

# XTO ENERGY MATURES

Cross Timbers Oil Co. has changed its name and upped the ante on its growth game.

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**X**TO Energy made its formal debut June 1 as the new corporate moniker for Cross Timbers Oil Co. No new kid on the block though, this Fort Worth producer was founded in 1986 and went public in 1993. The company may be 15 years old, but it has matured into an entity that is now about 80% natural gas—some 2.25 trillion cubic feet at year-end 2000—hence the name change.

It will retain its ticker, XTO, on the New York Stock Exchange, despite the new name. The stock started trading on a post-split, three-

for-two basis June 6. Some 122 million shares are now outstanding.

In an interview at Fort Worth headquarters the day before the name change, XTO chairman and chief executive officer Bob Simpson and vice chairman and president Steffen Palko explained the company's strategy to *Oil and Gas Investor*. Like any adolescent, XTO has been on a growth spurt, in production and reserves, through low-risk development drilling and some substantial acquisitions to the tune of more than \$1 billion during the last three years.

"In 1998, we got thoroughly bombed like everyone else did. But rather than focus on debt reduction and asset sales, which we knew would reduce the company's size, we decided to grow our way out of it," says Palko.

Large assets acquisitions from EEX Corp, Seagull Energy, Shell Oil, Ocean Energy and Spring Holdings, mostly in the Arkoma Basin and East Texas, followed. These increased production and cash flow. That, along with much higher commodity prices, enabled the company to reduce long-term debt from 78% of capitalization in 1999 to target about 50% by the end of this year.

This year XTO should produce cash flow of about \$500 million—an amount greater than total cumulative cash flow recognized from 1993-99, Simpson points out. A bit more than half is earmarked for development drilling and the rest for debt reduction and/or further purchases.

The majority of its 2001 gas production is hedged to lock in a price averaging \$5.50 per thousand cubic feet. "We will cash flow

**Bob Simpson, right, chairman and chief executive officer of XTO Energy, and Steffen Palko, vice chairman and president, founded the company in 1986. Previously, both were with Southland Royalty Co., where Simpson was vice president of finance and corporate development and Palko was vice president of reservoir engineering.**



## XTO Energy at a Glance

	2000	1999	1998
Total revenues (\$MM)	600.8	341.3	249.5
Earnings*	115.2	44.9	(71.5)
Operating cash flow/share**	4.84	1.89	1.21
Production (MMcfe/d)	448.1	393.8	325.4
Proved reserves (Tcfe)	2.25	2.02	1.64

\* Includes effects of noncash charges, gains on sale of assets Hugoton Royalty Trust units, and various losses due to derivatives loss and impairment of equity securities. \*\* Adjusted for 3-for-2 stocks splits in February 1998 and September 2000.

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Gary Simpson,  
XTO Energy

\$500 million again next year even if gas prices go down, due to our higher volumes and our hedges,” says Simpson.

The company’s fiscal picture thus continues to improve. Last year it bought back 5.3 million shares of its stock at \$7.88 per share and in September, it split the stock three-for-two. In November it recycled those shares, selling 6.6 million from treasury for \$19.11 per share. The proceeds—\$126.1 million—were used to reduce debt.

Investors are noting the changing profile. Last year XTO common stock rose more than 350%, hitting an all-time high of \$29 per share in December and becoming one of the best-performing stocks on the NYSE.

More good news should be forthcoming, as XTO has targeted a 20% increase in gas production in 2001 and again in 2002. “We now have enough development opportunities within the company that we can grow production 20% per year without any acquisitions,” Palko says. “I believe that’s about the highest rate of production growth forecast in our peer group, and certainly more than the industrywide estimates of 2% to 3%. We plan to drill about 300 wells this year and 350 to 400 next year.”

Since 1996, the company has acquired more than \$1 billion worth of long-lived natural gas properties, concentrated in the East Texas Freestone Trend, the San Juan Basin of New Mexico and the Arkoma Basin. It is now the largest producer in Arkansas and one of the largest in the Arkoma Basin.

Proved reserves grew 11% last year to reach 2.25 trillion cubic feet equivalent, with a target of 3 Tcfe by yearend 2002. In January of this year, XTO acquired another 240 billion cubic feet in its high-impact Freestone County area of East Texas, site of the Bossier play, one of the most actively drilled spots in the onshore U.S. during the past year.

The Freestone Trend is surpassing expectations, Palko and Simpson say. The company’s production there is expected to rise from 50 million cubic feet a day to more than 200 during the next two years. XTO has identified 500 well locations there.

“We’ve been paid on high commodity prices, but what we haven’t been paid on is the tremendous growth story we have—we think we have assembled the best package of long-lived gas reserves in North America,” says Gary Simpson, vice president of investor relations. “We think we’ll see explosive growth out

of 100%-owned assets and can grow even if gas is \$2.50.”

There may be only one problem: Traditionally Wall Street has favored companies with short reserve lives, awarding them a higher multiple than those with long-lived reserves such as XTO has. That may be one reason why, although XTO has traded as high as eight times cash flow, it currently trades at about five times.

“I like that their reserves are long-lived, because that fits in with what I call their ‘roll-up-your-sleeves’ engineering focus. That’s how they have added value to their acquisitions in the past,” says Pierre Conner, E&P research chief at Hibernia Southcoast Capital in New Orleans.

Indeed, “On everything we buy, we generally have doubled the proved reserves,” says Palko. Adds Simpson, “We are achieving the rate of return of an exploration-type company yet doing it with low-risk, but reiterative, development drilling.”

XTO Energy is facing a key inflection point as it approaches a market cap of \$3 billion.

Having just returned from a road show to introduce the new name, investor relations chief Gary Simpson says he detects a real window of opportunity now to improve valuations, especially with the ongoing energy crisis as a highly visible backdrop. “We can impress upon investors who haven’t been in energy for a while, that this company and this industry is a viable business. It’s more than just a momentum play. Once we get out of the roller-coaster of prices and the questions on where oil and gas prices will settle, then people will start trying to focus on which company they should buy.”

Longer-term, XTO Energy is facing a key inflection point as it approaches a market cap of \$3 billion and beyond. “Somewhere around that size, which we are close to, you have to either acquire a company, go offshore or go international to keep achieving the same level of growth,” says Palko. “Those are question marks for us. But East Texas provides us with the magnitude of opportunity such that we can forestall that decision. We have 1.5 Tcfe there that we have not even booked yet.”

Vows Simpson, who cites an overheated acquisition market, “We are growing rapidly, so we are not a stagnant company that has to sell out. We can grow the value enough that shareholders don’t have to sell the company to achieve their rate of return goals. This is not a situation where high gas prices create all the value.”

Research analysts’ studies place XTO No. 1 among its peers for five-year rate of return. The stock has achieved a compound annual growth rate of 38% in that time. □

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