



COMPANY UPDATE / ESTIMATE CHANGE

Key Metrics

AREX - NASDAQ - as of	3/9/17	\$2.21
Price Target		\$12.00
52-Week Range	\$1.11 -	\$4.35
Shares Outstanding (mm)		40.6
Market Cap. (\$mm)		\$89.6
1-Mo. Average Daily Volume		961,802
Institutional Ownership		51.1%
Net Debt/Total Capital	Q4'16	47.0%
ROE	FY'16	-9.3%
Book Value / Share	Q4'16	\$13.50
Price / Book Value		0.2x
Dividend & Yield		NA
LTM EBITDA Margin		57.1%

Adjusted EBITDA / Share FY 12/31

		Prior	Current	Prior	Current
	2016A*	2017E	2017E	2018E	2018E
1Q	\$0.21	--	\$0.22	--	--
2Q	\$0.33	--	\$0.26	--	--
3Q	\$0.34	--	\$0.28	--	--
4Q	\$0.37	--	\$0.29	--	--
Year	\$1.22	\$1.57	\$1.05	--	\$1.33
P/E	1.8x		2.1x		1.7x

* - quarterly figures do not sum on share count change

Revenue (\$mm)

		Prior	Current	Prior	Current
	2016A	2017E	2017E	2018E	2018E
1Q	\$17.6	--	\$26.2	--	--
2Q	\$22.4	--	\$29.1	--	--
3Q	\$23.7	--	\$30.8	--	--
4Q	\$26.5	--	\$32.5	--	--
Year	\$90.3	\$118.4	\$118.5	--	\$142.8

Company Description: Ft. Worth, TX – based Approach Resources, Inc. is a junior exploration and production company with a focus on west and south Texas. In 2016 the company produced approximately 4.5Mmboe (million barrels oil equivalent), 62% liquids, from its ~800 net wells and had proved reserves of approximately 156Mmboe, 63% of which was oil and NGLs.

Energy

Analyst: Joel Havard
 J.J.B. Hilliard, W.L. Lyons, LLC
 502.588.1833 / jhavard@hilliard.com
 Institutional Sales Desk: George Moorin
 502.588.9141 / GMoorin@hilliard.com
 March 10, 2017

Approach Resources, Inc.

AREX -- NASDAQ – Long-term Buy-3

Q4'16 Volume -17%, Pricing -19% Yr/Yr; Maintain Rating

Investment Highlights

- Approach reported Q4'16 adjusted EBITDA / share of \$0.37 vs. \$0.66 a year ago; consensus was \$0.36.
- Volume declined 1% sequentially in Q4 to 1.11 Mmboe with no well completions. Average realized pricing improved ~13% sequentially, with gains in all three product categories. All-in costs of \$36.77/Boe were 8% higher yr/yr and up ~5% sequentially.
- Debt to total capitalization was 47% at year-end. However, reflecting January's \$131M debt exchange in, that ratio is currently more like 34%. A follow-on debt exchange offer for the remaining ~\$96M expires March 17. At year-end the company had \$53M of capacity on the revolver and total liquidity of ~\$66M.
- Management's initial 2017 production guidance posits a midpoint decline of ~5% yr/yr. We are holding our volume forecast of 12.2 Mboe/d for 2017 with continued pricing gains partially offset by a firming cost environment. Reflecting the 65% increase in the share count from the recent debt exchange, we are reducing our 2017 adjusted EBITDA/share forecast from \$1.57 to \$1.05 and inaugurating a 2018 forecast of \$1.33.
- We maintain our 24-month target of \$12, at which the shares would trade at an EV/Mcfe of \$0.77, a 79% discount to the sector average of \$3.74, which we believe adequately compensates for the ongoing industry uncertainty. As such, we reiterate our Long-term Buy-3 rating.

Note Important Disclosures on Pages 5-6
Note Analyst Certification on Page 5

ADDITIONAL DISCUSSION

Approach continued to manage the decline curve in Q4, holding production at 12.0 Mboe/d vs. 12.2 Mboe/d in Q3. With no well completions in Q4'16 and some recent weather and pipeline disruptions, we are forecasting production will dip to 11.8 Mboe/d in Q1'17 before this year's Capex program levels volume at ~12.3 Mboe/d over the rest of the year. That scenario keeps our full-year production forecast unchanged at 4.8 Mmboe.

The company is hedged on ~85% of anticipated 2017 gas production and ~50% of NGLs at ~\$2.89/Mcf and ~\$21/Bbl, respectively. Hedges now cover ~50% of our forecasted 2018 gas production at ~\$3.08/Mcf. The lack of oil hedges remains a source of continuing concern for us, given the ugly turn in pricing this week, but we maintain our outlook for a continued recovery into 2018. Q1'17 pricing is in the bag, and the company's costs remain among the lowest in the Permian, although the four year downslope may be flattening.

As such, we are increasing our adjusted EBITDA forecast for 2017 from \$67.1M to \$72.4M and inaugurating a 2018 forecast of \$93.8M. The first phase of AREX's June 2021 7% Senior Notes exchange offer will add ~39M shares to the count in Q1, reducing our 2017 adjusted EBITDA per share forecast from \$1.57 to \$1.05. Our 2018 forecast works out to \$1.33/share. The exchange offer for the remaining ~\$96M of senior notes, which closes March 17, could add another ~30M shares.

Our 24-month price target of \$12 would value the shares at an EV/Mcfe of \$0.77, a ~79% discount to the sector average of \$3.74. Given the challenges of the industry's prolonged cyclical trough, we believe this discount is currently reasonable while providing room for revision as conditions warrant.

SUITABILITY RATING

Our Suitability rating is 3 on a 1-to-4 scale (1 = most conservative, 4 = most aggressive). This reflects our favorable view of the company's relatively high-performing production development and competitive cost structure in the Permian Basin and relatively healthy balance sheet condition. This is balanced, however, against challenging industry-wide market conditions and a modest hedge position for 2017 and 2018.

CONSIDERATIONS AND RISKS

The energy production industry is highly capital intensive and highly competitive and is subject to a range of economic and operational risks. Foremost among these risks may be volatility in the underlying commodity pricing, which is subject to supply and demand fundamentals related to factors such as economic conditions, weather patterns and logistical constraints. The industry is also subject to a range of regulatory risks, including changes in environmental and pollution policies, permitting requirements, and employee benefits obligations. Operating financial risks include success rates and costs related to expansion of the reserve base.

Company-specific risks include the potential for capital constraints that could limit AREX's operational flexibility, future pace of drilling or acquisition opportunities. Additionally, a substantial portion of the company's undeveloped acreage lease-holdings could expire through 2017. Finally, smaller-cap stocks can be subject to pronounced volatility and may not be appropriate for all accounts.

Additional information is available upon request.

Approach Resources, Inc. (AREX)

(\$'s in '000's) FYE Dec.

Income Statement Analysis	FY'14	FY'15	Q1'16	Q2'16	Q3'16	Q4'16	FY'16	Q1'17E	Q2'17E	Q3'17E	Q4'17E	FY'17E	FY'18E
Oil & Gas Sales	\$ 258,529	\$ 131,336	\$ 17,615	\$ 22,433	\$ 23,749	\$ 26,505	\$ 90,302	\$ 26,190	\$ 29,050	\$ 30,810	\$ 32,480	\$ 118,530	\$ 142,810
Costs & Expenses													
Lease Operating	32,701	28,972	6,356	5,234	3,894	3,766	19,250	4,810	4,990	5,180	5,370	20,350	21,350
Severance & Production taxes	15,934	11,085	1,664	1,855	2,013	2,685	8,217	2,230	2,470	2,620	2,760	10,080	12,140
Exploration	3,831	4,439	569	1,622	1,047	685	3,923	950	1,080	1,090	1,000	4,120	4,480
Asset Impairment	-	221,633	-	-	-	-	-	-	-	-	-	-	-
G & A	32,104	28,341	6,051	5,832	5,825	7,026	24,734	5,860	5,950	6,040	6,130	23,980	24,400
D, D & A	106,802	109,319	20,229	19,991	19,422	19,402	79,044	20,130	20,440	20,750	21,060	82,380	84,890
Operating Profit	\$ 67,157	\$ (272,453)	\$ (17,254)	\$ (12,101)	\$ (8,452)	\$ (7,059)	\$ (44,866)	\$ (7,790)	\$ (5,880)	\$ (4,870)	\$ (3,840)	\$ (22,380)	\$ (4,450)
%	26.0%	-207.4%	-98.0%	-53.9%	-35.6%	-26.6%	-49.7%	-29.7%	-20.2%	-15.8%	-11.8%	-18.9%	-3.1%
Investment / Other Gain (Impairment)	(114)	10,735	104	854	(10)	-	948	-	-	-	-	-	-
Interest Inc. / (Exp.)	(21,651)	(25,066)	(6,298)	(6,808)	(7,067)	(7,086)	(27,259)	(4,750)	(4,700)	(4,650)	(4,600)	(18,700)	(21,500)
Realized Commodity Deriv' Gain / (Loss)	2,359	52,489	3,500	1,409	781	442	6,132	-	-	-	-	-	-
Unrealized Comm. Deriv's Gain / (Loss)	42,113	(33,214)	(957)	(8,076)	760	(3,343)	(11,616)	-	-	-	-	-	-
Pre-Tax Income	89,864	(267,509)	(20,905)	(24,722)	(13,988)	(17,046)	(76,661)	(12,540)	(10,580)	(9,520)	(8,440)	(41,080)	(25,950)
Income Tax	33,692	(93,405)	(7,245)	(8,687)	(4,915)	(3,571)	(24,418)	(4,700)	(3,970)	(3,570)	(3,170)	(15,410)	(9,731)
%	37.5%	34.9%	34.7%	35.1%	35.1%	20.9%	31.9%	37.5%	37.5%	37.5%	37.6%	37.5%	37.5%
Extraordinary Items	-	-	-	-	-	-	-	-	-	-	-	-	-
Net Income	56,172	(174,104)	(13,660)	(16,035)	(9,073)	(13,475)	(52,243)	(7,840)	(6,610)	(5,950)	(5,270)	(25,670)	(16,219)
Shares Outstanding	39,418	40,463	41,069	41,564	41,680	41,705	41,488	68,914	69,030	69,150	69,270	69,091	70,800
EPS - GAAP	\$1.43	(\$4.30)	(\$0.33)	(\$0.39)	(\$0.22)	(\$0.32)	(\$1.26)	(\$0.11)	(\$0.10)	(\$0.09)	(\$0.08)	(\$0.37)	(\$0.23)
EPS - Operating, Adjusted	\$0.74	(\$0.37)	(\$0.32)	(\$0.25)	(\$0.23)	(\$0.27)	(\$1.07)						
Margin Analysis													
Production Gross margin	87.4%	77.9%	63.9%	76.7%	83.6%	85.8%	78.7%	81.6%	82.8%	83.2%	83.5%	82.8%	85.1%
Op. Taxes as % of O&G revenues	6.2%	8.4%	9.4%	8.3%	8.5%	10.1%	9.1%	8.5%	8.5%	8.5%	8.5%	8.5%	8.5%
S, G&A as % of O&G revenues	12.4%	21.6%	34.4%	26.0%	24.5%	26.5%	27.4%	22.4%	20.5%	19.6%	18.9%	20.2%	17.1%
D, D & A as % of O&G revenues	41.3%	83.2%	114.8%	89.1%	81.8%	73.2%	87.5%	76.9%	70.4%	67.3%	64.8%	69.5%	59.4%
Rate of Change Analysis													
Revenues	42.6%	-49.2%	-47.1%	-41.9%	-30.0%	4.0%	-31.2%	48.7%	29.5%	29.7%	22.5%	31.3%	20.5%
Op. Inc.	54.1%	nm	nm	nm	nm	nm	nm	nm	nm	nm	nm	nm	-80.1%
EPS - operating	43.0%	nm	nm	nm	nm	nm	nm	nm	nm	nm	nm	nm	-38.3%
Adjusted EBITDDA	47.5%	-34.4%	-73.9%	-57.9%	-53.9%	-42.6%	-59.1%	75.8%	29.0%	34.8%	31.7%	43.4%	29.6%
Shares Out.	1.0%	2.6%	2.3%	2.5%	2.8%	2.7%	2.5%	67.8%	66.1%	65.9%	66.1%	66.5%	2.5%
Working Cap.	-12.5%	-81.2%	45.0%	35.4%	-5.2%	-13.7%	60.5%	12.9%	10.9%	6.1%	5.4%	40.0%	9.9%
Guidance:	Guidance:	vol -11% yr/yr	vol -18% yr/yr	vol -28% yr/yr	vol -17% yr/yr;	Guidance:	3/3- 4.34-4.64	1/26- phase 1 of				Forecasting 4.38	Forecasting 4.45
11/7- vol's +40%	2/25-				11/3- propose	5/3- 4.34-4.64	exchange retires					Mmboe @ 62%	Mmboe @ 62%
on ~70 new wells;	-5.5Mmboe; 5/7-				debt exchange(s)	Mmboe;	\$131M of debt					liquids	liquids
5/8- 4.79Mmboe;	affirm; 8/6-				of \$230M Sr	5/4- affirm;	for 39M shares;						
8/5- 4.95Mmboe;	5.4-5.5;				Notes for 39.3M	8/6- affirm;	1/30- tender						
11/5- "lower end"	11/5- 5.4-5.6				(& ~29.9M)	11/3- affirm;	phase 2						
Actual: 5.05	Actual: 5.53				shares	Forecasting 4.48							
Mmboe @ 69%)	Mmboe @ 65%					Mmboe @ 62%							
liquids.	liquids.					liquids							

Source: Company reports and Hilliard Lyons estimates

Approach Resources, Inc. (AREX) (\$'s in '000s)

Cash Flow Analysis	FY'14	FY'15	Q1'16	Q2'16	Q3'16	Q4'16p	FY'16p	Q1'17E	Q2'17E	Q3'17E	Q4'17E	FY'17E	FY'18E
Net Inc.	56,172	(174,104)	(13,660)	(16,035)	(9,073)	(13,475)	(52,243)	(7,840)	(6,610)	(5,950)	(5,270)	(25,670)	(16,219)
D, D & A	106,802	109,319	20,229	19,991	19,422	19,402	79,044	20,130	20,440	20,750	21,060	82,380	84,890
Unrealized Commod. Deriv. Loss/(Gain)	(42,113)	33,214	957	8,076	(760)	3,343	11,616	-	-	-	-	-	-
Deferred Compensation Exp.	8,247	7,954	1,550	1,374	1,357	1,998	6,279	2,000	2,050	2,100	2,150	8,300	8,920
Deferred Inc. Tax (Charge)/Allowance	33,717	(93,140)	-	-	-	-	-	-	-	-	-	-	(29,379)
(Increase) Decrease in Wrkg. Cap.	(6,586)	(37,533)	3,903	4,451	(892)	(2,210)	5,249	1,800	1,720	1,060	1,000	5,569	1,934
Operating C.F.	156,239	(154,290)	12,979	17,857	10,054	9,058	49,945	16,090	17,600	17,960	18,940	70,579	50,146
(Cap. Ex.)	(3,024)	(67)	(3)	(12)	-	(50)	(65)	(20)	(20)	(20)	(20)	(80)	(88)
(Development & Acquisition Exp.)	(390,506)	(151,178)	(4,874)	(6,871)	(5,554)	(2,501)	(19,800)	(7,500)	(15,000)	(17,500)	(10,000)	(50,000)	(55,000)
Asset Sales / (Disposals)	(181)	-	-	-	-	-	-	-	-	-	-	-	-
(Dividends)	-	-	-	-	-	-	-	-	-	-	-	-	-
Free C.F.	(237,472)	(305,535)	8,102	10,974	4,500	6,507	30,080	8,570	2,580	440	8,920	20,499	(4,942)
ST Debt Drawn	353,921	272,000	12,600	21,000	7,000	-	40,600	-	-	-	-	-	5,436
(ST Debt Repaid)	(203,921)	(149,000)	(13,600)	(18,000)	(7,000)	(1,660)	(40,260)	(7,280)	(2,190)	(370)	(7,580)	(17,420)	-
LT Debt Drawn	-	-	-	-	-	-	-	-	-	-	-	-	4,448
(LT Debt Repaid)	-	(8,722)	-	-	-	-	-	(130,500)	-	-	-	(130,500)	(4,003)
Stock Issued	-	-	-	-	-	-	-	-	-	-	-	-	-
(Stock Repurchased)	-	-	-	-	-	-	-	-	-	-	-	-	-
Net C.F.	(87,472)	(191,257)	7,102	13,974	4,500	4,847	30,420	(129,210)	390	70	1,340	(127,421)	939
Adjusted EBITDA	188,282	123,553	8,698	13,712	14,145	15,468	50,512	15,290	17,690	19,070	20,370	72,420	93,840
Adjusted EBITDA / Share	\$4.78	\$3.05	\$0.21	\$0.33	\$0.34	\$0.37	\$1.22	\$0.22	\$0.26	\$0.28	\$0.29	\$1.05	\$1.33
yr/yr change	46%	-36%	-75%	-59%	-55%	-44%	-60%	5%	-22%	-19%	-21%	-14%	-
EBITDDA as % of O&G Sales	72.8%	94.1%	49.4%	61.1%	59.6%	58.4%	55.9%	58.4%	60.9%	61.9%	62.7%	61.1%	65.7%
CF Multiple	1.3x	0.6x	-	-	-	-	-	-	-	-	-	-	-
Balance Sheet Analysis	FY'14	FY'15	Q1'16	Q2'16	Q3'16	Q4'16p	FY'16p	Q1'17E	Q2'17E	Q3'17E	Q4'17E	FY'17E	FY'18E
Cash	430	600	840	893	2,708	21	21	2,500	2,890	2,960	4,300	4,300	5,200
Accounts Receivable	19,635	11,889	7,372	7,933	8,115	10,200	10,200	10,500	11,600	12,300	13,000	13,000	21,400
Other Current Assets	3,210	7,949	8,004	3,347	2,254	2,250	2,250	2,250	2,250	2,250	2,250	2,250	30,000
Total Current Assets	61,079	20,438	16,216	12,173	13,077	12,471	12,471	15,250	16,740	17,510	19,550	19,550	56,600
Net PP&E	1,331,659	1,154,546	1,138,868	1,124,282	1,109,504	1,092,061	1,092,061	1,089,520	1,094,320	1,101,470	1,100,960	1,100,960	1,096,630
Other Assets	11,692	1,212	-	-	-	-	-	-	-	-	-	-	-
Total Assets	1,404,430	1,174,984	1,155,084	1,136,455	1,122,581	1,104,555	1,104,555	1,104,770	1,111,060	1,118,980	1,120,510	1,120,510	1,153,230
ST & Current Portion of LT Debt	-	-	-	-	-	-	-	-	-	-	-	-	-
Accounts Payable	33,336	10,799	13,767	10,151	9,098	9,199	9,199	15,710	17,430	18,490	19,490	19,490	14,280
Oil & Gas Payables	8,536	4,245	3,211	4,196	4,171	4,170	4,170	4,170	4,170	4,170	4,170	4,170	4,170
Other Current Liabilities	64,980	13,464	10,971	13,957	13,232	13,000	13,000	13,000	13,000	13,000	13,000	13,000	13,000
Total Current Liabilities	106,852	28,508	27,949	28,304	26,501	26,369	26,369	32,880	34,600	35,660	36,660	36,660	31,450
Credit Facility	150,000	270,748	269,917	273,431	273,561	271,899	271,899	264,620	262,430	262,060	254,480	254,480	259,920
Sr. Notes (Jun'21)	250,000	225,839	226,042	226,246	226,450	226,450	226,450	95,950	95,950	95,950	95,950	95,950	95,950
Deferred Inc Tax & Other LT Liabilities	123,251	41,922	35,325	27,292	22,606	16,885	16,885	17,050	17,220	17,390	17,560	17,560	18,260
Shareholders' Equity	774,327	607,967	595,851	581,182	573,463	562,950	562,950	694,270	700,860	707,920	715,860	715,860	747,650
Book Value per share	\$19.64	\$15.03	\$14.51	\$13.98	\$13.76	\$13.50	\$13.57	\$10.07	\$10.15	\$10.24	\$10.33	\$10.36	\$10.56
Current Ratio	0.6x	0.7x	0.6x	0.4x	0.5x	0.5x	0.5x	0.5x	0.5x	0.5x	0.5x	0.5x	1.8x
LT Debt/Cap.-Net of Cash	24.4%	27.0%	27.4%	27.9%	28.0%	28.7%	28.7%	11.8%	11.7%	11.6%	11.3%	11.3%	10.8%
Total Debt/Cap.-Net of Cash	34.0%	44.9%	45.3%	46.1%	46.3%	47.0%	47.0%	33.9%	33.6%	33.3%	32.5%	32.5%	31.8%
ROE: DuPont	7.3%	-28.6%	-9.2%	-11.0%	-6.3%	-9.6%	-9.3%	-4.5%	-3.8%	-3.4%	-2.9%	-3.6%	-2.2%

Source: Company reports and Hilliard Lyons estimates

Analyst Certification

I, Joel K. Havard, hereby certify that the views expressed in this research report accurately reflect my personal views about the subject company(ies) and its (their) securities. I also certify that I have not been, am not, and will not be receiving direct or indirect compensation in exchange for expressing the specific recommendation(s) in this report.

Important Disclosures

Hilliard Lyons' analysts receive bonus compensation based on Hilliard Lyons' profitability. They do not receive direct payments from investment banking activity.

Suitability Ratings

- 1** - A large cap, core holding with a solid history
- 2** - A historically secure company which could be cyclical, has a shorter history than a "1" or is subject to event driven setbacks
- 3** - An above average risk/reward ratio could be due to small size, lack of product diversity, sporadic earnings or high leverage
- 4** - Speculative, due to small size, inconsistent profitability, erratic revenues, volatility, low trading volume or a narrow customer or product base

Investment Ratings

Buy - We believe the stock has significant total return potential in the coming 12 months.

Long-term Buy - We believe the stock is an above average holding in its sector, and expect solid returns to be realized over a longer time frame than our Buy rated issues, typically 2-3 years.

Neutral - We believe the stock is an average holding in its sector, is currently fully valued, and may be used as a source of funds if better opportunities arise.

Underperform - We believe the stock is vulnerable to a price setback in the next 12 months.



Rating	Hilliard Lyons Recommended Issues		Investment Banking Provided in Past 12 Mo.	
	# of Stocks Covered	% of Stocks Covered	Banking	No Banking
Buy	35	29%	14%	86%
Hold/Neutral	71	59%	6%	94%
Sell	15	12%	7%	93%

As of 8 March 2017

Other Disclosures

Opinions expressed are subject to change without notice and do not take into account the particular investment objectives, financial situation or needs of individual investors. Employees of J.J.B. Hilliard, W.L. Lyons, LLC or its affiliates may, at times, release written or oral commentary, technical analysis or trading strategies that differ from the opinions expressed here.

J.J.B. Hilliard, W.L. Lyons, LLC is a multi-disciplined financial services firm that regularly seeks investment banking assignments and compensation from issuers for services including, but not limited to, acting as an underwriter in an offering or financial advisor in a merger or acquisition, or serving as placement agent in private transactions.

The information herein has been obtained from sources we believe to be reliable but is not guaranteed and does not purport to be a complete statement of all material factors. This is for informational purposes and is not a solicitation of orders to purchase or sell securities. Reproduction is forbidden unless authorized. All rights reserved.