DeMatteo Research

IDEA NOTE

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UPL

Ultra Petroleum Corp

Energy

12/11/2017

S SHORT

PRESENTED

DATE		12/06/2017
PRICE	MARKET CAP	ENT VALUE
$8.81	$1.73B	$3.42B
P/E RATIO	BOOK VALUE	DIV YIELD
N/A	$N/A	0%
SHARES O/S	AVE DAILY VOL	SHORT INT
196.33M	2,343,601	12.82%

CURRENT

PRICE	$1.11	MARKET CAP	$0.22B

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Chart
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Ultra Petroleum Corp. is an independent oil and gas company engaged in the development, production, operation, exploration, and acquisition of oil and natural gas properties. It focuses on developing a tight gas sand trend located in the Green River Basin of southwest Wyoming; and assessing, exploring, and developing its position in the Marcellus Shale and other horizons located in the north-central Pennsylvania area of the Appalachian Basin of Pennsylvania. The company was founded on November 14, 1979 and is headquartered in Houston, TX.

Publicly traded companies mentioned herein: Ultra Petroleum Corp (UPL)

Highlights

The presenter is short shares of Ultra Petroleum (UPL) at ~$9, and sees substantial downside risk for shareholders because the Wyoming-based natural gas producer may face challenges executing its horizontal drilling program along the East Flank of the Pinedale Anticline. The basic problem he sees is that, based on his analysis, UPL appears to need $3.00-3.10 gas to reinvest and keep production flat. Henry Hub is ~$2.90 ($/MMBtu), but Waha Hub is presently ~$2.40 and Wyoming gas is losing share to Permian gas (feeding California). If his assessment of the setup and forecast are accurate, upside for UPL stock should be limited and it could trade down to $6 (based on a 6x EV/EBITDA multiple applied to his ~$600mm 2018 EBITDA estimate).

- UPL exited bankruptcy protection earlier in 2017, and the presenter believes the financials around its “real” operating results have been blurred by that process, talks of asset sales, and the new horizontal program. In his opinion, there may be some underlying issues that have led management to wait for higher gas prices to hedge.
    - In his opinion, UPL “needs” a $3.10 gas price to hedge/ protect its cash flows. The company has stated it is looking to hedge “at least 50% of production for 2018”, but its 2017 hedges are rolling off and for 2018 UPL has hedged just 27.5 Bcf - or, ~10-11% - of production [at an average floor price of $2.99/MMBtu ($3.19/Mcf)].
    - The presenter noted that he has a hard time reconciling UPL’s production results. Looking at the historical vertical wells’ production data (dating back to 2014 - 2015), the decline rates and production growth rate (from new wells) don’t seem to add up to a number that makes sense to him (for 2015 production). In 2016, he said the data looked ok; however, “In 2017 it flipped back and [I] can’t reproduce the number...just not sure what’s going on with the data (it makes it hard to trust the numbers)”.

- Geographically, Wyoming is the most disadvantaged basin right now. The presenter explained that WY gas competes with low-cost Permian gas, and the two basins are connected because California sources 45% its gas from the Permian, and 47% from Wyoming (over the last few years, Permian gas has taken share by pricing gas below Wyoming). The Waha basis has moved "in lock-step", 12 cents per year, over the last two years, said the presenter.
    - It is not necessary to be a huge bear to see that UPL is exposed. There is a ~33 cent basis differential this year and the discount is because of the location.

- Traditionally, UPL has been focused on vertical wells in the Green River Basin (WY). While it does have some Marcellus acreage and operational wells, the presenter views the plays as materially different. While management knows the [WY] gas field, he said, "UPL has drilled up a lot of the inventory, and the new horizontal program has seen inconsistent well results thus far".
    - Of the five horizontal wells that UPL has released data on, it's clear that two were good, with the most recent one looking "really good" (this is the two-mile horizontal well targeting the Lower Lance A interval). But, two were "disasters" and one was just "OK". It is not clear to the presenter how the 40% hit-rate will change given the geology, but Bulls think going horizontal can add $10 of NAV (which is worth $2 to the stock). In his opinion, this is baked-in already.

- The presenter said, "The Waha basis differential is not baked-in and the Street has production growing 20% year-over-year, which is clearly not happening". Gas production out of the Marcellus and Permian could be bearish for gas, and any increase in production by UPL in WY would be perversely bearish as well. Thus, if forecasts for +4 Bcf/day production growth are accurate, there could be "torque" to the downside.
    - Based on the number of wells drilled today, it takes 3-4 months from the start to when E&Ps get the gas online. So, there is a high degree of visibility into what production looks like.
    - Demand is not growing enough to absorb the new supply, and the presenter noted that a cold winter in the Northeast - if we see one - could mask the wall of supply coming. If it's a warm winter, Nat gas prices could head [much] lower.
        - Even in a polar vortex, US nat gas demand would equate to roughly +3 Bcf per day. The worst case for bears would be a $3.50 gas price in April, in his opinion.

- UPL is still levered over 5x on trailing (12-month) EBITDA, and if nat gas is $3 or lower in 2018 the operating and financial leverage will drag the stock down. UPL has the basis differential to contend with, and Street EBITDA estimates appear to be optimistic at $761mm for 2018). Based on the presenter's model, UPL should trade down to $6/ share, which reflects a 6x multiple on $600mm of 2018 EBITDA (his forecast). And, depending on how natural gas prices move, and how the horizontal program progresses, he can make a case for a $3 stock price, "if the wheels fall off or there's no upside from horizontal".

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