

# NOW HIRING

Five chief executive officers, representing a cross-section of independents, all foresee good things in 2000.

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**UPR's George Lindahl, left, Cross Timbers' Bob Simpson, center, and Unit Corp.'s King Kirchner are all bullish on 2000 gas prices. Kirchner and Simpson are cautious about oil prices.**

The 1998-99 oil price collapse was stunning, but the strength and suddenness of the 1999 oil price recovery has been just as swift. The roller-coaster oil price ride has left many E&P company executives shaking their heads and agreeing that change is the only constant that they can predict.

In the third quarter, many exploration and production companies started expanding their capital expenditure budgets for the rest of 1999. Drilling activity began to pick up. *Oil and Gas Investor* contacted five chief executive officers, seeking their observations on the state of the industry and the outlook for each of their companies for the coming 12 months. They are as follows:

**George Lindahl III, chairman, president and CEO of Union Pacific Resources Group Inc.** (NYSE: UPR), with a market capitalization of \$4.5 billion. Fort Worth-based UPR is one of the largest North American independents, with international operations in Guatemala, Venezuela, Brazil and Argentina. In the U.S., UPR has been the most active driller for the past seven years.

UPR is not in the market to do any big acquisitions in 2000, but Lindahl is keeping an eye on the market, just in case an opportunity emerges.

"As the majors sell off selected assets during the next several years in the U.S. and Canada, if they sell assets in our backyard, we could be in the market for a large deal," says Lindahl, who

was promoted to CEO this past summer. He has been UPR's president and chief operating officer since 1996.

**Bob R. Simpson, chairman and CEO of Cross Timbers Oil Co.** (NYSE: XTO), with a market cap of \$572 million. The Fort Worth-based company acquires, exploits and develops long-lived producing properties in Texas, Oklahoma, Kansas, New Mexico, Arkansas, Wyoming and Alaska.

In August, Simpson said, in a news release, that his strategic goals for 2000 include having cash flow of \$4 per share from operations, proved reserves of 40 million cubic feet equivalent (Mcf) per share, and debt of 40 cents per Mcf. These goals assume \$2.70-per-Mcf and \$21-per-barrel Nymex prices for gas and oil.

**King P. Kirchner, chairman and CEO of Unit Corp.** (NYSE: UNT), with a market cap of \$300 million, including long-term debt. Tulsa-based Unit is a diversified energy company that finds and produces oil and gas and is a contract driller of onshore oil and gas wells. Operations are principally in the Midcontinent, including the Anadarko, Arkoma, Permian and Gulf Coast basins.

Kirchner says his company is committed to the natural gas market. Its E&P subsidiary, Unit Petroleum Co., replaced 100% of first-half 1999 production—8.8 billion cubic feet equivalent (Bcfe). That was despite a 62% decrease in drilling, compared with that of the first half of 1998. Kirchner anticipates Unit Petroleum will





**Southwestern Energy's Harold Korell says the company prefers organic growth at this time, through the drill bit, rather than via financial engineering.**

drill twice as many wells in 2000, as it did in 1999.

**Harold M. Korell, president and CEO of Southwestern Energy Co.** (NYSE: SWN), with a market cap of \$224 million. The Fayetteville, Arkansas-based Southwestern Energy has completely overhauled its executive management in the past two years. Korell became CEO in January 1999. An integrated company focused on gas, Southwestern Energy was started in 1929 as a local gas distribution company. Today, the company also finds, produces, markets and transports gas. About 80% of its cash flow is from gas production. Its exploration and production activities are concentrated in Arkansas, Oklahoma, Texas, New Mexico and South Louisiana.

Korell is very bullish on Southwestern Energy because it has changed substantially in a short time. "We are small, in terms of reserves. However, we now have the inventory of prospects to drill, a high-powered staff, and a low operating cost structure, and cash flow from our utility is stable," he says.

**Michael L. Harvey, president and CEO of Cheniere Energy Inc.** (Nasdaq: CHEX), with a market cap of \$40 million. This past summer, Harvey joined and became CEO of the Houston-based development-stage company, which finds, develops and exploits oil and gas fields along the Louisiana Gulf Coast, onshore and in shallow water.

## GENERAL OUTLOOK

**Investor** What is your outlook for the industry as a whole in 2000? Are you cautious or bullish?

**Harvey** I'm really bullish. I think next year is going to be a remarkable year for the oil industry. We're going to see an increase in oil and gas prices, and an increase in demand for goods, services and prospects. It's a cyclical business so how long does the cycle last? Probably 18 to 24 months.

**Lindahl** We would not be surprised to see oil and gas trade north of \$20 a barrel and \$2.60 per Mcf for the year. Obviously, those prices would lead to a very strong year for E&P companies. However, with the massive layoffs and consolidation that have occurred in the service industry, the ability to quickly ramp up drilling and completion may prove quite difficult. And, a note of caution: "The cure for high prices is high prices."

**Simpson** I'm particularly bullish on gas since the supply appears to be declining, due to less drilling and the maturing of the Gulf of Mexico Shelf. On the oil side, I am a bit more cautious because OPEC is always a wild card. All in all, I would call myself cautiously bullish.

**Kirchner** We are cautious on oil because pricing is so dependent on OPEC. We are very bullish on gas, in that we believe growing U.S.

demand will support prices of \$2.50 per Mcf or more and that will result in substantially increased gas drilling. Our rig fleet is poised to participate in what we believe will be a strong market for several years.

**Korell** I'm bullish about commodity prices, yet cautious at the same time. I've been in the business long enough to know the price we see for oil and gas today won't last forever. I hope this industry does a better job in how it uses money and creates value, in the future. One of my pet peeves is that so much money has been raised and then, wasted. I hope Wall Street will be selective in whom it raises money for.

But we prefer to focus not on spending money, but on investing money. That is one of the problems I've had with the idea of acquiring properties.

## DRILLING BUDGETS

**Investor** How does your budget for 2000 compare with your budgets for 1999 and 1998?

**Lindahl** For 1999, UPR's capital budget is \$500 million, divided between \$450 million in development and \$50 million for exploration. For 2000, it's going to be around \$700 million total, with \$600 million for development and \$100 million for exploration. The second half of this year we are operating about 20 rigs, basically, in North America. Our budget of \$700 million would operate about 50 rigs next year.

**Kirchner** The number of Unit wells will be greater. In 1998, we drilled 68 wells, and we'll probably only do about 50 in 1999. We're on target to drill approximately 100 in 2000.

**Korell** The starting point for us is that we want to live within our cash flow. Therefore, the likelihood is that Southwestern Energy will spend \$55- to \$60 million in 2000, which is about 10% to 20% more than in 1999. We think we can add value at this level. In 1999, we spent \$52 million and in 1998, about \$50 million.

**Harvey** As of early October, Cheniere had drilled four wells and had two discoveries for the year. In 2000, we're anticipating drilling 12 wildcat wells plus follow-up development wells. Budget-wise, we will be somewhere between \$5- to \$20 million net to Cheniere. Until jackup dayrates reach \$35,000 to \$40,000, we're going to drill as many wells as we can.

**Simpson** In terms of dollars, Cross Timbers' budget will increase by about a third from somewhere around \$90 million this year to \$120 million next year. In 1998, it was around \$80 million. That would be the exploitation budget, not including acquisitions.

## M&A PLANS

**Investor** Do you anticipate buying or selling property in 2000?

**Korell** The strategy at Southwestern Energy is built around adding \$1.20 to \$1.30 of discounted value for every dollar we spend on drilling. M&A is not the main focus, although

we could acquire something opportunistic in our focus areas, similar to our recent \$9.2-million purchase of Permian Basin assets from Petro-Quest, a private Midland firm.

We will also continue to clean up the more mature or "low-end" part of our portfolio, primarily at auction. At this stage, we prefer organic growth through the drill bit rather than financial engineering.

**Kirchner** At Unit, we are constantly reevaluating our portfolio, selling minor properties from time to time. We are always looking for acquisitions, although we are not able to predict the timing on those.

**Harvey** No, we won't be buying. I think the market is overheated. Recognizing that this is a commodity business, my fear is that if you win the acquisition, you lose the economics. That's why we stick to the exploration business where we have control of the costs.

In the cycle we're in, the costs of goods and services are still depressed; however, the price of the product is escalating, so we have a window of opportunity to capture prospects at lower finding and developing costs. It will take six to 12 months for service-company demand to catch up. That is the window in which we expect Cheniere to have its greatest growth.

**Lindahl** In the last 14 months, UPR sold \$2 billion of assets, so anything going forward right now would be just small, noncore divestitures. From an acquisitions standpoint, we've earmarked about \$100 million of our \$600-million development capital budget for niche acquisitions in our core areas. We're not in the market to do any big M&A deals.

**Simpson** Cross Timbers has done about \$500 million of acquisitions this year already, and I would guess that next year we will do from zero to that amount, depending on what's available. We are in such good shape, as far as having ample opportunity already, that we don't need to do another acquisition. But if I see something that really fits, I'll always go after it.

We've always been active in acquiring from the majors, and the numbers I hear of coming divestitures from the majors' megamergers are \$10- to \$15 billion in properties. Within that, there could be something that we want.

## KEY PROJECTS

**Investor** What 2000 project will be most accretive to earnings?

**Lindahl** UPR has three projects that, if any one works, could be very accretive. The first is a gas discovery on our land grant in the Green River Basin of southwest Wyoming. We drilled a horizontal discovery this year that looks like it could be very significant. In South Louisiana, we are drilling three deep wildcats that each has large reserve potential. It could be very meaningful to the company if any one of the three works.

In Guatemala, we are going to drill a couple of exploration oil wells that are each 50- to 100-million-barrel targets. They are very near

our pipeline. If they work, they would come on production very quickly and add a lot of accretive value in 2000.

**Kirchner** Probably the greatest leverage to Unit would be increased rig utilization. We're really optimistic about that. On the production side, we're primarily involved in low-risk drilling prospects. As a result, there's not really one specific prospect that we focus on but acquisitions could always change that picture.

**Harvey** Currently, Cheniere is reprocessing a 9,000-square-mile 3-D seismic database. That data has been around for awhile but we are reprocessing it to see new things that couldn't be seen on the old data. We expect to generate a number of drillable prospects from this.

We've already started taking delivery, and the initial comparative results—the before and after—are striking in terms of what can be seen. The prospects that we will generate using this reprocessed data are going to provide the best opportunities for us in terms of drilling and return on the drilling dollar.

**Korell** Southwestern Energy's balanced portfolio makes that hard to answer. Our low-risk Arkoma properties give us predictable results and steady cash flow. Our medium-risk Permian Basin assets have been a big success for us, and we'll focus more dollars there in 2000.

The area that could have the biggest impact will be the Gulf Coast region, where we'll drill eight exploration prospects by the end of the first quarter. These expose us to 275 billion cubic feet equivalent of net unrisks reserves, versus the 350 Bcfe we have now. So, that's a significant opportunity. One well is in Texas state waters and the rest are onshore.

**Simpson** I think the one project that will be on the forefront will be the Arkoma Basin, where we spent \$500 million. We bought about 120 million cubic feet of daily production, and we continue to make that better. Our East Texas and San Juan Basin properties that we bought in the last two years will come more to the forefront. Those three areas—East Texas, San Juan and Arkoma—will be our highlights.

## HIRING

**Investor** Will you be doing any hiring in 2000? If so, in what areas?

**Harvey** Yes, we plan on increasing our drilling so Cheniere is hiring geologists, geophysicists, production engineers and accountants.

**Kirchner** Yes, we do anticipate we will be hiring. Unit has 47 rigs and 32 of them are working currently. As our rig utilization increases, we will hire people to meet those requirements. Also, as we grow the production side of the business, we're going to have to hire some personnel. We are anticipating drilling a lot more wells next year so that means more geologists, engineers and accountants.

**Simpson** Since we are growing, we will be a net hirer. I would guess probably 5% to 10%



**Cheniere Energy's Michael Harvey says the company is adding to its geoscience department as well as hiring accountants.**

"...The numbers I hear of coming from divestitures from the megamergers are \$10- to \$15 billion of properties. Within that, there could be something that we want." Bob Simpson, Cross Timbers Oil Co.

## AT WHAT PRICE GLORY?

Oil and Gas Investor asked what price deck these companies are using for 2000 and what their hedging strategies are.

**UPR** \$17.50 a barrel for West Texas Intermediate and \$2.40 an Mcf for natural gas. CEO George Lindahl says he is going to layer in hedges in small increments using a combination of floors and ceilings. For 2000, UPR has hedged about 20% for both oil and gas.

**Cross Timbers** Stated performance goals are based on \$21 oil and \$2.70 gas, but CEO Bob Simpson says rate-of-return models are built on lower prices, with expectations pegged at 50% or better for exploitation projects. Cross Timbers is basically unhedged.

**Unit Corp.** \$20 oil and \$2.40 gas, although CEO King Kirchner says projections change often, given volatility in pricing. Unit does minor hedging and usually only short-term.

**Southwestern Energy** \$18 for oil and \$2.30 for gas is the company's base case, which may be conservative, but CEO Harold Korell says he would rather have some upside and not have to retrench like other companies did in early 1999.

Southwestern Energy took advantage of high August prices to hedge about half of its summer production, compared with about a quarter of production hedged in the first and fourth quarters.

**Cheniere Energy** \$21 oil and \$2.70 gas, based on the futures market 12-month strip price. Cheniere's production started in September 1999. CEO Michael Harvey expects to hedge 40% of production commencing the first of 2000.

*Note: All price decks and hedging strategies in effect as of early October 1999.*

personnel growth, given the properties we own today. We will hire across the board in professional skills, engineering, accounting and related support staff. I think we have the field people. We've absorbed people with the acquisitions, and it ripples upward once we buy something.

**Lindahl** Yes, UPR will hire on a very selective basis to fill certain needs or fill attrition, obviously, but we think the organization is pretty much right-sized today. We had a 23% reduction in our workforce in 1999, and that was somewhat related to the downturn, but it was more related to the Norcen Energy Resources acquisition last year. Norcen brought us Canada and Latin America where we really had no people. So going forward, we are going to be spending money in Canada and Latin America, and we didn't need as many people domestically as we had.

**Korell** You may remember Southwestern Energy totally rebuilt its E&P business from top to bottom in 1998, so we basically have a new engine under the hood. If there is any additional hiring, it will be minimal, such as for one specific position. I feel we're positioned to go with the staff we have.

## PUBLIC MARKETS

**Investor** Do you anticipate going to public markets for money in 2000?

**Simpson** Yes, we probably will. We've done a royalty trust in 1999 called the Hugoton Royalty Trust, and we raised about \$150 million there. I would look, given our current financial structure, to raise between \$150 million and \$200 million in the next 18 months. We prefer equity but not at current prices so we are waiting on that situation.

We got enough properties bought ahead of the crowd. We've got our financing arranged in a way where we can be patient on placing the equity. I need the equity to be 50% higher than where it is now before it makes sense. We will be accessing that market, and I think it will be the first or second quarter of 2000.

**Lindahl** No, unless the majors divest something in UPR's backyard in Texas, Canada or in the Rockies. That would be the exception where we could possibly go to the public markets to help finance that type of deal. But outside of that, no, we don't have plans to go to the public markets.

**Korell** Southwestern Energy wants to take advantage of the prospect-generating machine we've created and focus on drilling, which, as I said, will be funded on cash flow. We don't want to get ahead of ourselves. As we move along and prove our strategy, there may be a time when we go to the market but historically, we've not accessed the public markets in the past, so we want to be careful if and when we do. Outside the possibility of a large acquisition, we don't have plans for anything currently, especially in the debt markets.

**Kirchner** We just finished an equity transaction. We bought all of Parker Drilling Co.'s Lower 48 land drilling fleet for \$40 million in cash and a million shares of common stock. Unit completed a \$53-million equity offering to fund the cash portion of the transaction. We probably will not go to the public markets in 2000 unless we complete another significant acquisition.

**Harvey** Yes, next year, we'll probably raise additional money. We expect to raise capital in the fourth quarter of 1999, using a private placement of convertible preferred stock and also a private placement of convertible debt. □