Initiation Report
December 22, 2008

Stone Energy Corporation

NYSE: SGY

Recent Price: $9.97
52 Week Price Range:
$8.47 – $73.96
Per Share Valuation Range:
$10.08-S37.95
Rating: NA

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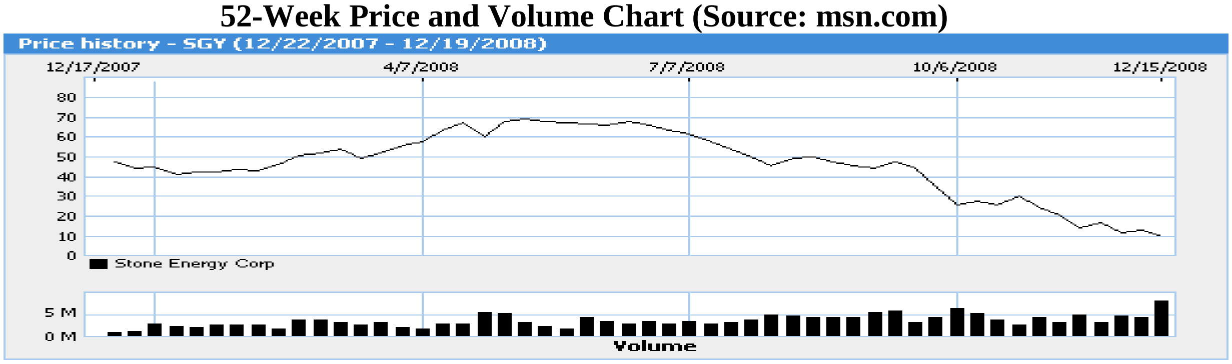
KEY STATISTICS*

Shares outstanding, basic (million)	39.9	**Proved reserves(1P)**[1] (Bcfe)	600
Market capitalization ($million)	397.8	**Valuation of proved reserves**[2] ($billion)	1.12
Enterprise value ($million)	2,448.60	**Probable and possible reserves**[3] (Bcfe)	590.0
P/E (ttm)	1.20 X	**Standardized measure**[4] ($billion)	3.3
Price/Book value	0.23 X	**Production/day**[5] (MMcfe)	225-250
Price/Revenue	0.47 X	**Enterprise value/3P reserves**	$2.06 per Mcfe

***** Price and market values as of Dec 19, 2008
1. Company's estimate for year end 2008
2. Our estimate for the value of the Company's proved reserves
3. As per SGY's Oct 8, 2008 corporate presentation, estimated by Netherland Sewell and Associates as of 12/31/07, not available for post BDX acquisition.
4. Sum of SGY and BDX as of December 31, 2007
5- Company's estimate for 2009

52-Week Price and Volume Chart (Source: msn.com)



FINANCIAL HIGHLIGHTS

All Amounts in $000, except pre share data	2008 (nine months)	2007	2006	2005
Revenue	634,938	753,252	688,988	636,240
Operating income	271,804	285,540	(365,249)	232,467
Operating margin (%)	42.8%	37.9%	-53.0%	36.5%
Net income	179,174	181,436	(254,222)	136,764
Net margin (%)	28.2%	24.1%	-36.9%	21.5%
Earning per share, basic	6.08	6.57	(9.29)	5.07
EBITDA	489,210	554,238	477,851	481,052
EBITDA/Interest expense	46.5	17.3	13.3	20.8
Oil and gas properties, net	3,263,746	1,181,312	1,784,452	1,810,959
Long-term debt	825,000	400,000	797,000	563,000
Stockholders' equity	1,839,799	885,802	711,640	944,123
Total assets	4,063,241	1,889,603	2,128,471	2,140,317
Long-term debt/Total assets (%)	20.3%	21.2%	37.4%	26.3%
Cash and cash equivalents	172,643	475,126	58,862	79,708
Net working capital	109,252	412,445	1,845	16,506
Cash flows from operating activities	487,198	465,158	399,035	461,213

VALUATION SUMMARY

Using our estimate of12.2% for the weighted average cost of capital of the Company as the discount rate and our projected net cash flows over the life of the Company's proved reserves, based on EIA 's December 17 reference case price projections, we estimated SGY's , proved reserves, equity, and per share values as per the following table:

All amounts in million except per share values	**Equity Valuation** disregarding probable and possible reserves
	Reference case
Proved reserves value	$ 1,115.79
Net working capital (9/30/08)	109.25
Fixed assets (9/30/08)	11.31
Long-term debt (9/30/08)	(825)
Equity value	411.35
Shares outstanding (million)	39.87
Per share value	$ 10.32

The above does not consider the value of the Company's probable and possible reserves. The following table shows our estimates of SGY's share value under different assumptions regarding recovery of the Company's probable and possible reserves.

Equity Valuation with recovery of probable and possible reserves	
	Reference case
Value of proved reserves/Mcfe of proved reserves	$ 1.86
Probable and possible reserves	590/Bcfe
Per share value/0% of probable and possible reserves recovered	$ 10.09
Per share value/10% of probable and possible reserves recovered	$ 13.08
Per share value/50% of probable and possible reserves recovered	$ 24.14
Per share value/100% of probable and possible reserves recovered	$ 37.95

Based on the above valuation analysis and the current price of the stock, we think SGY is undervalued. However, we like to emphasize this is not a buy recommendation or rating. If the price of crude oil continues going down further, SGY will also go down further. Investors should decide entry point based on their own analysis of the market trends.

EXECUTIVE SUMMARY

Stone Energy Corporation (hereinafter called "SGY" or the "Company") is an independent exploration and development (E&P) oil and natural gas company with corporate headquarters located in Lafayette, Louisiana. SGY's line of business is the acquisition and subsequent exploration, development, operation, and production of oil and gas properties located primarily in the Gulf of Mexico ("GOM"). The Company also had significant operations in the Rocky Mountain Basins and the Williston Basin (Rocky Mountain Region). Almost all these Rocky Mountain Region properties were sold to Newfield Exploration Company on June 29, 2007. The properties SGY maintained in the Rocky Mountain Region include working interests in several undeveloped plays which totaled approximately 96,000 net acres as of February 11, 2008.

Currently, The Company's strategic focus is on the Gulf of Mexico conventional shelf properties. The Company is also pursuing exploration opportunities in the deepwater and in the deep shelf of the GOM. During 2007 SGY began securing leasehold interests in Pennsylvania (Appalachia). As of February 11, 2008, The Company had secured leasehold interests in approximately 20,000 net acres. Additionally, SGY is also engaged in an exploratory joint venture in Bohai Bay, China.

On August 28, 2008, SGY completed acquisition of Bois d'Arc Energy, Inc. (NYSE: BDE, hereinafter called “BDX”), paying approximately $935 million in cash and issuing approximately 11.3 million shares. BDX properties are located in the outer continental shelf of the Gulf of Mexico, with estimated oil and natural gas proved reserves of 398 Bcfe as of December 31, 2007. According to SGY’s December 17 press release with the acquisition of BDX the Company estimates its year end 2008 proved reserves to be slightly under 600 Bcfe, up from 402.6 Bcfe as of December 31, 2007.

According to the Company’s October 8, 2008 corporate presentation, SGY also has 590 Bcfe of probable and possible reserves. The estimate was provided by Netherland Sewell and Associates as of December 31, 2007 and not available for post BDX acquisition.

SGY operates most of its properties. As of December 31, 2007 the company was the operator of 63% of its active properties which represented 89% of its year end 2007 proved reserve.

For the nine months ended September 30, 2008, SGY produced 24.6 Bcf of gas and 3,647 MBbls of oil totaling 45.5 Bcfe on the gas equivalent basis. According to the Company’s December 17 press release for the fourth quarter of 2008, SGY expects net daily production to average between 180 - 195 MMcfe per day. The Company expects production volumes to be approximately 225-250 MMcfe per day in 2009

SGY is a profitable oil and gas E&P company. For the nine months ended September 30, 2008, the Company generated $634.9 million revenues and reported $6.08 earning per basic share. However, due to the severe drop in the price of oil and gas in the fourth quarter 2008 the Company might be required to report significant non-cash ceiling test write-down to its full cost pool in its year end 2008 financials. If the size of the write-down would be too large, the Company might be reporting a net loss for the year 2008; but even if this be the case we think the company will resume profitability in the first quarter 2009.

SGY has a sound liquidity base. As of September 30, 2008 the Company had $172.6 million in cash and cash equivalents and $109.2 million in net working capital. Moreover, SGY has secured a revolving bank credit facility of $700 million maturing on July 1, 2011. However, in early December 2008 the bank group reduced the credit facility to $625 million, leaving $153.9 million of borrowings available under the credit facility as of December 17, 2008.

SGY has low debt leverage. As of September 30, 2008, the Company’s total long-term debt was $825 million; which was 20.3% of its total assets.

The Company’s common shares trade on the New York Stock Exchange under the symbol SGY. The Company does not pay dividends.

SGY'S OIL AND GAS PROPERTIES

As of December 31, 2007, prior to acquisition of BDX, SGY owned a total of 27,790.83 net developed acres and a total of 521,167.96 net undeveloped acres working interests in oil and gas properties. All of the Company's developed properties were located in the Golf Coast Basin as of year end 2007.

In the oil and gas business the term "working interest" or "leasehold interest" means an interest in an oil and gas lease that gives the owner of interest the right to drill for and produce oil and gas on the leased acreage (or wells). Gross acres (or wells) are acres (or wells) in which the Company has a working interest. Net acres (or wells) are the Company's aggregate working interests in the gross acres (or wells).

The following table summarizes the Company's developed and undeveloped gross and net leasehold acreage (pre BDX acquisition). Undeveloped acreage includes leased acres on which wells have not been drilled or completed to a point that would permit the production of commercial quantities of oil and gas, regardless of whether or not such acreage contains proved reserves.

SGY's Leasehold Acreage (Year end 2007)

	Developed		Undeveloped		Total	
	Gross	Net	Gross	Net	Gross	Net
Golf Coast Basin	41,734.23	27,790.83	608,724.71	405,349.78	650,458.94	433,140.61
Rocky Mountain Region	-	-	248,338.10	96,193.00	248,338.10	96,193.00
Bohai Bay, China	-	-	-	-	-	-
Appalachia	-	-	19,691.18	19,625.18	19,691.18	19,625.18
Total	41,734.23	27,790.83	876,753.99	521,167.96	**918,488.22**	**548,958.79**

BDX properties are located in the outer continental shelf of the Gulf of Mexico in which include properties located offshore of Louisiana in state and federal waters of the Gulf of Mexico. As of December 31, 2007 BDX owned a total of 176,494 net developed acres and a total of 150,551 net undeveloped acres working interests in oil and gas properties.

The following table summarizes BDX developed and undeveloped gross and net leasehold acreage as of December 31, 2007.

BDX's Leasehold Acreage (Year end 2007)

	Developed		Undeveloped		Total	
Offshore:	Gross	Net	Gross	Net	Gross	Net
Louisiana	6,660	5,574	1,399	1,399	8,059	6,973
Federal	231,271	170,920	150,202	149,152	381,473	320,072
Total	237,931	176,494	151,601	150,551	**389,532**	**327,045**

The following tables provide information about SGY and BDX productive oil and gas wells as of December 31, 2007;

SGY's Producing Oil and Gas Wells (Year end 2007)						
	Oil		Gas		Total	
	Gross	Net	Gross	Net	Gross	Net
Golf Cost Basin	145.00	100.09	126.00	80.37	271.00	180.46
Rocky Mountain Region	1.00	1.00	-	-	1.00	1.00
Bohai Bay, China	-	-	-	-	-	-
Appalachia	-	-	-	-	-	-
Total	146.00	101.09	126.00	80.37	**272.00**	**181.46**

BDX's Producive Oil and Gas Wells (Year end 2007)						
	Oil		Gas		Total	
Offshore:	Gross	Net	Gross	Net	Gross	Net
Louisiana	15	13.7	9	6.4	24	20.1
Federal	46	30.5	75	57.7	121	88.2
Total	61	44.2	84	64.1	**145**	**108.3**

SGY'S OIL AND GAS RESERVES

As of December 31, 2007 SGY had 31,586 MBbls proved oil reserves (189,516 MMcfe gas equivalent) and natural gas proved reserves of 213,083 MMcf making it a total gas equivalent of 402,599.MMcfe. BDX proved reserves as of December 31, 2007 were 24,632 MBbls of oil and 250,134 MMcfe of gas, for a total of 397,925 MMcfe.

The gas equivalent of oil is calculated by converting one barrel of oil to six thousand cubic feet of gas, that is:

1 Bbl of oil = 6 Mcf of natural gas

The following table shows historical trend of SGY (pre BDX acquisition) proved reserves of oil and gas as of the fiscal years ending December 31, 2005 through December 31, 2007. The abbreviation Bcfe stands for billion cubic feet gas equivalent.

SGY Proved reserves	2007	2006	2005
Oil (MBbls)	31,586	41,360	41,509
Gas (MMcf)	213,083	342,782	344,088
Total (MMcfe)	402,599	590,942	593,142

The following table shows historical trend of BDX proved reserves of oil and gas as of the fiscal years ending December 31, 2005 through December 31, 2007

BDX Proved reserves	2007	2006	2005
Oil (MBbls)	24,632	20,425	19,530
Gas (MMcf)	250,134	221,463	205,986
Total (MMcfe)	397,926	344,013	323,166

Proved reserves are classified into proved developed and proved undeveloped reserves. Proved developed reserves (PD) are reserves that are expected to be recovered through existing wells with existing equipment and operating methods. Proved undeveloped reserves (PUD) are reserves that are expected to be recovered from drilling new wells on undrilled acreage, or from existing wells where a relatively major expenditure is required for recompletion.

Proved developed reserves could be producing or nonproducing. Proved developed producing (PDP) reserves are reserves that are expected to be recovered from the

currently producing acreage under existing production methods. Proved developed nonproducing (PDNP) reserves consist of (i) proved reserves from wells which have been completed and tested but are not producing due to lack of market or minor completion problems which are expected to be corrected and (ii) proved reserves currently behind the pipe in existing wells and which are expected to be productive due to both the well log characteristics and analogous production in the immediate vicinity of the wells.

As of December 31, 2007 over 80% of SGY's proved reserves were proved developed reserves. The following table shows the structure of SGY's proved reserves based on the above categories.

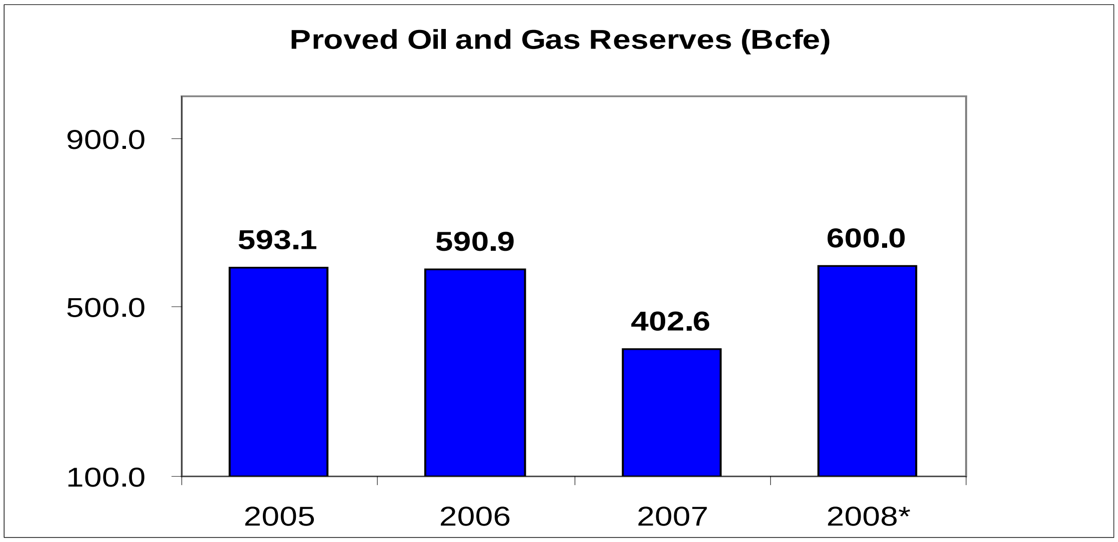
SGY Reseves Structure				
Reserve category	**Oil (MBbl)**	**Gas (MMcf)**	**Total (MMcfe)**	**Percent of total**
Proved developed reserves	25,172	171,815	322,847	80.2%
Proved undeveloped reserves	6,414	41,268	79,752	19.8%
Total	31,586	213,083	402,599	100.0%
Percent proved developed	79.7%	80.6%	80.2%	

The following table shows BDX structure of proved reserves as of December 31, 2007.

BDX Reseves Structure				
Reserve category	**Oil (MBbl)**	**Gas (MMcf)**	**Total (MMcfe)**	**Percent of total**
Proved developed reserves	17,390	189,249	293,589	72.9%
Proved undeveloped reserves	7,242	60,885	104,337	25.9%
Total	24,632	250,134	397,926	98.8%
Percent proved developed	70.6%	75.7%	73.8%	

According to SGY's December 17 press release the Company estimates its year end 2008 proved reserves to be slightly under 600 Bcfe. The projected increase in estimated reserves compared to the year end 2007 was primarily due to acquisition of BDX, partially offset by production, a small divestiture package in the first quarter, a reduced combined capital expenditure program, and several dry holes whereby production was not replaced via the drill bit, as well as the effect of lower oil and gas prices.

The following chart shows SGY's proved reserves of oil and gas from 2005 through 2008



*****SGY's estimates

It should be noted that reserve estimates, including proved reserve estimates, are not precise because the estimates are based upon certain factors considered and assumptions made and may change as the underlying factors and assumptions change.

Oil and Gas companies are not permitted to discuss their non-proved (**probable and possible**) reserves in their SEC filings. But, they can provide that information to the public in the press releases or their corporate presentations.

According to SGY's October 8, 2008 presentation at the Oil & Gas Investment Symposium, IPAA, San Francisco, the company's probable and possible reserves as of December 31, 2007, has been estimated to be 590 Bcfe, pre acquisition of BDX

Below are definitions of proved, probable, and possible reserves as per The Society of Petroleum Engineers (SPE):

Proved Reserves

> "Proved reserves are those quantities which, by analysis of geological and engineering data, can be estimated with reasonable certainty to be commercially recoverable, from a given date forward, from known reservoirs and under current economic conditions, operating methods, and government regulations. Proved reserves can be categorized as developed or undeveloped. If probabilistic methods are used, there should be at least a 90% probability that the quantities actually recovered will equal or exceed the estimate".

Proved reserves are also referred to as **1P** reserves in the industry.

Probable Reserves:

> "Probable reserves are those unproved reserves which analysis of geological and engineering data suggests are more likely than not to be recoverable. In this context, when probabilistic methods are used, there should be at least a 50% probability that the quantities actually recovered will equal or exceed the sum of estimated proved plus probable reserves".

Proved plus probable reserves are referred to as **2P** reserves in the industry.

Possible Reserves:

> "Possible reserves are those unproved reserves which analysis of geological and engineering data suggests are less likely to be recoverable than probable reserves. In this context, when probabilistic methods are used, there should be at least a 10% probability that the quantities actually recovered will equal or exceed the sum of estimated proved plus probable plus possible reserves".

Proved plus probable plus possible reserves are referred to as **3P** reserves in the industry.

Standardized Measure and PV-10 of Proved Reserves

Companies in the oil and gas exploration and production are required by the SEC to estimate the present value of their future net cash flows related to **proved reserves**, called **the standardized measure**, in accordance with SFA No. 69 prepared by the Financial Accounting Standard Board (FASB). As per SFA No. 69 the standardized measure should be calculated by applying current year end prices to estimated future production (considering fixed and determinable price changes only to the extent provided by contractual arrangements or law), less future expenditures (based on current costs) to be incurred in developing proved undeveloped and proved producing oil and gas reserves and less future income taxes and net abandonment costs. The resulting future net cash flows should then be discounted using a rate of 10% per annum to arrive at present net discounted cash flows, or the standardized measure. Because of keeping future prices and costs the same as current ones and the arbitrary discount rate of 10% it should be noted that **the standardized measure is merely a legal requirement and does not necessarily reflect a fair estimate of an oil and gas company's value**.

Some oil and gas E&P companies calculate a similar measure called **PV-10** in addition to the standardized measure. The PV-10 is calculated similar to the standardized measure except that it doe not include the estimated future income taxes and net abandonment costs that are unique for each company. The PV-10 is, therefore, a more realistic measure than the standardized measure for comparing the value of proved reserves of companies across the industry. Nevertheless, because of keeping future prices and costs the same as current ones and the arbitrary discount rate of 10%, PV-10 does not necessarily represent a fair estimate of an E&P company's value also.

As of December 31, 2007 SGY's standardized measure of proved reserves was $1.52 billion. The standardized measure was calculated based on average year-end prices of

$94.72 per barrel of oil and 7.25 per Mcf of gas. SGY did not report PV-10 of proved reserves. BDX's standardized measure of proved reserves for the year ended December 31, 2007 was $1.78 billion with PV-10 reported to be $2.19 billion based on average year-end prices of $94.64 per barrel of oil and 7.26 per Mcf of gas

PRODUCTION

Historically SGY has had a balanced production mix, about 55% gas and 45% oil. During the year 2007, SGY's gas production was 45.1 Bcf (3.7% more than 2006) and its production of crude oil was 6,088 MBbls (8.8% more than 2006). Total production of oil and gas on the gas equivalent basis for the year 2007 was 81.6 Bcfe which was 5.8% above total production of 2006.

For the nine months ended September 30, 2008, SGY produced 24.6 Bcf of gas and 3,647 MBbls of oil totaling 45.5 Bcfe on the gas equivalent basis. The 2008 production was negatively impacted by shut-ins from Hurricanes Gustav and Ike estimated at 7.1Bcfe during the third quarter and positively impacted by the acquisition of Bois d'Arc properties estimated at 0.6 Bcfe.

The following table shows SGY's annual production volumes, weighted average realized prices, and unit costs for the years ended December 31, 2005 through December 31, 2007 and for the nine months ended September 30, 2008.

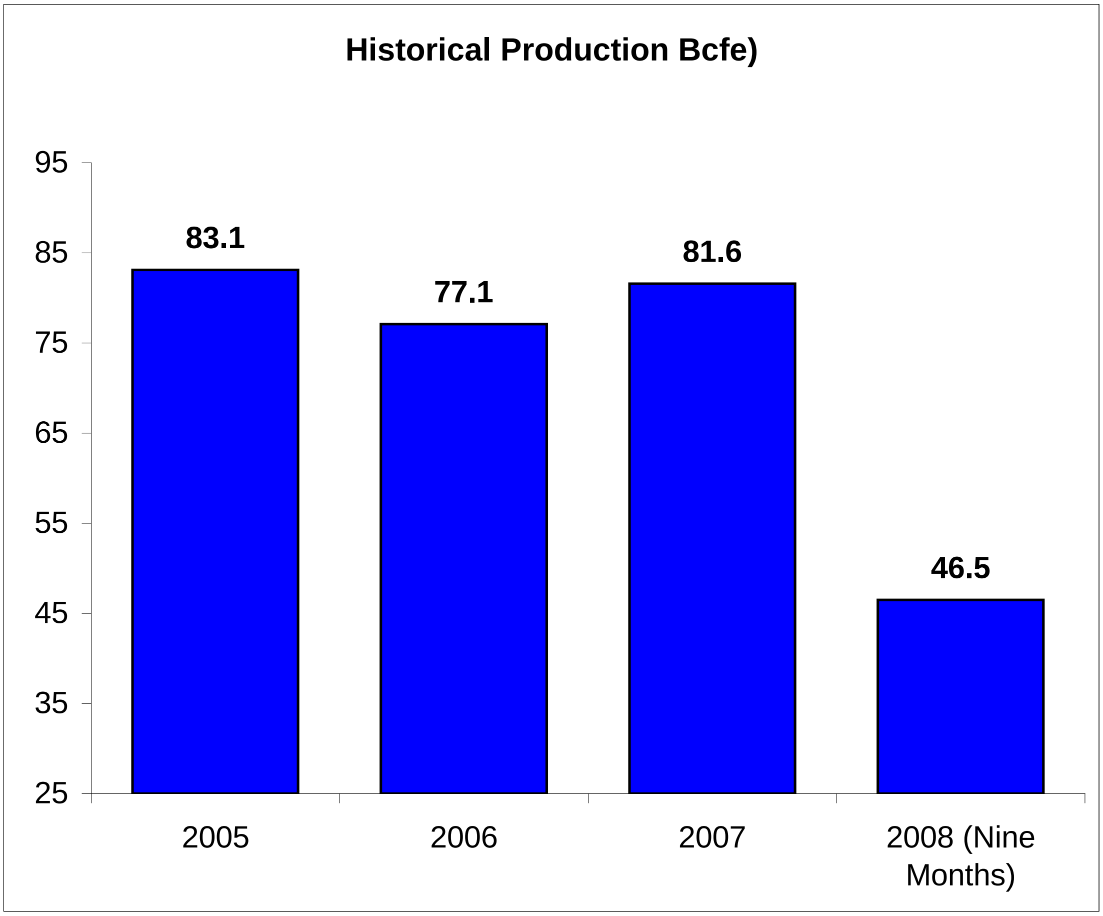
The table contains production and DD&A costs per Mcfe of production. Comparison of production and DD&A costs with the weighted average realized prices provides useful information about the trend in margin of profitability in production of oil and gas.

	Production			
Production	**2008** (nine months)	**2007**	**2006**	**2005**
Gas (Bcf)	24.6	45.1	43.5	54
Oil (MBbls)	3,647.0	6,088	5,593	4,838
Total production (Bcfe)*	46.5	81.6	77.1	83.1
Average realized prices				
Gas($/Mcf)	$ 10.29	$ 7.30	$ 7.75	$ 7.24
Oil ($/Bbl)	$ 104.20	$ 69.68	$ 62.40	$ 50.53
Weighted average oil and gas ($/Mcfe)	$ 13.62	$ 9.23	$ 8.90	$ 7.65
Oil and gas costs ($/Mcfe produced)				
Production cost**	$ 2.26	$ 1.86	$ 2.06	$ 1.38
DD&A	$ 3.95	$ 3.67	$ 4.11	$ 2.87
Salaries, general, and administrative expenses	$ 0.69	$ 0.41	$ 0.44	$ 0.27

* We apply the ratio of 6:1 to convert each Bbl of oil to Mcfe of natural gas.

** Lease operating costs per Mcfe

The following chart shows SGY's total net production on the gas equivalent basis for the years ended December 31, 2005 through December 31,2007 and for the nine months ended September 30, 2008.



According to the Company's December 17 press release for the fourth quarter of 2008, SGY expects net daily production to average between 180 - 195 MMcfe per day. The Company expects production volumes to be approximately 225-250 MMcfe per day in 2009.

SGY engages in hedging activities, primarily zero-premium collars, fixed-price swaps, and puts, to protect its production against downward price risk. Management can hedge up to 50% of estimated production quantities without the consent of the board of directors.

OPERAING HIGHLIGHTS

STONE ENERGY CORPORATION
CONDENSED CONSOLIDATED STATEMENT OF OPERATIONS
(In thousands, except per share amounts)

	For the Six Month Ended June 30		For the Year Ended December 31		
Operating revenues	**2008**	**2007**	**2007**	**2006**	**2005**
Oil	$ 279,276	$ 204,757	$ 424,205	$ 348,979	$ 244,469
Gas	186,919	168,467	329,047	337,321	391,771
Derivative income, net	-	-	-	2,688	-
Total operating revenues	**$ 466,195**	**$ 373,224**	**$ 753,252**	**$ 688,988**	**$ 636,240**
Operating expenses					
Lease operating expenses (Production)	65,153	91,596	149,702	159,043	114,664
Production taxes	4,903	6,672	9,945	13,472	13,179
Depreciation, depletion, and amortization (DD&A)	134,218	160,179	302,739	320,696	241,426
Write-down of oil and gas properties	10,100	-	8,164	510,013	-
Accretion expense	8,221	8,832	17,620	12,391	7,159
Salaries, general and administrative expenses	21,534	17,635	33,584	34,266	22,705
Incentive compensation expense	1,900	1,361	5,117	4,356	1,252
Derivative expenses, net	3,612	91	666	-	3,388
Total operating expenses	**249,641**	**286,366**	**527,537**	**1,054,237**	**403,773**
Gain (loss) on sale of assets	-	55,816	59,825	-	-
income (loss) from operations	**$ 216,554**	**$ 142,674**	**$ 285,540**	**$ (365,249)**	**$ 232,467**
Interest income	8,346	1,609	12,135	2,524	1,095
Interest expense	(7,492)	(21,475)	(32,068)	(35,931)	(23,151)
Other income (expenses)	2,354	3,235	4,813	6,128	2,799
Net income (loss) before income taxes	219,762	126,043	270,420	(392,528)	213,210
Income tax provision (benefit):	74,709	43,584	88,984	(138,306)	76,446
Net income	**$ 145,053**	**$ 82,459**	**$ 181,436**	**$ (254,222)**	**$ 136,764**
Basic earnings (loss) per share	**$ 5.19**	**$ 2.99**	**$ 6.57**	**$ (9.29)**	**$ 5.07**
Diluted earnings (loss) per share	**$ 5.13**	**$ 2.98**	**$ 6.54**	**$ (9.29)**	**$ 5.02**
Weighted average shares outsanding, Basic	27,948	27,560	27,612	27,366	26,951
Weighted average shares outsanding, Diluted	28,260	27,642	27,723	27,366	27,244

The revenues and expenses associated with the acquisition of BDX have been included in SGY's condensed consolidated financial statements since August 28, 2008.

For the nine months ended September 30, 2008, SGY realized $380 million revenue from sale of oil and $253.5 million revenue from sale of gas, which with $1.4 million net derivative income led to $634.9 million operating revenue for the period. Total operating revenue for the nine months ended September 30, 2008 was about 15% more than total operating revenue for the similar period in 2007. This increase was primarily due to the increase in average realized prices, partially offset by lower production due to divesture of Rocky Mountain properties.

Lease operating expenses (production expenses) for the first nine months of 2008 were $105.3 million as compared to lease operating expense of $131.1 million for similar period in 2007. The reason for this decrease was that the lease operating expense for the nine months ended September 30, 2007 included $8.6 million for the Rocky Mountain properties which were divested on June 29, 2007, and $9.9 million for an expensed replacement well.

For the nine months ended September 30, 2008, DD&A expense on oil and gas properties was $183.9 million as compared to $228.5 million DD&A expense during the same period of 2007. The decrease in DD&A expense was primarily due to lower volumes in 2008.

For the nine months ended September 30, 2008, the Company expensed an impairment charge of $18.9 million relating to the investment in Bohai Bay, China. The remaining investment in the Bohai Bay is included in unevaluated properties and totals $12.1 million.

SG&A expenses for the first nine months of 2008 totaled $32.0 million which was over 25% higher than SG&A expenses of $25.5 million for the similar period of 2007.

Total operating income for the nine months ended September 30, 2008 amounted to $271.8 million which was over 39% higher than similar item for the nine months ended September 30, 2008. Net income for the nine months ended September 30, 2008 was $179.2 million, showing an increase of about 54% as compared to net income of $116.5 million for the similar period of 2007.

Overall, for the nine months ended September 30, 2008 the SGY reported $6.08 basic earning per share on $29.5 million weighted average basic shares outstanding. This was 44% higher than the Company's basic earning per share of $4.22 on 27.6 million weighted average basic shares outstanding for similar period of 2007.

The following table contains some supplementary information about SGY's operating performance.

Production	2008 (nine months)	2007	2006	2005
Gas (Bcf)	24.6	45.1	43.5	54
Oil (Mbls)	3,647.0	6,088	5,593	4,838
Total production (Bcfe)*	46.5	81.6	77.1	83.1
Average realized prices				
Gas($/Mcf)	$ 10.29	$ 7.30	$ 7.75	$ 7.24
Oil ($/Bbl)	$ 104.20	$ 69.68	$ 62.40	$ 50.53
Weighted average oil and gas ($/Mcfe)	$ 13.62	$ 9.23	$ 8.90	$ 7.65
Oil and gas costs ($/Mcfe produced)				
Production cost**	$ 2.26	$ 1.86	$ 2.06	$ 1.38
DD&A	$ 3.95	$ 3.67	$ 4.11	$ 2.87
Salaries, general and administrative expenses	$ 0.69	$ 0.41	$ 0.44	$ 0.27
Operating metrics				
Operating margin	42.8%	37.9%	-53.0%	36.5%
Net margin	28.2%	24.1%	-36.9%	21.5%
Cash flows from operating activities per basic share	$ 16.54	$ 16.85	$ 14.58	$ 17.11

CAPITAL EXPENDITURES

In order to continue generating revenues, oil and gas E&P companies should continually engage in exploration activities to enhance their proved reserves as well as incur capital expenditures to develop and produce their existing proved reserves. For the nine months ended September 30, 2008 SGY's capital expenditures excluding acquisitions, capitalized salaries, general and administrative expenses (SG&A,) and capitalized interest was $319.5 million.

The Company's 2008 capital expenditures budget, which excludes acquisitions, asset retirement costs and capitalized interest, and capitalized SG&A expenses, was approximately $395 million prior to the BDX acquisition. After acquisition of BDX and the impact of the hurricanes, the company expected 2008 capital expenditures to be approximately $425 to $450 million.

In its December 17, 2008 press release the Company announced its capital expenditure plan for 2009 is $300 million. According to the Company, approximately $170 million is projected to be for Gulf of Mexico (GOM) exploitation/development projects, $40 million is estimated for GOM exploration, $70 million is budgeted for GOM facilities and plug and abandonment projects, and $20 million is budgeted for Appalachian activity. SGY expects its capital expenditure program to be fully funded by cash flow from operations.

SGY has adopted the **full cost (FC)** method of accounting for its oil and gas properties in contrast to **successful efforts (SE)** method of accounting. Under the FC method all costs associated with acquisition, exploration, development of oil and gas reserves, and estimated abandonment costs including directly related overhead and SG&A costs are capitalized and subsequently amortized on the unit-of-production method using estimates of proved reserves. Unevaluated property costs are excluded from the amortization base until existence of proved reserves or impairment is determined. Oil and gas properties of companies using the full cost method are subject to the **ceiling**

test, according to which at the end of each financial reporting period the company should calculate the present value of estimated future net cash flows from proved reserves and compare it with the net capitalized costs of proved oil and gas properties. If the net capitalized costs of proved oil and gas properties exceed the present value of estimated future net cash flows from proved reserves, then the company should write-down the net capitalized costs of proved oil and gas properties to the present value of estimated future net cash flows from proved reserves.

The SE method, on the other hand, allows only costs incurred in successful exploration activities to be capitalized and subsequently amortized according to the unit of production method. Therefore, companies adopting the SE method may write off part of their capitalized costs under lease impairment or exploration cost (geological and geophysical costs) if the company hits a dry hole or if certain properties or prospects become no longer commercially viable.

Given the current price of oil and gas and as our DCF valuation of the Company's proved reserves indicates, the company will probably be reporting significant non-cash ceiling test write-down to its full cost pool in its year end 2008 financials.

CAPITAL RESOURCES AND LIQUIDITY

For the nine months ended September 30, 2008 net cash flows provided by operating activities totaled $487.2 million, which was used to finance the company's capital expenditures on its oil and gas properties and partial financing of the BDX acquisition. The Company believes its cash flows from operating activities during the year 2008 would be adequate to finance its 2008 capital expenditures.

SGY has a sound liquidity base. As of September 30, 2008 the Company had $172.6 million in cash and cash equivalents and $109.2 million in net working capital. Moreover, SGY has secured a revolving bank credit facility of $700 million maturing on July 1, 2011.

According to the Company's December 17, 2008 press release, in early December 2008 the bank group reduced the credit facility to $625 million. Borrowings outstanding as of December 17, 2008 under the facility totaled $425 million, and letters of credit totaling $46.1 million had been issued under the facility, leaving $153.9 million of borrowings available under the credit facility.

The following table provides information on SGY's capital resources and liquidity

All amounts in $000	2008 (nine months)	2007	2006	2005
Cash and cash equivalents	$ 172,643	$ 475,126	$ 58,862	$ 79,708
Net working capital	109,252	412,445	1,845	16,506
Cash flows from operating activities	487,198	465,158	399,035	461,213
Long-term debt	825,000	400,000	797,000	563,000
Total assets	4,063,241	1,889,603	2,128,471	2,140,317
Long-term debt/Total assets (%)	20.3%	21.2%	37.4%	26.3%

VALUATION

We used the discounted cash flow (DCF) methodology to estimate fair values for SGY's equity. Main parameter that affects oil and gas E&Ps' future revenues and net cash flows is the projected price of oil and gas over the life of their reserves. Given the uncertainty about how and when the current U.S. and global economic recession come to an end, that demand for oil and gas is highly correlated with the level of global economic activities, and that alternative energy might drag some demand from oil and gas in the future, it is difficult to have a reliable projection of future oil and gas prices. As currently there is no consensus about future prices of oil and gas, we used the most recent U.S. Energy Information Agency's (EIA) price forecasts. On December 17, 2008, the EIA published its early release Annual Energy Outlook 2009 (AEO 2009 early release) for the reference case. We used their forecasted Golf of Mexico wellhead nominal prices for the year 2009 through 2015 to project revenue and net cash flows for the rest of the Company's proved reserves life. We applied SGY's proved reserves mix of 59% gas and 41% oil to estimate weighted average future projected prices.

We estimated the weighted average cost of capital (WACC) for SGY to be 12.2% and used that as the discount rate to estimate present value of the Company's net future cash flows. Because the stock price of oil and gas E&P companies generally move more with the price of crude oil than with the general market, these companies do not have a high beta, mostly below 2. Although SGY has a beta of about 1.2, we chose the beta of 2 for SGY to estimate its cost of equity capital, mainly because the low beta could be the result of low trading of the company's stock and not due low systematic risk of the stock. With the beta of 2 we estimated the company's cost of equity capital to be about 19.7%. As of September 30, 2008, SGY had $200 million outstanding in 8 ¼% senior subordinated notes, $200 million in 6 ¾% senior subordinated notes, and $425 million bank debt with average 5.5% interest rate. This puts its weighted average cost of debt to be around 6.5% before tax, or 4.29% tax adjusted. To get the weights of equity and debt in calculation of WACC we used the past 12 months average market cap of the company and its long-term debt as of September 30, 2007, which gave weights of equity and debt to be 51.1%and 48.9% respectively, yielding to a WAAC of 12.2%.

Using the 12.2% discount rate and our projected net cash flows over the life of the Company's proved reserves, based on EIA 's reference case price projections we estimated SGY's , proved reserves, equity, and per share values as per the following table:

All amounts in million except per share values	**Equity Valuation** disregarding probable and possible reserves
	Reference case
Proved reserves value	$ 1,115.79
Net working capital (9/30/08)	109.25
Fixed assets (9/30/08)	11.31
Long-term debt (9/30/08)	(825)
Equity value	411.35
Shares outstanding (million)	39.87
Per share value	$ 10.32

The above does not consider the value of the Company's probable and possible reserves. The following table shows our estimates of SGY's share value under different assumptions regarding recovery of the Company's probable and possible reserves.

Equity Valuation with recovery of probable and possible reserves	
	Reference case
Value of proved reserves/Mcfe of proved reserves	$ 1.86
Probable and possible reserves	590/Bcfe
Per share value/0% of probable and possible reserves recovered	$ 10.09
Per share value/10% of probable and possible reserves recovered	$ 13.08
Per share value/50% of probable and possible reserves recovered	$ 24.14
Per share value/100% of probable and possible reserves recovered	$ 37.95

Based on the above valuation analysis and the current price of the stock, we think SGY is undervalued. However, we like to emphasize this is not a buy recommendation or rating. If the price of crude oil continues going down further, SGY will also go down further. Investors should decide entry point based on their own analysis of the market trends.

STOCK PRICE BEHAVIOR

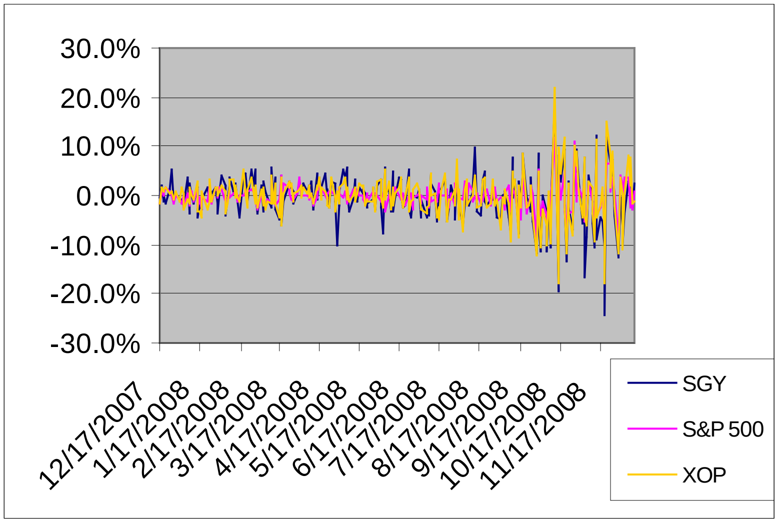
The 52 -Week price and volume behavior of SGY is exhibited below:

Source: MSN.com

During the one-year period SGY was trading in the $8.47 to $73.96 range. The average daily volume for the one year period was about 740,000 shares. For the most recent 90 days the stock was trading in the $8.47 to $62.61 range with an average daily volume of around 920,000 shares. With 39.87 million common shares of SGY outstanding as of November 30, 2008 the one-year average daily volume represents about 1.9% of the company's outstanding shares and the 90-day average daily volume represents 2.3% of the Company's outstanding shares.

We benchmarked daily return performance of SGY stock against Standard & Poor's ETF for Oil and Gas E&P companies (symbol XOP) as well as against the S&P 500 Stock Index

The figure below shows daily price return volatility of SGY versus XOP and S&P 500.



Analysis of daily prices of SGY over the past 52 weeks indicates a daily return volatility of 4.96% with average daily rate of return of -0.28%.

The following table summarizes return and volatility of SGY versus XOP and S&P 500 over the past 52 weeks

	S&P 500	XOP	SGY
Total one year return	**-39%**	**-42%**	**-71%**
Average daily return	**-0.16%**	**-0.17%**	**-0.28%**
Daily return volatility	**2.56%**	**4.54%**	**4.96%**
Daily return /volatility	**-0.061**	**-0.036**	**-0.057**

As the above risk-return profile indicates, in the past 12 months, on a risk-return performance basis, common shares of SGY has underperformed XOP, but almost had the same risk-return performance as the S&P 500 Stock Index.

RISK FACTORS

In its 10K SEC filings SGY provided detailed descriptions of its business risks. Below we pin point some of the major risks investors should be aware of when investing in common shares of SGY.

The Company's future profitability is highly sensitive to oil and natural gas prices, which are solely determined by the market. Oil and gas prices are historically very volatile and highly correlated with economic cycles. Continuation of current slow down in domestic and global economic activity could lead to further decline in oil and natural gas prices which not only will lower the profit margin but could also make portions of the Company's proved reserves commercially not recoverable.

The Company primarily operates in the Golf of Mexico and its production is particularly vulnerable to significant risk from hurricanes and tropical storms.

SGY employs the full cost accounting methods. Lower oil and gas prices and or downward revisions in proved reserves may cause the Company to record ceiling test write-downs. A write-down of oil and gas properties does not impact cash flow from operating activities, but does reduce net income and thus market price of its share.

Even with the current stage of 3-D seismic and other advanced technologies, exploratory drilling is still a highly speculative activity. There is always the possibility of hitting a dry hole which leads to substantial loss of capital.

E&P activity is a very capital intensive business and the Company might need additional external funding to acquire new properties or develop its undeveloped properties and expand future operations. There is no assurance that the Company would be able to raise additional capital if needed in the future

The oil and gas E&P industry segment is highly competitive with integrated oil companies dominating reserves and production. Long-term growth of the Company depends on acquiring new properties and adding to its reserves, which given the highly competitive nature of the E&P industry segment may not be viable.

Reserve estimates may be subject to downward or upward revision based upon actual production performance, results of future development and exploration, and prevailing oil and gas prices. Therefore, projections made on the basis of current reserves estimates may have to be modified if there would be revisions in the reserves estimates.

Oil and gas companies are subject to various governmental and environmental regulations which in the future might impose substantial costs on these companies. Particularly, there is the risk of possible future regulations in favor of alternative energy which might pose serious competition on the oil and gas industry.

Finally, future success and growth of the Company depends, among other things, on the availability of qualified personnel.

COMPETITIVE STRUCTURE OF E&P SEGMENT

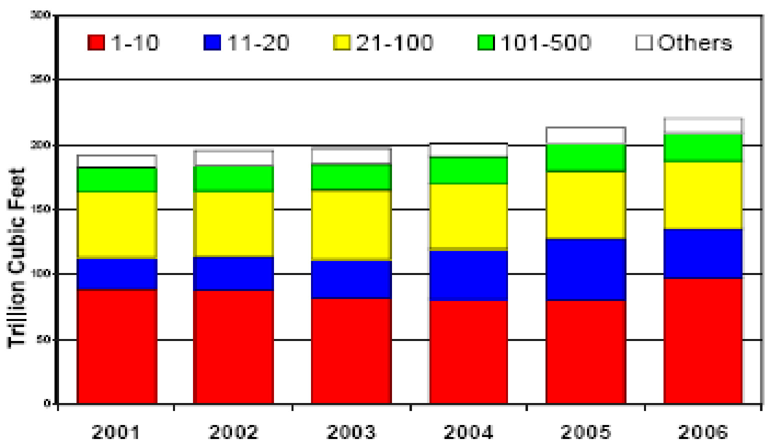
The U.S. upstream oil and gas industry segment (the E&P) is highly concentrated and has an oligopoly structure. The industry segment consists of a few large corporations, the Majors, which control reserves and productions, and numerous small independent companies entering into the industry as a result of the lucrative energy market in recent years.

The U.S. Energy Information Administration (EIA) ranks the reporting companies according to total production size and then places the companies into 5 size classes; Class 1-10, containing the top 10 largest producing companies, Class 11-20, containing the second largest 10 producing companies, Class 21-100 containing next 80 largest companies, Class 101- 500 containing the next 400 largest companies, and Class Others which contains 14,658 small companies.

According to the EIA survey,

> In 2006, the top 20 operators (Class 1-10 and Class 11-20) producing companies had 61 percent of the proved reserves of natural gas. The next two size classes contain 80 and 400 companies and account for 24 and 10 percent of the U.S. natural gas proved reserves, respectively. The top 20 operators had an increase of 19 percent in their natural gas proved reserves from 2001 to 2006. The rest of the operators in (Class 21-100, Class 101-500, and Class Other) had an increase of 7 percent in their reserves in the same time period. In 2006, the top 20 operators' natural gas reserves had an increase of 6 percent from 2005. (EIA 2005 Annual Report)

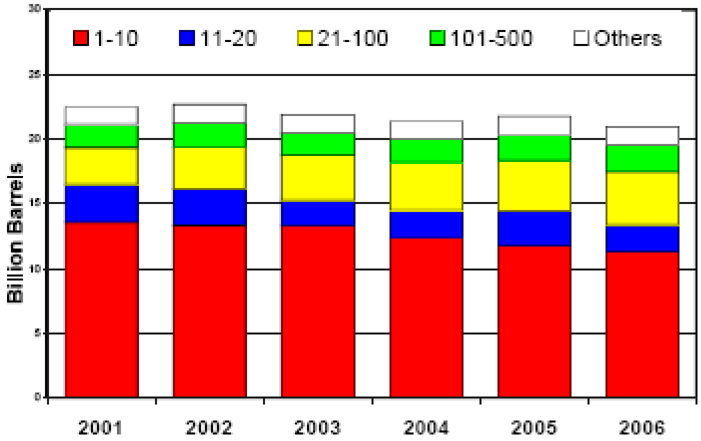
The following chart shows distribution of U.S. proved reserves of natural gas according to the company size for the period 2001-2006:



Source: EIA 2006 Annual Report

The EIA also reports that in the year 2006 the same top 10 producing companies had 54% of the US proved reserves of crude oil. The 20 largest oil and gas producing companies in 2006 had 64% of proved reserves of crude oil.

The following chart shows distribution of U.S. proved reserves of crude oil according to the company size for the period 2001-2006:

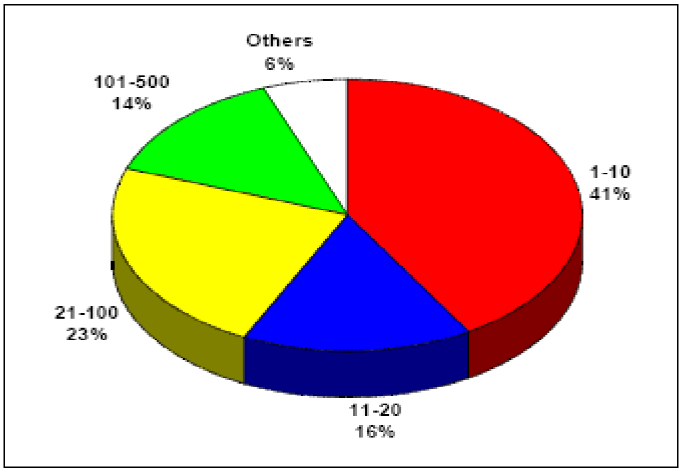


Source: EIA 2006 Annual Report

Similar size distributional numbers hold for production of crude oil and natural gas.

According to the EIA, in the year 2006 the top 20 largest U.S. companies accounted for 57%of wet U.S. natural gas production. The next two size classes had 23% and 14% of wet natural gas production, respectively. Smaller companies (the others) accounted for only 6% of U.S. wet natural gas production in 2006

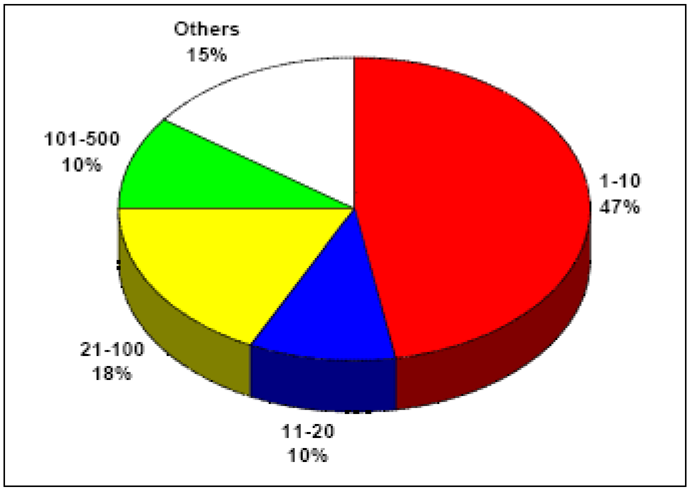
The chart below shows distribution of US natural gas production according to the company size for the year 2006:



Source: EIA 2006 Annual Report

Similarly, the 20 largest oil and gas producing companies had 60% of U.S. production of crude oil in 2006.

The chart below shows distribution of U.S. crude oil production according to the company size for the year 2006:



Source: EIA 2006 Annual Report

Given the commodity nature of oil and natural gas and the fact that prices are uniquely determined by the market, internationally for crude oil, and regionally and nationally for natural gas, it is not possible for independent oil and gas companies to establish competitive advantage through product differentiation and price advantage. Competitive advantage through cost reduction is also not viable for these companies because they are small and it is the major oil companies that enjoy the economies of scale.

The key to competitive advantage in the independent upstream oil and gas industry segment is, therefore, to discover or acquire new opportunities with high potentials, secure them, and act upon them in a timely manner.

ANALYST CERTIFICATION

We, **Mohammad Sharifzadeh, PhD, CFA and Simin Hojat, M.Phil** are, the Research Analyst responsible for the preparation of this Research Report hereby certify that:

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(2) the compensation payable to the Research Analysts, is not, has not, and will not, directly or indirectly, be related to the specific views and opinions expressed by the Research Analysts in this Research Report.

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Mohammad Sharifzadeh, PhD, CFA, is a member of CFA Institute, Los Angeles CFA, and GARP.

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Rating and Price Target Methodology

In arriving at an investment rating and price target, we use the following analytical measures:

1) Potentials and opportunities: Competitive advantage, market potentials, patents, properties, reserves.

2) Risk factors: Regulatory approvals, R&D results, ability to raise capital, going concern issues, competition, industry prospects.

3) Evaluation of the stocks fair value given the company's potentials and risks through various valuation metrics.

RESEARCH RATING SYSTEM

STRONG BUY	**(5)**
BUY	**(4)**
SPECULATIVE BUY	**(3)**
HOLD	**(2)**
SELL	**(1)**
AVOID	**(1)**

DEFINITION OF OUR RATINGS

STRONG BUY (5): Company's stock price appears to be substantially undervalued relative to its future growth potential.

BUY (4): Shares appear to be undervalued in light of several factors.

***SPECULATIVE BUY (3):** Shares appear to offer potential gains though risk is considerably higher. Such a company may have "going concern" problems, or company's future prospects may hinge on critical assumptions, such as (but not limited to) the company's ability to compete effectively in the marketplace, achieve most or all of its stated business goals, maintain sufficient financial liquidity and resources for daily operations, for expansion, and for the avoidance of legal or other pitfalls.

HOLD (2): Shares appear to be fairly valued and while there is no incentive to add such shares, there are similarly no current known compelling factors that would warrant selling absent a subsequent trading drop in value.

SELL (1): At present, shares appear to be overvalued.

AVOID (1): At present, shares appear to be significantly overvalued

***What does "speculative" mean in a rating?**

Companies with meager or no historical data or that are at the development stage, are generally considered highly SPECULATIVE. Such companies may even have "going concern" problems and an analyst recommendation should be considered only as a part of a total investigative process by anyone considering purchase. A speculative buy opinion generally refers to future valuations only if the company is able to achieve most or all of its business goals and avoid most or all of the possible risks, including raising sufficient capital and effectively competing in its marketplace.