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Shares fall after WPX introduces new operating model

By: D. Ray Tuttle The Journal Record October 9, 2014 0

TULSA – WPX Energy unveiled a revamped company model that CEO Rick Muncrief said will produce a fivefold jump in oil production, triple operating margins and bolster the firm's overall value – all by 2020.

While it was a welcome development, the news merely reinforced Wall Street's existing view of WPX's potential, likely driving no major positive reaction in shares, according to a published note by the equity firm Robert W. Baird and Co.

Despite the company revealing the new strategy, WPX shares were lower in trading Thursday, along with most oil and gas companies.

WPX stock tumbled 8.49 percent, or $1.83 per share, on the New York Stock Exchange. Meanwhile, a sell-off in the Dow Jones industrials erased Wednesday's gains. The Dow was down 1.97 percent Thursday.

Baird remained cautious following the event, analyst Daniel P. Katzenberg said.

"We like the more focused approach, but are sidelined until we see consistency in WPX operating results," Katzenberg said in an email.

WPX will narrow its geographic focus over the next five years, Muncrief said.

WPX's core resource plays will be the Williston Basin in North Dakota, the San Juan Basin in New Mexico and the Piceance Basin in Colorado, Muncrief said. Those regions have about 16,000 remaining drillable locations, 480,000 net acres and more than 14 trillion cubic feet of proved, probable and possible oil and gas reserves as of December 2013.

"We have upside in all three," Muncrief said as he outlined the scenario during a teleconference with analysts. "Our strategy accelerates our oil development and capitalizes on what we can gain from technical excellence and new technology.

"All three of our core resource plays have opportunities to increase returns through cost reductions and other operational efficiencies by driving down development costs," Muncrief said.

Dave Meats, an equity analyst with Morningstar Inc., wrote in an email that putting the spotlight on driving down drilling costs was a positive sign.

At the same time, WPX is exiting the Marcellus Shale in the northeastern United States, Muncrief said.

The WPX Marcellus acreage was not optimally located, Meats said.

"The divestment makes sense," Meats said. "Raise capital to fund development in more attractive assets."

In addition, WPX has trimmed employment to align with the multiyear strategy, Muncrief said. This summer WPX completed an early retirement program in which more than 100 people accepted offers, Muncrief said. The action cut employment about 15 percent, reducing the companywide workforce to about 1,050.

Despite the recent emphasis on oil and liquids growth, WPX remains a natural gas company, said Qian Zhang, a market analyst with Tulsa-based Fredric Russell Investment Management Co.

"Almost 80 percent of WPX Energy's sales are U.S. natural gas," Zhang said. "That makes the company exposed to ongoing weakness in North American natural gas prices."

Zhang said that with WPX's announced new emphasis on oil, investors could expect strong growth in oil output through 2020 through production growth in the Bakken, San Juan and Piceance.

The company's move toward crude is noticeable. In 2012, oil accounted for 8 percent of WPX's equivalent production, Muncrief said. In 2013, oil accounted for 10 percent. During the second quarter 2014, oil comprised 14 percent of equivalent volumes. Over the same time frame, oil sales as a percentage of WPX total product revenues rose from 23 percent to 37 percent.

WPX Energy's business model will become more diversified through the long-term strategy, Zhang said.

Yet there are hurdles.

The biggest challenge will be bringing down Bakken well costs, which are above average compared to its peers, Katzenberg said. Other obstacles include increasing drilling inventory in oil plays and San Juan Gallup production.

"Crude growth outlook is impressive, and we could get upside if the Gallup improves in 2015, but we are awaiting updates on these areas before getting more bullish on the stock," Katzenberg said.

Already WPX is executing its strategy by completing its first two 7,500-foot laterals in the San Juan's Gallup oil play and implementing 6 million-pound completions in the Williston Basin, Muncrief said. Early results from doubling the stimulation size showed a 14-percent production increase from three Bakken Shale wells and a 13-percent increase from three wells in the Three Forks formation.

During its spinoff more than two years ago, WPX's portfolio consisted of assets in eight areas – seven domestic plays along with South American interests through ownership in Apco Oil and Gas International. This year, however, WPX announced the sale of its coal-bed methane assets in Wyoming and other assets in the Mid-Continent and the northeastern U.S., along with its international interests in Apco.

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