

PETROLEUM FINANCE WEEK™

Independent News and Analysis on Capital Formation and Corporate Performance

UNIT CORP. BEEFS UP ITS E&P DIVISION WITH PETROCORP ACQUISITION

Unit Corp. (NYSE: UNT) agreed to buy fellow Tulsa-based producer **PetroCorp Inc.** (Amex: PEX) for about \$190 million. Though the sale beefs up the E&P division of Unit, the company's soon-to-be president said it is not at the point where it would consider splitting its E&P group and its drilling group into separate entities.

"In our minds, we still need critical mass, and primarily on the E&P side," Larry Pinkston, Unit executive vice president, treasurer and chief financial officer, told *Petroleum Finance Week*.

Unit has 75 rigs, with its 76th under construction, but would like to have closer to 100 rigs before it would consider forming a separate drilling company, said Pinkston, who will add president to his list of titles on Aug. 1.

On the E&P side, the PetroCorp deal gives Unit about 340 billion cubic feet of gas equivalent (Bcfe) in reserves. The company would like to be in the 600-Bcfe range before it contemplates a split.

That's not to say that Unit has definite plans to divide, however. "It's not a goal, but it's an option we'd like to have at some point in time," he said.

Allen Brooks, an analyst with **CIBC World Markets**, wrote in a report that Unit is currently undervalued because of its drilling/E&P combination.

"In comparing Unit's current valuation with other U.S. land drillers, the valuation discount is obvious," Brooks wrote. "Today, Unit is trading at 15.0 times our 2004 earnings-per-share estimate of \$1.40, representing a 21 percent valuation discount to the land drilling average 2004 consensus multiple of 22 times."

"In this case, the sum of the parts may be greater than the whole," Brooks wrote.

Unit will pay for PetroCorp with a combination of 2 million shares and cash. Brooks estimated the price at \$1.40 per thousand cubic feet equivalent of reserves. PetroCorp traded as high as \$14 the day the deal was announced. The previous day, it had closed at \$11.15. The transaction is dependent upon PetroCorp shareholder approval.

Allocation of the purchase price is about \$101 million to working capital, \$78 million to proved reserves and \$11 million to undeveloped leasehold and partnership interest.

Unit and PetroCorp First-Quarter Results At A Glance

	Unit	PetroCorp
Oil and Gas Revenues (\$M)	33,248	9,803
Contract Drilling Revenues (\$M)	35,622	--
Other Revenues (\$M)	632	38
Total Revenues (\$M)	69,502	9,841
Operating Expenses (\$M) (1)	48,873	4,806
Operating Income (\$M)	20,629	5,035
Net Income Per Diluted Share (\$) (2)	0.29	0.24
Oil Production (Mbbbl)	114	114
Gas Production (MMcf)	4,855	938
Total Rigs	75	--
Average Rig Utilization (%)	68	--

Source: Company first-quarter results (1) Excludes interest expenses. (2) Does not include income from PetroCorp's discontinued operations.

From the publishers of

PetroCorp explores for and develops oil and gas primarily in the Midcontinent and Gulf Coast regions, and has proved reserves of 55 Bcfe. Pinkston said Unit liked PetroCorp's development potential in South Texas and its established production in Oklahoma. Earlier this year, PetroCorp sold its Canadian subsidiaries to an affiliate of **Enerplus Resources Fund** (NYSE: ERF) for about US\$112 million, which allowed it to retire all its existing debt and gain \$33.5 million.

That deal also prompted PetroCorp to consider a sale, Pinkston said. "They were too small to stay out there as a public company."

Unit had 269.4 Bcfe of reserves as of year-end 2002, primarily in the Anadarko and Arkoma Basins. Its 75 onshore rigs are in the Anadarko and Arkoma basins, the Rocky Mountains and the Texas and Louisiana Gulf Coast.

It is anticipated that the deal will be immediately accretive to Unit's earnings and cash flow per share. After the deal was announced, Unit was trading up 5 cents from its previous-day close of \$20.91. Brooks' price target is \$25.

Unit is currently undergoing some leadership changes. Last month, the company announced that King Kirchner, a company founder, will retire as chairman of the board effective Aug. 1, the company's 40th anniversary. He will remain on the board. John G. Nikkel, Unit president and chief executive officer, was elected to succeed Kirchner as chairman. Nikkel will give up his role as president to Pinkston.

—*Jodi Wetuski*