EXTRACTION IPO

Extraction IPO success seen as indicator of better markets

BY DAN LARSON • FOR ENERGY PIPELINE

SUCCESS IN THE OIL AND NATURAL GAS business cannot happen without money and lots of it. Usually, that money comes from selling part ownership in the company to private investors or selling to the public on the stock market.

For Extraction Oil & Gas, a company founded in 2014 and grown through private equity investments, offering the public an ownership stake in the company gives it access to the additional dollars needed to drive growth and solidify its future. After three weeks on the market, public investors liked what they saw by the end of October in the Denver-based company.

In an industry hammered for a year and a half by historic low prices, an oil and gas company IPO is regarded as risky. Indeed, the overall IPO market has seen a lackluster year with several high-profile tech and health care IPOs earning the investor equivalent of a Bronx cheer.

So the apparent success of Extraction's IPO quickly attracted attention in the media and the favor of investors.

Noted as the first oil and gas IPO in more than two years, Extraction's public offering of 33.3 million shares at $19 each commenced Oct. 12 on the NASDAQ. The IPO saw immediate positive movement and by Election Day, shares were trading at $21.05.

According to market analysts, timing plays a critical role in the success or failure of an IPO.

"This IPO could be seen as a bit premature or not, depending on what its private equity backers are looking for," said Bernadette Johnson, a managing partner at Ponderosa Energy in Denver.

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> **BERNADETTE JOHNSON**
> Ponderosa Energy managing partner

"The oil market will remain volatile in the short term and the share price will reflect that. But prices will eventually rise, making an investment in the right producer a good bet," Johnson said.

"There is also a general sentiment that the equity market is overheated so Extraction's private equity backers may see this as a good time to IPO," she added.

Johnson noted that another important factor influencing the timing of Extraction's IPO was related to Colorado's election ballot and what was not on it this year.

A week before Labor Day, Colorado Secretary of State Wayne Williams announced that a pair of initiatives that would have restricted new oil and gas development did not qualify for this year's ballot. Supporters of Initiatives 75 and 78 did not include enough valid signatures to qualify for a spot on the ballot, Williams said.

With that uncertainty lifted, Extraction could compete for investors with producers from states like Texas where the location and permitting of a new well is less subject to political and community resistance.

The third factor that Extraction offers investors is its favorable production balance of liquids to natural gas.

Johnson noted her research shows Extraction's current production is 43 percent oil, 15 percent natural gas liquids and 42 percent gas. With a portfolio that includes significant gas assets, Extraction is positioned to take advantage of a gas market predicted

to rise over the near term.

Where crude prices are not expected to rise much further over the next year, prices for natural gas are forecast to average $4 per thousand cubic foot (mcf) in 2017, Johnson said. That is an increase of $1.14 mcf above the expected average this year.

"Most of those drilling rigs that are being added are headed for oil production in the Permian," she observed. "A company with strong gas reserves should benefit as prices rise."

ON THE MEND

By one account, the devastation visited on the oil industry by the price collapse has by now ended, even if quarterly filings continue to show red ink. A recent report in the San Antonio Express-News declared in late October that despite generally dismal third quarter numbers, "there are signs of life in the oil field and expectation that things are on the mend."

After hitting bottom at 404 rigs in May, the number of drilling rigs operating across the U.S., and especially in Texas, has ticked up slowly in the weeks since. The weekly rig count issued by Baker Hughes on Nov. 4 showed 569 rigs operating in the U.S.

The near-term outlook has turned optimistic, as well. Even with prices that could "fall back into the $45 range," according to an industry analyst, companies are expected to increase capital spending next year, some by as much as 20 percent. In a presentation at this year's EnerCom Oil & Gas conference in August in Denver, an analyst for Wunderlich Securities forecast increased spending and activity in the oil patch next year.

As companies open their checkbooks for things like drilling rigs, completion projects and all the services that support them, hiring will pick up and economic activity increase.

Ponderosa, which says it provides investors with "detailed market intelligence in crude oil, natural gas and NGL markets," predicts prices will rise to an average $52 per barrel in 2017. Johnson said the firm predicted crude prices to average $46 per barrel for 2016, and barring the unexpected, will be very close to the mark.

"The market is still oversupplied," Johnson said. "We see continued volatility short-term. Even if OPEC pulls 750,000 barrels a day off the market, the U.S. can easily fill that gap."

"That's the problem with optimism," she observed. "As producers see an improving market, they start hedging and increase production. As a result, the market volatility will continue."

Johnson noted Ponderosa predicts oil will not rise to $60 until 2018.

For a company formed two years ago, Extraction is on a remarkable growth curve. Its recent success in winning state approval for its permit to develop the Triple Creek site west of Greeley appears to justify the company's plan to add a third drilling rig next year.

Where other companies dipped a toe in the IPO waters only to pull back, Extraction weighed the risks against the benefits and jumped in feet first. So far, it appears to be the right move. ♠