

ROUGH RIDERS

Locked up in an MLP bankruptcy for nearly two years, Maverick Natural Resources has new management and a business model aimed at the relentless pursuit of free cash flow.

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Sprint, Day 1, March 18. WTI spot price, \$20.48. Total savings identified, \$4.1 million—18% of goal.

In mid-March, Maverick Natural Resources was like every other E&P in the Lower 48—boxed in by OPEC, a pandemic and buried under an avalanche of bad news that in roughly two weeks had drained the value of oil by 56%.

While other E&Ps rapidly slashed billions of dollars from their drilling programs, Maverick didn't have that option. The company lacks a robust capex program, forcing it to find savings elsewhere. But the Houston company is practiced at taking tight turns. This is, after all, a company of remnants, created by someone else's decisions and miscalculations during another bad time for the oil and gas industry.

By the time the company was ready to find places to cut, CEO Chris Heinson said the company's executives had been independently watching the news and taking actions he didn't direct. That's the way it was intended to work.

"I've told the organization their job, regardless of the environment, is to create free cash flow," Heinson said. Since the company

began to adjust to the new commodity prices in March, it has identified millions in savings while preserving its sources of cash flow.

It's the way Heinson insisted on rebuilding Maverick from the remnants of Breitburn Energy Partners LP, a former MLP that entered bankruptcy protection with about \$3 billion in debt. Nearly two years later, in 2018, Maverick emerged from the courthouse with about \$105 million in debt and a sprawling set of odds-and-ends assets from one coast to the other as well as the Midwest and the Permian Basin.

Breitburn, like other MLPs that rose up in the shale boom, was a giant aggregator, consuming complex assets in a seemingly unending cycle of acquisitions meant to increase cash flow. Following the 2014 downturn, MLPs fell apart in the low-price environment, leading to billions of dollars in bankruptcies and a diaspora of oil and gas assets.

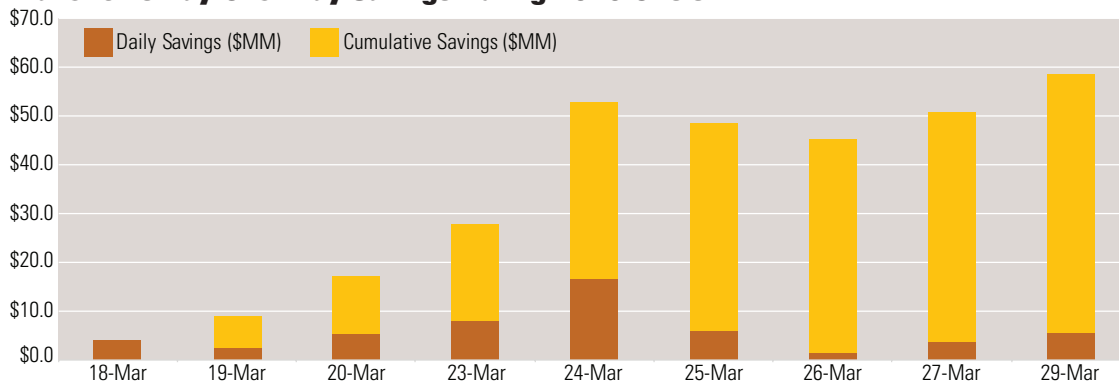
Working with corporate improvement specialists at consultancy Alvarez & Marsal, Maverick's turnaround was swift and stunning. After four months of analysis and internal stress tests, Maverick emerged even leaner from bankruptcy—while generating more revenue.

Maverick Natural Resource's Postle Field operations in the Midcontinent are among a variety of assets, including conventional wells and horizontal shale development, that the company had to knit together and make profitable following Breitburn Energy's bankruptcy.



SOURCE: MAVERICK NATURAL RESOURCES

Maverick's Day-Over-Day Savings During 2020 Crisis



Source: Maverick Natural Resources

Breitbart had used restructuring advisers to make “what you’d think of as the typical cost reductions,” Heinson said. Maverick’s target was a 20% reduction in lease operating expenses (LOE) per barrel of oil equivalent (boe).

But Heinson also wanted to create a new company with employees who weren’t merely excellent operators but could also direct themselves. The resulting two-week long exercises were strenuous and anxiety-inducing.

“They are intense,” Heinson said. “They’re intense by design.”

The company called them sprints.

Running flat out

Sprint, Day 3: March 20. WTI spot price, \$19.48. Total savings identified, \$11.85 million—53% of goal.

In one of the remote areas where Maverick operates, the company was faced with paying high rates for power, a part of oil and gas industry life when dealing with electricity co-ops or highly-regulated providers.

A group of Maverick employees self-organized and brainstormed on how they could pay less or renegotiate a lower rate or find a credible alternative to purchase power on the grid.

One plan would use microgenerators to power operations from Maverick produced fuel. Another idea would send power from another state into the area by building a major transmission line over a river.

After generating credible alternatives, Maverick’s group was able to win concessions—a strategy the company has adopted elsewhere.

“It was real, credible actions that these teams are independently taking that no one in senior management ever thought of,” Heinson said. “But they would not accept that the utility prices coming out of these restricted areas and co-ops could not be changed even though I will say in most of these areas that is actually the rule.”

The breaking of bad habits is grueling, vigilant work. The command-and-control structure in place at Breitburn, like that at most E&Ps, became more deeply engrained after its May 2016 bankruptcy. The path workers took to reach decisions deepened into ruts as Breitburn’s reorganization dragged on in a 21-month saga.

“The first [thing] we needed to change was the culture, which is a very difficult problem

to tackle,” Heinson said. “Decisions, particularly during the extended bankruptcy, were quite constrained. They had to be routed for special approval all the way up to the bankruptcy court, which is incredibly crippling. It gets professionals into this state where they’re just frozen, and the effort it takes to get a decision made ends up becoming not worth the trouble.”

With the sprints, the goal was to shake things up—creating a culture that dispensed with employees asking for permission to take action and freed up managers reluctant to make decisions before seeing every scrap of available data.

The model isn’t new and is relied upon among Silicon Valley technology companies.

“What we do is not uncommon,” Heinson said. “It is uncommon in oil and gas.”

Heinson, an avid reader, said he took cues from the writings of the economist Peter Drucker, whose most influential works were written in the 1940s and 1950s.

“He has a whole school of thought associated with clarifying what leaderships’ jobs are and what management’s role is and what the workforce is all built around,” Heinson said.

Heinson wanted to empower employees and tearing down impediments, particularly at lower levels of the organization, and create a workforce that was unafraid to make decisions on the fly, without seeking approval.

“It is a perverse thing, but it is better to be hands off and to allow more trust, more decisions. The natural temptation you must resist is to direct the actions of the organization below you.”

Maverick’s sprints were designed to wring every dollar of savings out of the company but to also jolt the staff out of any sense of complacency.

The first of the company’s three sprints was decidedly unproductive from a cost-savings standpoint, Heinson said.

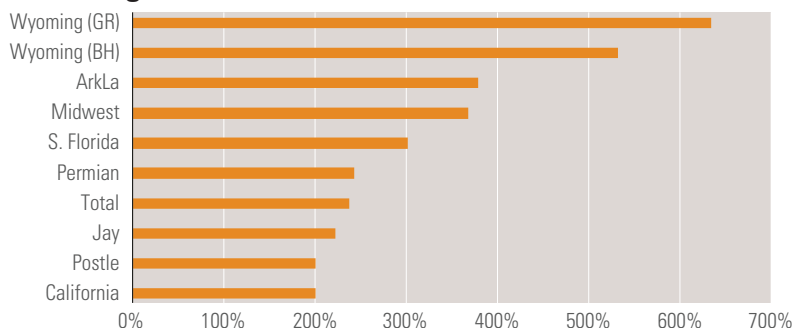
“You have to do the most unpleasant things first. The first sprint, reducing field labor, had a much smaller impact than the next couple.”

But the sprints were also a way to rewire the nervous system of the company so that executives would engage in taking calculated risks. The entire company, including the accounting staff, field operations, engineering and the receptionist, ran the sprints tighter in a large common area.



“It is a perverse thing, but it is better to be hands off and to allow more trust, more decisions. The natural temptation you must resist is to direct the actions of the organization below you,” said Maverick Natural Resources CEO Chris Heinson.

Exceeding Cash-Flow Goals Amid 2020 Crisis



Source: Maverick Natural Resources

Maverick Natural Resources emerged from bankruptcy in 2018, reorganized financially but still in disarray. A review into the company's holdings in the Permian Basin, Oklahoma, Wyoming, Florida and other states found a company replete with wasteful practices.

To break habits, “you focus on intensity. You focus on creating stress. And you have to sustain that for a long enough period that it becomes their practice,” he said. “And that’s what you’re left with.”

“Every day, the metric that we were looking to hit was an LOE per boe target ... which creates an incredible amount of focus and pressure on the results,” he said.

As Maverick eyed its LOE targets, the new way of working began to take hold.

Anchored to reality

Sprint, Day 7: March 24. WTI spot price, \$21.03. Total savings identified, \$19.88 million—89% of goal.

After a close look at some of Maverick’s wells, some clearly didn’t make sense—or, more importantly, oil.

In the 90 days after Maverick emerged from bankruptcy in February 2018, the company’s new backer, EIG Global Energy Partners, tasked Alvarez & Marsal with rightsizing the company.

At the time, Maverick held roughly 600,000 net acres and 7,600 net wells spread out across the Permian, Oklahoma, Wyoming, Florida, Michigan and other several other states. The company now operates roughly 5,000 wells.

Then came the company’s data, which, when analyzed, gave a sobering picture of a company that had been in stasis for far too long.

Jay Campbell, a managing director at Alvarez & Marsal, said the firm created economic models, mapping out costs for wells, based on a variety of factors such as water hauling costs.

“When we did that, we saw that there were wells that were producing large amounts of water and almost no oil,” he said. “The well was basically under water, literally, from a financial standpoint and an actual standpoint. They were just water wells.”

The company’s historic mindset was that a well could not be shut in because every barrel of production mattered. However, shutting in the well would cause a relatively minor loss of production and realize an economic gain from reduced hauling costs.

Working with fellow managing director Lee Maginniss, Campbell began piecing together a picture of a company that turned out to be the worst performer in every basin in which it operated.

With its first 90 days complete, a new management team arrived, headed by Heinson, the former COO of Sanchez Energy Corp. Campbell said Maverick’s team made it clear that only economic barrels mattered.

From the outset, Maginniss said Heinson was not only open to what the data showed but aggressive about understanding the company’s top-quartile peers. Maverick’s team were “relentlessly figuring out ... what are

other operators doing differently that we could think about adopting that to some degree,” Maginniss said.

Maverick’s team was also open to taking concepts from other industries and “how those examples could apply to us, even if it wasn’t an E&P,” he said.

After benchmarking showed how Maverick compared to other operators, Campbell recalled that the management team didn’t argue with the data.

“They basically said, ‘If those are the facts, what do we do about it?’ And I think that mindset has served them well because ... they move forward and figure out how to address it,” he said.

Heinson said his reaction was to “anchor ourselves in reality.” Heinson insisted on a level of granular data so his team could understand as much as possible about the company’s operations.

“It was a sobering wakeup call,” he said. “But you know, we did find interesting things.”

In some cases, for instance, labor costs were out of step with peer operators.

“The average cost per employee in one particular area was something like \$30,000 or \$40,000 more than the average,” he said.

Alvarez & Marsal’s benchmarking showed that top quartile performance would require the company to reduce its LOE per boe by 20%.

After Maverick’s first sprint was complete, Maverick continued to seek improvements in its LOE costs.

The autonomy that the company was building helped bridge regional differences in an organization that has conventional wells, horizontal shale development and nitrogen flood enhanced oil recovery. Further sprints identified actions that could be taken to create value and, finally, to start planning how to make changes.

“In the end, you are left with this menu of actions that your organization can take which allowed us to be strategic with our decisions.”

The task seemed daunting considering the organization had already gone through bankruptcy, conducted layoffs, renegotiated vendor rates and cut other costs.

After four months, and three rounds of company sprints, the company had found initial savings of 23% LOE per boe. Maverick has made the changes while squeezing an additional \$45 million in EBITDA from operations.

“You’re going to ask me, ‘Well how in the world did they do that?’ But, well, I have no idea.”

By fourth-quarter 2019, Heinson said the company had reduced LOE by 32% while improving EBITDA 33%.

“It gives you the idea of the magnitude of change that is actually possible if you identify where the value creation is appropriate and that you can really energize and empower the whole of the organization to work on these things,” he said.



SOURCE: MAVERICK NATURAL RESOURCES

Stop the bleeding

Sprint, Day 12: March 29. WTI spot price, \$15.48. Total savings identified, \$52.93 million—238% of goal.

Over the phone, Heinson hesitated, pondering whether to answer a question about Maverick’s process for setting new cash flow targets for each of the company’s nine business units.

In March, Heinson set new goals for Maverick’s 200 employees as it responded to the coronavirus pandemic and the oil price war. Oil prices had been ravaged, and the company was again on the hunt for savings while improving its free cash flow by a target of \$22 million.

From March 18 through March 29, the company ran what it called a “stop the bleeding” sprint. Maverick’s plans included shutting in 785 wells. One division also found health, safety and environmental savings across the business. Other changes across the organization, like its sprints in 2018, are ones Heinson may never know about.

Heinson relented. His free cash flow targets? “I make them up. What I try and do is come up with a number that is sufficiently large enough that I make all my managers nauseous,” he said.

He conceded he was being somewhat facetious. But in general he doesn’t delve into data models, instead relying on what he calls “reasonableness checks” involving some analytics and an awareness of discrete actions he knows will eliminate larger costs.

“It is really important that you don’t over-science your targets because as soon as you start doing that, you’re putting an artificial constraint on the organization,” he said. “And you’ve eliminated the organization’s ability to positively surprise you.”

At the end of the sprint, the company’s nine business units each bested Heinson’s free-cash-flow targets. Overall, the company estimated improving free cash flow by nearly \$53 million. □

Following a rapid drop in oil prices, Maverick Natural Resources ran what it calls “sprints” to reduce expenses and increase cash flow by \$22 million. The company ultimately increased cash flow by nearly \$53 million.