil** (a **Banco Santander** spinoff and Brazil's fourth largest bank) raised $7.0 billion, **Verisk Analytics** (provider of risk analysis backed by large insurance companies) raised $1.9 billion and **Shanda Games Ltd.** (a spinoff from China's leader in online games) raised $1.0 billion. **Hyatt Hotels** and **Talecris Biotherapeutics** both raised just under $1 billion.

Three of the 52 IPOs in the first eleven months of 2009 raised $1 billion or more.

Clearly Cobalt assembled impressive management and exploration teams to explore some of the world's most prospective acreage. Today's unremarkable oil prices and low natural gas prices probably should not impact greatly investors' decisions because they will rise and fall before Cobalt produces its first barrel of oil or cubic foot of gas. Investors must decide if they are able to bear the risk of $100+ million dry hole(s) that may be drilled before reserves can be booked or production started. Market focus on each well drilled likely will be intense. On prospects where it is not the operator, Cobalt will not control the timing of drilling and development. In the wake of the financial crisis, the knowledge that Cobalt will need to raise even more capital before producing any revenue may also be daunting. However, time after time the markets reward those bold enough to take big risks and find big reserves.

A Little History

Deepwater Drilling

The first well completed in water depths of 3,500 feet was drilled in 1976. The first field in comparable water depths to be placed on stream was in 1994, 18 years later. In December 1994, the market for deepwater drilling rigs came into balance, pushing dayrates on the most capable rigs from $67,000 to $90,000. Utilization rates for these rigs remains high, even through the oil price troughs. Dayrates now range from $400,000 to over $600,000. Fifteen years ago, the most advanced drillships could drill in 7,500 feet of water, ten years ago it was 10,000 feet; today it is 12,000 feet.

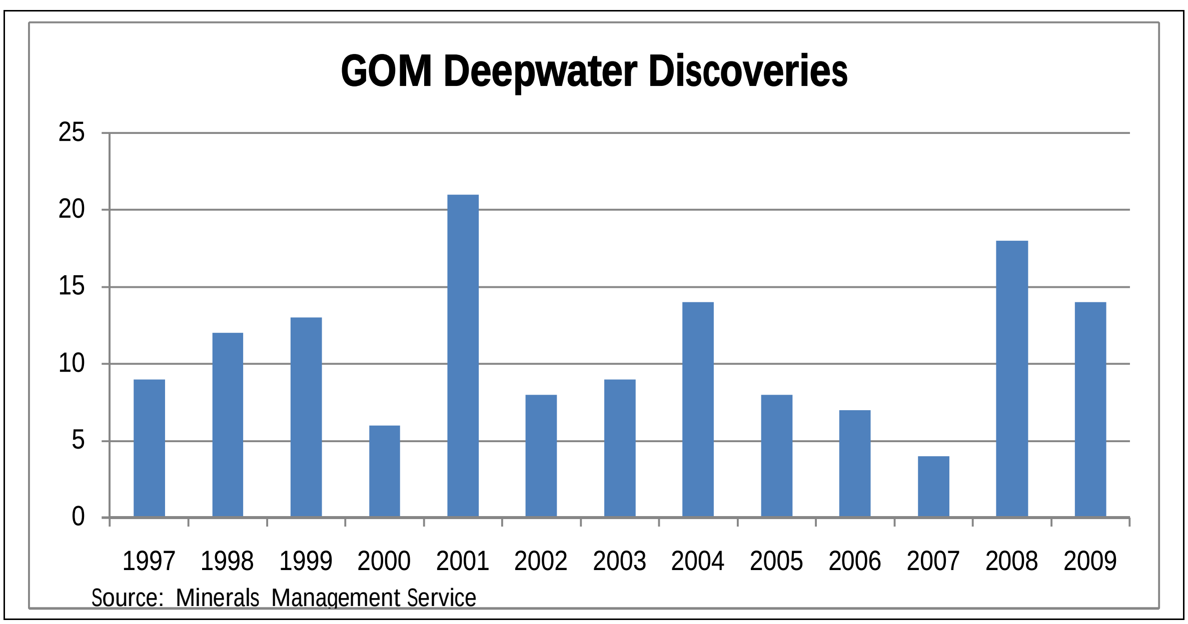
Deepwater drilling technology was years ahead of deepwater production technology.

Subsalt Play

Before the 1980s, explorationists believed that there was no oil or gas below the salt. The ability to "see" below the salt is a recent advancement. The highly refractive nature of the salt layer obscured the data. Wide-azimuth 3-D seismic data helps determine both the trapping mechanics and fluid migration patterns.

Subsalt wells drilled in the 1980s on the U.S. Outer Continental Shelf managed to find suitable reservoir rock, but no hydrocarbon accumulations. In 1990, Exxon had the industry's first subsalt success with its 4,000-foot water depth *Mica* prospect, but it was 12 years to first production. Phillips and Anadarko's *Mahogany*, discovered in 1993, was the first field to produce from the subsalt in 1997.

The subsalt confounded explorationists until the 1990s.



Cobalt Balance Sheet			
$ millions	**12/31/08**	**12/31/09**	**Pro forma IPO**
Cash and equivalents	5.1	266.9	1,222.0
Total current assets	23.8	320.2	1,461.5
Total property, plant & equipment	760.7	473.6	473.6
Total assets	**784.6**	**793.9**	**1,935.2**
Total current liabilities	44.1	37.5	37.5
Total long-term liabilities	0.0	0.0	0.0
Total partners' capital/stockholders' equity	740.5	756.4	1,897.7
Total liabilities & partners' capital/ stockholders' equity	**784.6**	**793.9**	**1,935.2**
Source: Cobalt S-1			

Cobalt Loss Statement				
	Year Ended	**Nine-Month Period Ended**		**11/10/05-**
$ millions	**12/31/08**	**9/30/08**	**9/30/09**	**9/30/09**
Oil and gas revenue	-	-	-	-
Operating costs				
Seismic & exploration	41.3	32.2	6.2	227.1
General & administrative	31.3	18.9	22.4	97.2
Depreciation & amortization	0.7	0.5	0.4	1.9
Total operating costs	**73.2**	**51.6**	**29.1**	**326.2**
Operating (loss)	(73.2)	(51.6)	(29.1)	(326.2)
Other income				
Interest income	(1.6)	(1.6)	(0.4)	(4.0)
Total other income	**(1.6)**	**(1.6)**	**(0.4)**	**(4.0)**
Net (loss)	**(71.6)**	**(49.9)**	**(28.7)**	**(322.1)**
Pro forma net (loss)				
Net (loss) as reported	(71.6)		(28.7)	
Pro forma adj. for mgmt. fees	1.7		1.5	
Pro forma net (loss) allocable to common shareholders	(69.9)		(27.2)	
Pro forma net (loss) per common share	$(0.26)		$(0.10)	
Wtd. avg. common shares out (pro forma) millions	266.5		270.4	
Source: Cobalt S-1				