

BONANZA SAYS IT ALL

After a problematic IPO late in 2011, Bonanza Creek Energy Inc. came roaring back in a number of ways, increasing its spending, production and stock price.

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Sometimes equities slide for seemingly inexplicable reasons. And on occasion such a slide can set up a slingshot-style recovery—the kind that later leaves investors wondering why they missed out on such a remarkable investment opportunity.

Markets, of course, are made up of varying mixtures of greed and fear. And a turbulent tape toward the end of 2011 made for a difficult market backdrop for Bonanza Creek Energy Inc. to launch its initial public offering (IPO) in December of that year. Price talk for the offering was lowered from an original range of \$20-\$22 per share to \$17 per, and the offering size was also reduced. A weak aftermarket and subsequent tax-loss selling combined to send the stock down to a close of \$12.50 per share on the final trading day of 2011—down more than 25% from its eventual IPO price of \$17.

That marked the nadir for the Denver-based Niobrara player, and since then the trend has been up—and dramatically so. From its December 2011 low, Bonanza Creek's stock more than doubled to \$27.79 by year-end 2012, and this year it has extended its run to reach \$37-\$38 per share in mid-May, roughly a threefold gain off its 2011 bottom. In recognition of its remarkable performance, led by chief executive officer and president Mike Starzer, Bonanza Creek wins *Oil and Gas Investor's* Excellence Award for Best Performance in 2012.

The dramatic turnaround did not stem from any shift in management strategy, which in spite of stock market volatility has held a steady course in the wake of its 2011 IPO.

"We kept our heads down, hit our targets, showed we could execute, and moved ahead exactly with our plan," says Gary Grove, Bo-

nanza Creek's executive vice president, engineering and planning.

But clearly helping to buoy Bonanza Creek's fortunes has been what Starzer calls the "technological renaissance" of horizontal drilling and hydraulic fracturing. With advances in technology and industry's success in lowering costs, the company was able to chart a course away from its history of vertical drilling in Colorado's Wattenberg Field—typically fracturing into Niobrara and Codell zones and returning later to do re-fracs—and instead start a program of horizontal drilling.

Encouraged by the nearby horizontal successes of, among others, Noble Energy and PDC Energy, Bonanza Creek drilled four successful horizontal wells in Wattenberg in 2011, opening the door for its equity capital raise later that year.

Bonanza Creek's IPO in late 2011 was not its first trip to the capital markets. Earlier, the company had been backed by D.E. Shaw & Co. in its acquisition of Wattenberg properties during 2006-2010, as well as the purchase in 2008 of oily Cotton Valley properties in Arkansas. In late 2010, in anticipation of its move to horizontal drilling in Wattenberg, Bonanza Creek raised \$265 million from two Canadian private-equity sponsors, West Face Capital and Alberta Investment Management Corp. (AIMCo).

Pricing of the subsequent IPO below the filing range—10 million shares priced at \$17 per share versus the \$20-\$22 price talk earlier—was a fate shared by several independent E&Ps going public in particularly grim equity-market conditions in December 2011. West Face Capital and AIMCo opted to withdraw their planned sale of shares in light of the reduced pricing.



Bonanza Creek president and CEO Mike Starzer says "the runway just continues to expand" for his company now, especially in the Niobrara play.

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Executive vice president Gary Grove says Bonanza Creek's turnaround wasn't due to a shift in strategy, but rather, due to hard work and a clear vision.

The reduced float from the smaller offering hurt liquidity in the shares' trading volume. Some observers feared that—with an enterprise value of around only \$560 million at its \$12.50-per-share closing low—Bonanza Creek's appeal to institutional investors might have suffered long-term damage.

Apparently not: It was one of the energy sector's best-performing stocks last year. At its mid-May 2013 price in the upper \$30s, Bonanza Creek's enterprise value is now around \$1.7- to \$1.8 billion. Not only has the stock risen, but its float has also improved significantly following the sale by West Face Capital of the vast majority of its shares. In early 2013, the Canadian fund manager sold 13 million shares at \$29.50 per share, representing a gain of almost \$17 per share, based on its investment cost expressed in today's stock price. The float, at one point only about 25% of shares outstanding, now stands at 73%. AIMCo remains a significant shareholder in Bonanza Creek with a 19% position.

But it is the fundamentals of Bonanza Creek's business, much more than the liquidity of its stock, that have been the primary driver for its success.

As it transitioned from vertical to horizontal drilling in 2012, it implemented a capital program that, at over \$300 million, was twice that of any previous year, setting in motion a program of accelerated growth for years to come. By the end of 2012, Bonanza Creek had drilled some 36 horizontal wells, with production from these outstripping legacy vertical Wattenberg production.

In first-quarter 2013, horizontal production increased to 5,532 barrels of oil equivalent (BOE) per day, up 50% from the prior quarter, and accounting for 45% of company-wide production.

At its April 2013 analyst day, Bonanza Creek unveiled a five-year production outlook for the company's Wattenberg production. The forecast calls for a 33% compound annual growth rate for its Wattenberg volumes, taking production to over 40,000 BOE per day in 2017. This assumes Bonanza Creek increases its rig count to eight rigs by 2017, up from four rigs currently.

The company expects to drill 740 gross (621 net) wells over the five-year period—an ambitious target that will still leave an equal amount of wells to drill from its current 3P (proved, probable and possible) inventory of 1,527 gross (1,151 net) undrilled locations.

Starzer cites several factors accounting for the company's emergence as one of an elite group of the rapidly growing Niobrara players, among them a philosophy of “continuous improvement” at all levels at Bonanza Creek. In addition, he points to the company's flexibility in combining innovative practices of its own with, on occasion, being a “fast follower” of

others' technological leadership. And, perhaps most emphatically, he points to the company's success in having been able to very selectively assemble key assets in Wattenberg Field with talented operators in close proximity.

“We have great, high-growth assets in the Wattenberg. And we have fantastic neighbors who are enjoying successes of their own across the field,” says Starzer.

“The combination of the horizontal evolution of the Wattenberg with the steady performance of our oil-weighted Cotton Valley development in Arkansas and a strong balance sheet has been, and will continue to be, a powerful recipe for success at Bonanza Creek.”

One measure of industry's success with horizontal programs in the Niobrara play is reflected in E&P companies' growing confidence that they can continue to ratchet recovery factors higher. Just several years ago, recovery factors of 4%-5% were the norm with vertical drilling in the Wattenberg. Now, with horizontal programs, recovery factors of around 7% are feasible and viewed as possibly just one step towards recovery factors eventually being in the mid-teens.

Looking back, how easy was it to launch the transition towards an entirely horizontal program?

“We were confident,” recalls Grove. Not only could Bonanza Creek look for confirmation from its own seismic and vertical well penetrations, as well as many years of prior well stimulation work, but it also had correlating data from Noble Energy's recent well results in areas nearby. Petrophysical models pointed to the Niobrara B bench. This gave the team the confidence not only to drill an initial four wells in the Niobrara B bench in 2011, but to drill another 36 Niobrara B bench wells in 2012.

In 2013, Bonanza Creek's plans call for drilling as many as 56 Niobrara B bench wells in what it says is now “manufacturing mode.” Wells are designed with standard 4,000-foot laterals and 18 frac stages. Estimated ultimate recovery (EUR) per well is 313,000 BOE, comprised of 62% crude oil.

With a typical well cost of \$4.2 million, pay-out is in 1.5 years at an assumed \$80 per barrel oil price. The most recent 12 wells have had 30-day initial production (IP) rates of 537 BOE per day, up from an average 503 BOE in 2012 and 470 BOE for its first four wells.

Beyond the B bench

Beyond its B bench program, there are three main areas where Bonanza Creek is pushing ahead with field tests.

One area is the Niobrara C bench and Codell formations, where a single test in each zone in 2012 is being expanded to four wells in each of the C bench and Codell over the course of this year. The initial C bench well last year tested at a 30-day IP rate of 444 BOE per day, while the Codell test had a 30-day IP of 370 BOE per

day—and a 60-day rate that was only marginally lower at 367 BOE a day. The latter, coupled with results from other industry tests, tends to support the Codell having a shallower decline curve and possibly higher type curve and EUR.

A second area of progress comes from employing extended-reach laterals. Last year's extended-reach lateral (9,000 feet) had a 30-day IP of 795 BOE per day, in spite of the company being unable to complete the last 1,000 feet of lateral as planned. Cost came in at a favorable \$7.4 million. Two extended-reach laterals are planned for 2013. The first (9,450 feet, with 40 frac stages) has been drilled and was waiting on completion at press time; a second is scheduled in the third quarter of this year.

The third area is testing for optimum well density—a key factor in determining development plans for Bonanza Creek's leasehold of approximately 32,000 net acres.

Although Starzer is confident that all the acreage has been de-risked for 80-acre development in the B bench, he holds back from joining those Niobrara players with public plans to develop their acreage down to 40-acre spacing—or denser—in most areas of Wattenberg field's oil window.

"We're not there yet," he says, noting results are still due from a six-well program underway this year to test 40-acre spacing. To date, two wells have been drilled offsetting an existing horizontal Niobrara B producer, and a four-well, 40-acre spacing pilot was scheduled to begin in the second quarter of this year.

Nonetheless, Bonanza Creek's inventory of 1,452 gross (1,083 net) undrilled locations underpins a 3P net reserve estimate of 247 million BOE. This reflects an assumed development on 40-acre spacing for both the Niobrara B and C benches. Development of the Codell forma-

tion—which thins as it moves east and is viewed as productive on about 15,000 net acres—is assumed to be on 160-acre spacing. The A bench of the Niobrara is also considered prospective across the company's entire acreage, but no such potential locations have been assumed pending Noble Energy's nearby A bench test results.

A "current plan for future development" outlined at the company's analyst day highlighted these assumptions. The example shows a section of land being developed with as many as 36 horizontal wells, comprised of 16 B bench wells on 40-acre spacing, 16 C bench wells on 40-acre spacing and four Codell wells on 160-acre spacing. The example shows wells being drilled from four nine-well pads, located on Bonanza Creek's western acreage, and using two centralized facilities.

"That's our thinking on what our potential may be on our western acreage down the road," says Starzer.

Bonanza Creek is quick to point to likely modifications to its plans if they can result in a lowering of its expected finding and development costs.

"Our goal would be to develop the same amount of oil in place, and get the same recovery, with the least amount of capital employed," emphasizes Grove. "For example, if we could develop a section with 30 wells, instead of 36 wells, we would be more capital-efficient."

He cites the example of a 16-well-per-section Niobrara B development being supplemented by an alternating or "sawtooth" pattern of Niobrara C wells, or Niobrara A wells, or Codell wells.

"Areally, a lot of testing has been done to de-risk the Niobrara, mainly the B bench and in some cases the C," says Grove. "And now the question is, how do we best stack wells inside that vertical column in order to get the most oil and gas out of the ground as inexpensively as possible. And the more that we can influence vertically in the column, and recover the oil from additional zones above and below, that's obviously very advantageous for us."

Does that mean contributions from, say, both B and C benches can be tapped from a single lateral?

If so, it may be an issue of simply enhancing otherwise already attractive economics.

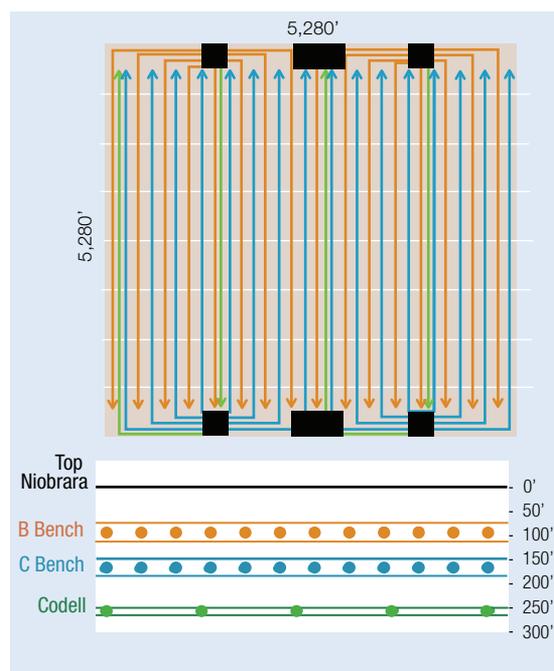
"It's still early in the game. Even if we need to drill 16 wells in the B bench, and 16 wells in the C bench, we can do that very economically," says Grove.

"However, our goal would be to see if we can develop the resource with less capital employed in order to be more efficient."

Whatever the outcome, the opportunity set for Bonanza Creek appears to be on an upward plane.

"Whether it's a 16-well optimal development plan, or 32 wells, or 36, including the Codell zone on our western acreage, the runway just continues to expand," says Starzer. □

Current Plan for Future Development



Bonanza plans up to 36 horizontals per section, from four pads.

- Tied to 3P Assessment**
- 36 Total Wells Per Section
 - 16 B Bench on 40-acre spacing
 - 16 C Bench on 40-acre spacing
 - 4 Codell on 160-acre spacing
- Four 9-Well Drilling Pads
Two Centralized Facilities