DeMatteo Research

IDEA NOTE

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SWN

Southwestern Energy Co

Energy, Event Driven/Special Sit

03/19/2018

L LONG

PRESENTED

DATE		03/14/2018
PRICE	MARKET CAP	ENT VALUE
$4.28	$2.17B	$6.17B
P/E RATIO	BOOK VALUE	DIV YIELD
2.61x	$3.86	0%
SHARES O/S	AVE DAILY VOL	SHORT INT
507.14M	26,600,609	10.64%

CURRENT

PRICE	$5.12	MARKET CAP	$3.00B

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Chart
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Southwestern Energy Co. is an independent holding company, which engages in the development and production activities including related natural gas gathering and marketing. It operates through the Exploration and Production (E&P); and Midstream Services segments. The E&P segment involves in the exploration and production of natural gas, oil, and natural gas liquids. The Midstream Services segment deals with natural gas gathering activities. The company was founded on July 2, 1929 and is headquartered in Spring, TX.

Publicly traded companies mentioned herein: *Devon Energy Corp (DVN), Energy Transfer Partners LP (ETP), Kinder Morgan Inc (KMI), Southwestern Energy Co (SWN)*

Highlights

Following the early February announcement that Southwestern (SWN) is "pursuing strategic alternatives for the Fayetteville Shale E&P and related midstream gathering assets", the presenter is bullish on SWN and sees multiple sources of upside for shareholders. He believes the assets could fetch $2.5B in a sale. This would leave "core" SWN trading at a 2 - 3 turn discount to its Marcellus peers on an EV/EBITDA multiple basis. While that may not seem significant, a re-rating of SWN's multiple could lead to a 50% - 100% gain over 12 - 24 months.

- In the presenter's opinion, most of the Wall Street analysts covering SWN have not taken a hard look at the implications of SWN's announced plan. In his opinion, it could end up with a "best in class" cost structure, but he said he has only observed target price reiterations or tweaks, largely based on changes to the multiples.

- The Fayetteville legacy gas asset is a low multiple business. The asset is viewed poorly, as there is not a lot of great inventory. However, the wholly-owned midstream assets have value. And, a key consideration, in his opinion, is the cost for long haul gas takeaway going forward. SWN has been paying significantly more than it will, as volumes are "double booked on the Boardwalk and Fayetteville Express pipelines; not putting any gas volumes on Kinder's/ETP's Fayetteville Express pipeline will save, apples-to-apples, ~$160MM from 2018 - 2021 (this savings falls "right to the bottom line").

    - On a pro forma basis, making that adjustment, the 2018 Fayetteville EBITDA could be ~$600MM at strip gas prices. Because the midstream assets are wholly owned, there's high FCF conversion (from EBITDA) and it's not difficult for him to envision a $2.5B deal. For example, if private equity stepped in and levered up 2x - 3x EBITDA, the cash returns/ IRR could be 15% - 20% over five years (based on his model); so, there's well over $2.5B of value there.

- If the restructuring is successful and yields SWN $2.5B, it will have a "huge" NOL with low tax leakage (perhaps resulting in AMT and a hit of $100MM). It will create a Marcellus asset that should do over 2 Bcf/d in production (2018), and grow over 10% annually.
    - Comparing "new" SWN to its Marcellus peers, the presenter sees it trading roughly 2 – 3 turns cheaper (EV/EBITDA). "While that may not sound like a material discount, on a $2.2B market cap company it's easy to see how this could lead to a 50% - 100% return".
    - The presenter noted that Devon Energy recently sold mature Barnett shale assets for ~$550MM. The production level averaged around 200 MMcf/d, and the value was $2,750 per flowing barrel, with no midstream component.
- When asked if he thinks SWN will see a re-rating after Fayetteville is gone, the presenter said, "[It's] just regular gas equity valuation risk, so there's no bid for that. But, [I'm] most optimistic about consolidation in the Northeast, as players need to take out cost and there could be meaningful synergies". SWN has 1400 employees, and ~1/3 would go with Fayetteville, so that leaves ~900. He could envision a scenario where there's at least $100MM of cost savings to be had, and if that's capitalized at 6x it adds another $1/share of value. "There are a lot of ways to win".
- The group also debated the $2.5B estimate on pro forma EBITDA of $600MM (a little over 4x). The presenter acknowledged that there will be some [production] declines over time and estimates the capex spend necessary to manage "small" declines to be ~$200MM. Even if EBITDA is only $500MM in the out years, there will still have been a significant amount of FCF generated from 2018 - 2021.
- There is a risk that SWN takes the cash and makes an acquisition; "there will be a temptation to do so".

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