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WPX - Q4 2016 WPX Energy Inc Earnings Call

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PRESENTATION

Operator

Good day, ladies and gentlemen, and welcome to the WPX Energy quarterly report and operations update. At this time, all participants are in a listen-only mode. Later, we will conduct a question-and-answer session and instructions will follow at that time. (Operator Instructions). As a reminder, this call will be recorded.

I would now like to introduce your host for today's conference, Mr. David Sullivan, Director of Investor Relations. You may begin.

David Sullivan - ***WPX Energy, Inc. - IR Director***

Thank you. Good morning everybody. Welcome to the WPX Energy fourth-quarter 2016 call. We appreciate your interest in WPX Energy. Rick Muncrief, our CEO, Clay Gaspar, our COO, and Kevin Vann, our CFO, will review the prepared slide presentation this morning. Along with Rick, Clay and Kevin, Bryan Guderian, our Senior Vice President of Business Development, will be available for questions after the presentation.

On our website, WPXEnergy.com, you will find today's presentation and the press release that was issued after the market closed yesterday. Also, our 10-K will be file later today. Please review the forward-looking statement and the disclaimer of the oil and gas reserves at the end of the presentation. They are important and integral to our remarks, so please review them.

With that, Rick, I'll turn it over to you.

Rick Muncrief - ***WPX Energy, Inc. - Chairman, President, CEO***

Thank you David. Good morning to everyone on the call. We sincerely appreciate your interest in WPX this morning and look forward to updating you on our fourth-quarter results as well as our continued progress on our multi-year plan.

First, let's start by reflecting for a moment where this industry was just a year ago. We all recall sub-$30 oil, the drastic cuts in capital budgets, job losses, weak natural gas prices, and the instability in the debt and equity markets. Last year was a test of character for energy companies across the spectrum, both large and small. I am proud to say this morning that WPX not only passed the test but has emerged as a much, much stronger company. I believe this speaks to our culture of accountability, continuous improvement and a true bias for action.

Simply put, our teams delivered all throughout the Company. And at this time, I personally want to thank our people in Carlsbad, in Aztec, in Killdeer, and here in Tulsa for their tremendous efforts over the past 12 months.

Last year, we completed critical transactions, paid down debt ahead of schedule, raised our production guidance twice, and kept playing very strong offense and defense. You will hear more about that from Clay and Kevin in a few moments.

Over the past two years, we have now done $6.5 billion worth of transactions to reposition this Company for prudent, profitable, and disciplined growth.

Now, let's turn to Page 2. The story for our fourth quarter is pretty clear. We accomplished several things ahead of schedule, like working through our backlog of our Williston Basin DUCs and putting some first oil on our new Permian gathering system. By accelerating the DUC schedule, we drove some of the oil volume growth that we thought we would see in the first quarter actually into the fourth quarter of 2016. We see that benefit in our fourth-quarter performance, but it will also have somewhat of a dampening effect on some of our first-quarter numbers. We will see how that plays out.

So, regardless of when the growth occurs, the bottom line is that it's already happening. With that, we will see some flat -- we will see some volume fluctuations in 2017 based on the timing of completion first sales with most of the growth occurring in the latter half of the year.

Ultimately, we want to balance our near-term production growth with the opportunity to truly create shareholder value. That's why we are doing critical delineation and resource assessment work in the Delaware. We believe the payoff for this work will turn into a long-term, detailed inventory of projects that we can pull off the shelf at any time when the market and capital conditions are right. This is all about building sustained growth.

Speaking of the long term, we've begun a process to create a midstream JV in the Delaware Basin. Now, to be clear, that's not all of our midstream assets. Right now, we are only looking at a new gathering oil system and some gas processing in our Stateline area. We will absolutely keep you updated as this process runs its course. We believe it will wrap up sometime around the end of the second quarter. We've already seen a great deal of interest, and our goal is to do something that will enhance the overall value of our Delaware asset, and, by that, I mean our core upstream business.

I also want to point out the strength of our 2016 proved reserves. Reserves were up in all three basins with Permian leading that charge with 56% growth.

Now, let's turn to Page 3. If you think about the position we currently have in the Permian Delaware, you can see that our fundamental tendency is to only acquire what we believe is unique value. Our purchase of RKI back in 2015, followed by some inexpensive bolt-ons, was based on this approach. Not everyone understood at the time. Everyone does now. Value is exactly what we found in the Panther acreage. The Delaware Basin is arguably the best real estate in the oil and gas business in the nation, as evidenced by the sheer number of industry transactions over the past 12 months. We are gaining more than 18,000 net acres, over 900 gross drillable locations, roughly 6,500 BOE a day of existing production, along with an existing two-rig program.

The ability to drill a number of long laterals even more quickly also attracted our attention. We know the rock quality very well. It's a self-funding development, and we are excited that it's an accretive transaction for our shareholders and one that can accelerate our deleveraging. This is very important to us.

The same technical team here at WPX that evaluated and recommended the purchase of RKI back in 2015 is the same team that evaluated the Panther acreage. I only wish you could see the confidence in their faces now. The Panther wells provide extremely attractive returns, ranging from 55% and 95% IRRs at today's strip, and we expect to close this transaction next month.

Now let's turn to Page 4. Previously, we have been talking about growing oil volumes and EBITDAX at a compound annual growth rate of 20% to 35%. Once we close the Panther acquisition, the range gets even tighter and even stronger. Now, we are looking at 30% to 40% growth from 2017 through 2020 on a pro forma basis. And I have said the plan only contemplates modest rig additions of one to three rigs per year. This is not pedal to the metal. This is prudent and disciplined.

The thing I want to emphasize is our goal is sustained growth. If this were only about boosting near-term oil production, we could easily do that by increasing our rig count even faster. But we want to make sure we are focused on attractive returns in the near term and the long term. We believe that we have a compelling plan to accomplish both and a portfolio that's more than capable of doing everything we've set out to do. This plan is consistent with our character because we've always talked about being able to measure our progress in a tangible, transparent way. We have clearly spelled out our goals, our objectives, and our commitment to value creation on a per share basis.

Now let's go to Page 5, and I'll turn it over to Clay Gaspar, our Chief Operating Officer.

Clay Gaspar - ***WPX Energy, Inc. - SVP, COO***

Thank you Rick and good morning, everyone. 2016 was a momentous accomplishment in our never-ending pursuit of operational excellence. In all three basins, we meaningfully improved well returns with increased performance and lower well costs.

Beyond individual well performance, we are also progressing our understanding of each basin's optimal full field development. As an example, in the Delaware Basin, we drilled an important spacing test that will come online at the end of this quarter. This test will give us a much better understanding of proper vertical and horizontal spacing for the Upper and Lower Wolfcamp A. As I mentioned on the third-quarter call back in November, this spacing test will disrupt the cadence that we were able to bring wells on during this period. As we've seen in every resource play, the transition to more significant pad drilling causes production growth to come in lumps rather than steady, single well increments. I assure you the benefits of having this data and the value of pad drilling is incredibly important to our development plans as we ramp activity.

Let's turn to Slide 6 and take a look at what is and what will be a very hot topic for 2017, service costs. This is a very simple looking pie chart, but I can tell you that it represents a lot of work by many people in our organization.

I need to take you back a couple of years for you to really appreciate what's been accomplished. Two years ago, we set out to create a first-class supply chain organization. The objectives were to control costs, leverage internal service company experience, improve performance and, importantly, work alongside our operations team, supporting them. The team brought us to the early adoption of reaching back further in the supply chain to directly contract with sand mines, chemical manufacturers, and several other direct-source vendors. Although this is not the easy approach, it has allowed us to become an industry leader in well costs during the downcycle and will be equally important as we enter this inflationary market.

For 2017, approximately 70% of our drilling and completion costs are under contract. We have focused on the larger ticket items that also have the greatest exposure to inflation, like stimulation services, sand and rigs. The remaining 30% are primarily products and services that have significant market capacity, and should shield us from runaway inflation. Many of these contracts were signed back in 2016, probably the middle part of the year, when we were ahead of many peers in announcing our plans to get back to work with a multi-year production forecast. This allowed us to align with some incredible service company partners and support their efforts to retool facilities and rebuild their crews. Please let me be clear. While I applaud this great work, these are only mitigation steps to help us avoid a massive disruption in service cost structure.

We are certainly not bulletproof, and we will be exposed to market forces. We will continue to work with our service company partners who can provide the best value to the project and thus to our shareholders.

Now let's turn to Slide 7 and talk about the Delaware Basin. I should start with reminding you that our rig ramp from two to five rigs occurred late in the fourth quarter and we dedicated three of those rigs to drilling nine well spacing tests we've illustrated in the bottom right-hand corner of the slide.

We also focused the year-end efforts to better understand the X/Y and the D upside potential. We are very pleased with these delineation well results, especially considering that these were only 1 mile laterals. Our third Wolfcamp D well, the Pecos State 46-5H, came on with an IP 30 of over 1,600 BOE per day and, two months in, the well is still flowing at nearly 4,000 psi of back pressure. These are very stout wells. Importantly, this well confirms the prospectivity of the D of our entire Stateline position in that we expect similar results on a per-foot basis as our neighbors to the west that are drilling some amazing wells.

The next step for the Wolfcamp D is to understand well spacing and the potential for additional landing zones within the D. We will drill a handful of these wells this year to test some of these concepts.

We also brought on our second X/Y well. This one, in the southern part of our Stateline acreage, was a significant step out from other industry X/Y tests, and it confirmed our hopes. This well showed that the X/Y is prospective in the Stateline in addition to the Rustler Breaks acreage where we had more tests, and therefore more confidence. The Pecos State 46-6H had an IP 30 of nearly 1,800 BOE a day, again 1 mile lateral. The oil production from this well is tracking in line with our Wolfcamp A 1 million barrel type curve after 45 days.

We have drilled and fractured the nine well spacing tests. We are now starting to drill out plugs and will soon begin initial flow-back and should have the wells on production at the end of March. We are taking the time and expense to make sure that we are gaining critical knowledge from this unique opportunity. We will end up with fully bounded wells in the upper and lower landing zones while we test vertical and horizontal spacing.

Some of the early data has been very positive. We performed pressure tests on a couple of wells to understand the interference from the two-year-old existing producer. It's depicted on the left side here on the block at the interface of the upper and lower intervals. The pressure test in the new well closest to that existing producer showed no pressure depletion. This was surprising to the upside and it speaks well about our ability to keep pushing the well density. We are anxious to see the results of these wells after they're brought online and will share those results with you as soon as it becomes available.

Let's turn to Slide 8 and talk about the consistently strong results in the Williston Basin. As I mentioned earlier, we completed our entire DUC inventory in the Williston Basin earlier than planned. This helped drive oil growth approximately 40% from third quarter 2016 to fourth quarter 2016. We put 14 wells online in the fourth quarter, six from the Middle Bakken and eight from the Three Forks, and set a new drilling record of 11.7 days spud to rig release on a 2 mile lateral.

As one of our very well-respected peers commented to me, WPX has officially joined the Best-Of Club in improving our drilling times from roughly 40 days to 12 days in a couple of years. I'm so proud of how far this team has come, and I truly believe the progress is indicative of the future upside we will see in the Permian Basin as well.

On the right side of the slide, you see two bar charts -- 90 day oil cum and 180 day oil cum. These wells were generated from public state data for the wells drilled in the Williston Basin in 2016. On both the 90- and 180-day charts, the WPX wells are best-in-class. The high oil cuts in these wells have been and will continue to be a big part of our oil growth story. These results reflect the quality of our resource and the great technical work that our ops team has done to optimize our completion design.

Let's turn to Slide 9 and I can update you on San Juan. The six well West Lybrook wells -- excuse me, six-well West Lybrook pad continues to exceed expectation. The six wells surpassed 1 million barrels of equivalent production in the first 180 days with a 70% oil cut. As I have mentioned in previous calls, the Gallup play, we are targeting our drilling efforts for proper landing and geosteering. We've change the well azimuth. We've implemented more intense completion designs, and we are drilling longer laterals. All of these elements plus some really good rock quality have helped drive these impressive results.

I'm also happy to remind you we have averaged $4.1 million for these wells, which includes drilling, completions, facilities and even artificial lift. The West Lybrook unit is a 54-well development which will be the primary focus for the capital dollars in San Juan Basin in 2017.

With that, I'll turn it over to Kevin for a discussion of the financials.

Kevin Vann - ***WPX Energy, Inc. - SVP, CFO***

Thank you Clay. As they say, what a difference a year makes. As Rick mentioned, 2016 started out just about as rocky as they come. As a matter of fact, last year, much of the emphasis for WPX was around liquidity and managing through the downturn. As you know, we stayed focused on execution and seeing through the storm and the opportunities that lay within. We didn't hunker down, just hope for the best or wait for better commodity prices.

In managing a business, hope is not a viable strategy or tactic. We stayed true to form and maintained our bias for action. We cut our capital spending, made more progress on cost reduction, continued to high-grade our portfolio, and remained opportunistic as we strengthened WPX's financial position.

For 2017 and beyond, the stage is well set. We have a strong hedge book in place for 2017 and 2018 and ample liquidity to drive the value creation efforts that Rick and Clay discussed. As Rick mentioned, we'll take the stability we are seeing now over last year's volatility any day, but, at the same time, we have the flexibility and discipline to keep the ship headed in the right direction regardless if the waters are calm or rough.

Let's turn to Slide 11 and take a look at the fourth-quarter and full-year results. For the quarter, at 44,700 barrels per day, our oil production is 16% higher than for the same period of 2015. The increase in our Delaware production, together with the completion of Williston DUCs, drove this increase. For the full year, our oil production is 21% higher than last year and is also driven by the Delaware.

When comparing to the third quarter of this year, our oil production was up 15%. As we stated during the third-quarter earnings call, well completions in the Williston Basin did not recommence until August. We began to see the benefits from these completions during the fourth quarter. In fact, as Clay mentioned, our cadence of completions was faster than we anticipated, which helped fourth-quarter production and also kept us in front of some of the weather.

At approximately 200 million cubic feet per day, our natural gas production for the fourth quarter was down slightly versus the same quarter of 2015. However, when comparing full-year gas production, we were up 10%, which was again driven by the Delaware. At over nearly 89,000 equivalent barrels per day, our production is 9% higher than the fourth quarter of last year, and, at 85,000 barrels per day, we are 19% higher on a full-year basis.

For the quarter, for the fourth quarter, we are reporting an adjusted EBITDAX of $135 million, which is $71 million lower than the fourth quarter of prior year. The reduction in EBITDAX is primarily driven by the lower realizations on our commodity hedges. The lower hedge prices accounted for $153 million of the decline, which was offset by higher oil production and higher margins achieved on that production.

Also reflected in this quarter's results are the impacts of $11 million of costs related to severance associated with our continued efforts to size the organization commensurate with the remaining portfolio, and an additional expense related to the employee annual incentive program for performance that exceeded our 2016 targeted metrics.

For the full year, the $475 million of EBITDAX was $306 million lower than the prior year, and, again, was exclusively driven by the reduction in our realizations from our hedge portfolio as the average hedge price for crude was $60 per barrel in 2016.

For the quarter, we are reporting an adjusted net loss of $54 million versus a net loss of $23 million in 2015. The decline was driven by the same factors impacting adjusted EBITDAX but also by higher depreciation, depletion, and amortization in 2016 primarily related to DD&A recorded for Permian on higher production.

Our capital expenditures incurred for the fourth quarter totaled $160 million. On a year-to-date basis, our total CapEx of $584 million includes $84 million of land acquisition costs and $27 million of Piceance expenditures that were reimbursed to us by the buyer of those assets, which closed back in April. Excluding these amounts, our drilling and completion capital spending was in line with our full-year guidance.

Turning to Slide 12, just a quick update on our liquidity and hedges. First, as you will see, our liquidity remains strong. Prior to the end of the quarter, we did redeem the remaining balance of our 2017 bonds, leaving us with approximately $1.5 billion in liquidity at year-end.

Our hedge position for 2017 also remains strong. We have nearly 80% of our oil and natural gas production locked in at approximately $51 per barrel and $3.02 per MMBtu. For 2018, we now have nearly 30,000 barrels of oil hedged at nearly $57 per barrel.

On the natural gas side, for 2018, we had 155,000 MMBtus per day hedged at nearly $3.00.

We layered in more hedges over the fourth quarter to further protect our cash flows during 2017 and 2018. These positions, together with services which we have contracted for going forward, help ensure the growth targets that we have established for production and EBITDA. The hedge book we have compiled for 2017 and 2018 demonstrates our continued discipline to managing the balance sheet.

Lastly, and although not on the slide but back in the appendix, we have been actively pursuing some Midland basis protection. We've executed contracts for approximately 13,000 barrels per day of Midland basis swaps for 2017 and -- for 2017 and 2018 at $0.52 and $0.94.

Turning to Slide 13, we continue to be excited about our guidance for 2017, which grows oil production by 30%, inclusive of the recent Panther acquisition in the Permian. On a pro forma basis, we are continuing -- we are guiding to a production range of 103,000 to 113,000 equivalent barrels of oil production per day. Of this amount, our oil production is expected to be between 52,000 and 56,000 barrels. We will accomplish these production results through a drilling and completion capital program between $870 million and $940 million.

As you can see on the slide, half of our projected capital will be deployed into developing our Delaware position. As I've said before, with production from the Delaware growing as a percentage of our overall portfolio, certain consolidated items like price differentials and production taxes will continue to decrease.

I've talked before about what we've done over the last couple of years to strengthen our liquidity and balance sheet by restructuring our credit facility, executing one of the strongest hedge positions in the industry, and opportunistically issuing equity as the returns and growth potential came into view. I'm excited now about just what the three assets can deliver in terms of financial performance over the coming years. As you've heard from Clay, we now have the assets that can generate first-quartile type of performance.

With that, I'll turn it back to Rick.

Rick Muncrief ***- WPX Energy, Inc. - Chairman, President, CEO***

Thank you Kevin. Nice job.

On Page 14, we are a company that I believe is going to continue to accomplish some pretty remarkable things. I've been in this business all my life, and without a doubt I can tell you that our industry is entering another age of discovery and a new era of opportunity.

Are we going to have challenges? Sure. Will we work through them? Absolutely. And I can assure you WPX is going to be right in the middle of it.

Today, I am more excited about what lies ahead than I have ever been. The technology, the talent, the possibilities, and what we are learning are greater than ever.

Here at WPX, we are building more than a company. We are building true shareholder value. We've already built a bold future filled with decades of known drilling opportunities. I'm extremely confident that the technical teams that we have here will continue to generate even more future opportunities on our existing acreage base that will ignite even more value creation.

Finally, our multi-year development plan we have funded through cash flows from operations and cash on hand. To be very clear, we don't plan to access the debt or equity markets for this plan's implementation.

And at this time, we will now open the line up for questions. I'll turn it back over to you, operator.

QUESTION AND ANSWER

Operator

(Operator Instructions). Jeff Grampp, Northland Capital. (technical difficulty). Jeffrey Campbell, Tuohy Brothers.

Jeffrey Campbell - ***Tuohy Brothers - Analyst***

Good morning. I wanted to ask you if you could discuss the five ancillary zones that might be prospective in the Panther, or at least some of them. And is this prospectivity purely on geological analysis or are they supported by any industry results?

Bryan Guderian - ***WPX Energy, Inc. - SVP Business Development***

Good morning. This is Bryan Guderian. So, I'll sort of move around the acreage position here. There were three separate blocks that we described in our investor rollout for the acquisition.

Looking at the East Loving area, and really I would refer you back to Slide 4 of that investor rollout when you get a chance to go back and look at those materials. The areas that we felt were derisked in East loving, some of the shallower Delaware horizons there, there are analog wells nearby. And so I guess the initial part of your question -- really all of our analysis is based on analog wells, a deep petrophysical model that we built out in the Basin over the last couple of years, and then of course our own experience operating in the Basin and really across the entire Panther position.

I would say there is significant current development activity that we are evaluating on an ongoing basis.

So, again, back to the East Loving area, we felt that the zones that really were clearly derisked there based on what I just described and at least in that area largely driven by analog wells and current activity, the Lower Brushy up in the shallower horizons, but where the value really lies is in the upper section of the Wolfcamp in the X/Y, and then also in Wolfcamp A. It is a rich column there, and so we think there is upside potential, in particular in the second Bone Spring. Again, we have analog wells, but they are not as close or as proximal to the acreage position, but it certainly looks very prospective on logs.

And then once we get into the lower sections of the Wolfcamp, the B, C, and D, really the same situation there. We have analog wells. They are not as close or proximal to the Panther acreage position, so we treated that as upside and didn't value it.

In the central area, I would just say that everything from the third Bone down, , and in particular the Wolfcamp zones, X/Y all the way down through D, we gave certainly a derisked classification to there. We did not value all of it. Most of our value, again, was associated with the X/Y and the Wolfcamp A, but there are a significant number of wells existing, current development activity ongoing there that give us confidence.

And then finally, down in the southern area, less delineation in the south, but we have a really great Wolfcamp A well that sits on top of the Panther acreage. We will inherit that well once we close the deal. There's also some really nice Wolfcamp C that's kind of emerging in that area, once again driven by our petrophysical analysis logs and actual well performance. And then we gave upside to the B and D, the Wolfcamp B and D, in that area as well.

Jeffrey Campbell - ***Tuohy Brothers - Analyst***

I appreciate that really comprehensive answer. And --

Clay Gaspar - ***WPX Energy, Inc. - SVP, COO***

There is no short answer to what is the upside in this area. It just takes a little while to go through it.

Jeffrey Campbell - ***Tuohy Brothers - Analyst***

That's fine. I appreciate it.

And kind of sticking with the X/Y, particularly I guess the result in Eddy, but looking at both of them, you may already answered it for Loving, when you look at those two strong results, what other zones are most likely to be developed in concert with each of these when you get to the point of stack pad development?

Clay Gaspar - ***WPX Energy, Inc. - SVP, COO***

As I think about the X/Y, I think there will be a blended development with the third Bone Spring and I think a blended development with the Upper and Lower Wolfcamp A. We kind of see that as one sort of continuous cube.

I can tell you one of the things that the team has done that I really appreciate, they are starting to kind of peel the labels off some of these zones and just look at it as a cube and say, okay, let's not try and optimize an X or a Y development. Let's think about how this ultimately interacts with the third Bone and in the Wolfcamp A below it, and really kind of start delineating and wine-racking through that.

As you see in the Section 22, we have some penciled in Wolfcamp X/Y wells that we will eventually drill. That will expand our vertical understanding of how it interacts with the Upper Wolfcamp. But I can tell you we also need to look at the third Bone that's prospective in the area as well and ultimately how those resources are shared.

Jeffrey Campbell - ***Tuohy Brothers - Analyst***

Okay. Thanks very much. I appreciate the color.

Operator

Brian Corales, Howard Weil.

Brian Corales - ***Scotia Howard Weil - Analyst***

Good morning guys. How are you? I have two questions, one of the spacing tests. Are you all going to play in other tests, down-spacing both in the Wolfcamp A, and what does it ultimately mean? Are we going to get to development later in 2017, like full development type mode, or how much more production history and other tests do you need to see?

Clay Gaspar - ***WPX Energy, Inc. - SVP, COO***

We started with an assumption at the time of acquisition of a single landing zone, eight wells per section. We since matured that to two landing zones, eight wells per section, and that's what we are testing with the Section 22 development. I can tell you we have enough relative confidence in it that that's how we are moving forward. We have I believe three or four other pad developments that we will be drilling on that idea until we see something different either from Section 22 or from another spacing test either on our acreage or from what somebody else is doing. So I think we are not waiting to get the 99% solution. We are plowing ahead. We believe we are directionally in the right direction. And so we believe we can continue to improve that and hone that over time.

Brian Corales - ***Scotia Howard Weil - Analyst***

That's helpful. Thank you. And then you all were early to put out kind of a two-year development plan, which I think a lot of people have since followed. What are your biggest risks to achieving those oil production goals? Is it service cost inflation? Is it take-away? What are the big risks there?

Clay Gaspar - ***WPX Energy, Inc. - SVP, COO***

We were really thoughtful about how we laid that out, because we actually put a five-year bar chart together. We were more specific about the oil production in 2017 and 2018. But obviously, in doing so, just look at the last two years. There's no way to predict what opportunities or challenges the industry is going to throw our way. The macro environment, there's a number of things that could come up as a challenge or an additional opportunity.

So what we did was we assumed a very reasonable kind of strip looking oil price, $50 to $55. We assumed current technology on well development, how fast we are drilling the current completion design, the current number of landing zones and essentially the acreage we have in place.

And then as far as a cost structure, we assume that, with our -- the mitigation steps we've taken in place today, that the additional upside of additional learnings would offset the inflation, call it 10% plus, 10% minus, it's a relative wash. I can tell you we continually reassess that as we are seeing the $55 world that we are living in today on a three-year strip is really encouraging a lot of rigs to come back to work. Service companies are coming back to work as well.

So, ultimately, the answer to the inflation question, which I believe is probably one of the most significant risks to anyone's plan, you really have to understand how the service companies are responding to the rig growth and how the rig growth is really responding to the commodity price, whatever that shakes out to be. So we can just answer some things like what's the forward curve look like, what's the response from industry and how do the service companies respond to that, and I can give you a much more defined look of our response and how we grow over time.

Rick Muncrief - ***WPX Energy, Inc. - Chairman, President, CEO***

This is Rick. Let me expand just a little bit. One of the things that when -- I think we have a tendency to talk about service cost inflation. We are certainly not seeing it across the board. We operate in three basins.

And so one of the things that's been real key to our strategy is, if we were to run into some kind of a bottleneck, takeaway capacity, environmental issue, whatever it may be, it's really nice to have a second and third basin that we can lean on a little bit to get some great returns. And that's why we've maintained having the Bakken and our San Juan Gallup in our portfolio. So it's really nice.

As far as the Permian itself, if you roll up all of the expectations from most of the producers, you can see some pretty rapid growth. So I think that our work internally is we feel really good about crude oil and crude oil takeaway. We think we feel really good about the ability for operators to build gas processing plants and NGLs takeaway, those sorts of things. And I think we'll have to keep our eye on gas takeaway in 2019 and 2020 time frame. But I think we have enough time. We do see the nice growth in Mexico and a lot of existing pipe in the ground now. So, I really feel pretty good about the Permian, and that's the place I would think that we would run into some potential issues first.

Clay Gaspar - ***WPX Energy, Inc. - SVP, COO***

Brian, I think it's very noteworthy, Rick and I kind of threw out our top-of-head ideas on challenges and potential hurdles we may have to overcome. Neither of us talked about subsurface issues. We are fully confident in this resource that we have, and that is a great starting point. Everything else is ultimately fixable, but if you have that amazing stack of rocks to grow a business on, that's irreplaceable.

Brian Corales - ***Scotia Howard Weil - Analyst***

If I could squeeze one more. The Gallup wells are fantastic. How much of that acreage has been derisked?

Clay Gaspar *- WPX Energy, Inc. - SVP, COO*

Certainly, the West Lybrook where we have 2017's activity we feel very confident in. We've also spaced in a handful of other wells around our acreage position. We've been very, very pleased with the results. I can tell you some of them are pretty significant step-outs, very consistent. I wouldn't say it is quite as derisked as West Lybrook, but we haven't seen any red flags from the tests that we have done. I talk about kind of the last, oh, 13 or so wells with this new methodology have been very consistent and significantly better than anything we had drilled before.

Brian Corales *- Scotia Howard Weil - Analyst*

Thank you all.

Operator

Neal Dingmann, SunTrust.

Neal Dingmann *- SunTrust Robinson Humphrey - Analyst*

Good morning gentlemen. Clay, or Rick, looking at Slide 7 where it talks about the delineation of the Wolfcamp, can you give me an idea? My first question is just, of the five rigs running, how we should expect to see for the plan this year where actually I should assume those five are going to be running looking at that map.

Clay Gaspar *- WPX Energy, Inc. - SVP, COO*

You said you're on 7. Yes, so looking at that map, I would zoom out a little bit even further than that because it doesn't include a lot of the -- some of the other Panther acreage. Right now, we have five rigs running on the WPX acreage. When we close Panther, we will inherit two rigs there. So think of our seven-rig program, I would say, after close, they become all WPX rigs and we are ultimately trying to optimize that rig development.

Certainly, without question, Stateline is our epicenter. I would consider 75%, 80% of the capital to be focused there. The Wolfcamp A is still our bread-and-butter zone. That's been delivering every day. So a disproportionate share will be directed to the Wolfcamp A.

You know, we continue to sprinkle in a few other zones. We had talked before Panther about roughly 50 wells for Wolfcamp A, 15 for X/Y, and then five or so for Delaware, and then a handful of others that will be -- I mentioned the third Bone Spring, the Wolfcamp C, the Wolfcamp D. There's other zones that we need to start to understand, not so much for 2017's benefit but for 2019, 2020, and 2021's benefit and we will continue to just sprinkle a few of those in to make sure that we are building that greater inventory, and ultimately being able to high-grade those wells in as they compete with Wolfcamp A.

Neal Dingmann *- SunTrust Robinson Humphrey - Analyst*

Clay, when you take those two rigs over from Panther, will you in fact keep those same two rigs running? Could you just talk about, as part of that, what your rig contracts look like for all seven for the rest of the year?

Clay Gaspar *- WPX Energy, Inc. - SVP, COO*

Sure. Those two rigs are well-to-well contracts. We are talking to that company now. I would say it's very -- it's their game to keep. We will see. We have some flexibility. I think, ultimately, Rick and I's philosophy is to kind of have a mix of short, medium and long-term rig contracts, so you're not completely tied in where you don't have the flexibility, but, at the same time, you are not fully exposed to the market. And that's about where we sit today. So think of our rig contracts that we have for the five, by the third quarter, we have a couple of rigs coming off. Those actually might be Williston. So I'm thinking of the whole rig [fleet]. Let's round up to the

10 for a second, including the Panther rigs. So, we have a couple on well-to-well contracts. We have a couple that are rolling off contract by year-end, call it third quarter. Then we have a handful that are early 2018, and the balance will be late 2018. That's about the extent of our rig contracting.

Neal Dingmann - ***SunTrust Robinson Humphrey - Analyst***

Got it. Thanks Clay.

Operator

John Nelson, Goldman Sachs.

John Nelson - ***Goldman Sachs - Analyst***

Good morning, and thank you for taking my questions. Rick, in evaluating the strategic options for the Delaware Basin midstream assets, can you just speak to why the decision not to include the natural gas gathering and water handling assets, or what do you think it would take to potentially include some of those assets where I think the majority of your current midstream EBITDA is?

Rick Muncrief - ***WPX Energy, Inc. - Chairman, President, CEO***

I'm going to let Clay weigh in a little bit on this here in a moment. But I think, with us, as with a lot of things that you've seen us do over the last few years, is it's all about tempo and it's timing. Obviously, with the gas gathering and the water gathering, there's a lot of value creation there. We are looking at things like that, along with other areas that we operate in, as being future drop-down type opportunities. So, sometimes it just is an issue of maturity and timing and tempo.

Clay, do you want to --

Clay Gaspar - ***WPX Energy, Inc. - SVP, COO***

Yes, what I would just add to that is that, also, there's the continuity. As you can imagine, the well hookups on the gas gathering, the water system, those are things that are lifeblood to our daily operations. And we really wanted to make sure there was a smoothness in that transaction.

I can tell you we are talking to a variety of counterparties. Some come with very robust operations teams. Others would be putting those teams together. And so we wanted to hold out on that until we've gotten to a point where we feel like the team is running to have confidence in the JV. And then we fully intend, with the success of this JV structure, that we can roll in the gas gathering, the water infrastructure. And then, as Rick mentioned, there's much more acreage than just Stateline. This initial contemplation is just Stateline because of its maturity. But you can see our acreage to the northwest and also to some of the new stuff to the south and southeast. That would be great additional drop-downs for the right partnership.

John Nelson - ***Goldman Sachs - Analyst***

That's interesting. So your base case expectation now is that the JV partner would actually be operator of the midstream, not -- you would not you remaining as operator of those midstream assets?

Rick Muncrief - ***WPX Energy, Inc. - Chairman, President, CEO***

Not necessarily, John. It depends. And we are in the process, and so we've got a wide range. I'll just go back. We've done two earlier midstream deals in our past, one in the Williston and one in the San Juan, which, even though we work with another team, we remain the operator of those systems. And so it's still too early to say whether we would relinquish the processing operations and gathering operations to someone else yet.

Clay Gaspar - ***WPX Energy, Inc. - SVP, COO***

Yes, it really -- we are talking to different parties, and they need to assure us, and we need to have full confidence that in no way we are jeopardizing this much more significant value of the E&P business just to get a midstream deal done. So that's an interesting balance. There's great conversations, tons of interest, and I think we will have a lot of flexibility to create shareholder value through this transaction.

John Nelson - ***Goldman Sachs - Analyst***

That's helpful. And then Clay, just on the oilfield service that you laid out, you think about 70% of 2017 costs are locked in. Does that still allow for cost pass-throughs, or is that kind of absolute costs are locked in? And can you give us some context of how much you would expect costs to rise then in 2018?

Clay Gaspar - ***WPX Energy, Inc. - SVP, COO***

Yes, sure. As you can imagine, the 70% is a host of contracts, agreements, various forms and contracts. I hope to not dive into any of those at that level of detail. you'd imagine a company coming to us saying, look, our hands need an additional X dollar percent raise. We are willing to talk on some of those kind of things. We do have a couple of the agreements that contemplate rising oil price, and there's price escalators. These are very moderate price escalators that, to be honest, I'd be happy to pass through and take on in the face of rising commodity price.

I think something to emphasize, most of these are agreements, and again, mitigation steps to make sure that we have that surety of service. We have selected vendors that we really want to partner with. We've been incredibly happy with the results. This has allowed them to get back to work and ahead of some of their other peers. So, they've been willing to be pretty aggressive in their pricing to have that surety. I can tell you the move that we made in announcing that multi-year production growth really enabled us to kind of bring that to our service companies and say, look, guys, we are locking in. We've locked in a lot of the commodity price. Now we are looking to lock in a little bit more certainty on the cost structure. And I can tell you, it was an incredibly receptive conversation, especially when we started the conversations in mid-2016. I hope that these partnerships, those guys, will continue to honor their word and appreciate the relationships that we have, and that we can ride this wave up together.

To your secondary question, overall inflation, it's so hard to predict these things. We feel like we've made a lot of strong steps to help mitigate. Really kind of runaway inflation or scarcity of service is my biggest concern. If I had to put a number to it, I would say put an overall 10% adder on our costs. And I would also caution you, or advise you, I bet we find another 10% improvement on EURs and IPs and just a number of things that we are continuing to research on landing zones and steering and completion technology that's not baked in as well. So we've budgeted as a wash. In reality, it will be something different than the way we see it now, but hopefully in that kind of margin of error.

John Nelson - ***Goldman Sachs - Analyst***

I guess just clear on that, so -- sorry Rick. Go ahead.

Rick Muncrief - ***WPX Energy, Inc. - Chairman, President, CEO***

One thing I would expand on is it's only been one year ago, then about a year and a half before where we had two pretty dramatic events with commodity pricing. And we looked -- a lot of these service providers have either worked for Clay or myself quite a bit over the last 30 years. And we certainly honored our contracts, worked with them. The easy thing would have been to pull the plug when the commodity prices collapsed, but that's not the way we run our business, and I don't think it's the way our service partners run theirs. So I want to concur exactly with what Clay was saying, that we think that we can manage this very, very well, but the fact that we were one of the first companies to put a multi-year plan out there gave us the confidence and the ability to sit down and have some very, very meaningful conversation, because these organizations are absolutely rebuilding and they were very, very appreciative of what we could do to help them.

John Nelson - ***Goldman Sachs - Analyst***

Great. Congrats on the quarter. Take care guys.

Operator

Robert Christensen, Drexel Hamilton.

Robert Christensen - ***Drexel Hamilton - Analyst***

Thank you. A couple of questions on the midstream JV. Are you talking to the existing companies, with MLPs or MLPs? That's question one.

Question two, are you talking to partners that have interests in assets nearby you, or are they even outside the Basin or somewhere else in the Basin?

And number three, how quickly do you think you're going to ramp up to 100,000 barrels a day on your existing -- or your I should say build-out of your oil system? Thank you.

Clay Gaspar - ***WPX Energy, Inc. - SVP, COO***

What I would say is the answers to questions one and two are yes. We have opened the aperture pretty wide. We have tried to not be overly prescriptive of this is the exact counterparty we are looking for. I can tell you the counterparty we are looking for is a partner. We see this very differently than the San Juan or the Williston asset sales. This is a partnership that will live on for a long time. This is a very immature, under-developed piece of business that we'll have significant investment and very significant decisions along the way that we'll need a really good partner to stay alongside us. And I'm sorry, your third question was the growth to...

Rick Muncrief - ***WPX Energy, Inc. - Chairman, President, CEO***

100,000 barrels.

Robert Christensen - ***Drexel Hamilton - Analyst***

I think 100,000 barrels is the design of your oil system. I know you're contributing to it, but I imagine there's third-party oil coming on to the system. How quickly do you think we are going to be ramping towards capacity?

Clay Gaspar - ***WPX Energy, Inc. - SVP, COO***

Bob, when you think about a system like that, you have the trunk line, which is kind of the main hub that runs north-south right through the middle of Stateline. And that's where you can have capacity for 100,000 barrels a day. You obviously have trunks, or excuse me, branches off of that trunk that are somewhat smaller and smaller branches off that. And so as we look at it, I can tell you the cost difference to making that trunk 100,000 versus 75,000 or even 50,000 is relatively small. So, we put in some big pipe. How it expands over time, we want to maintain that flexibility. You can see very significant growth. We talked about growth only in terms of, at the corporate level, we don't offer that granularity to look at just Permian or even just Stateline. But I can tell you there's a disproportionate amount of our total company growth happens right there in Stateline, so it's a pretty big, material number. We've certainly sized it with the contemplation that we could have third-party business come on. We are wide open to that. Very importantly, we will have ultimately four offloads from that system, and so we will have a great flexibility to achieve some really good markets there. But we just wanted to build in something that wasn't an overall bottleneck or a constraint. We see huge, huge running room in Stateline. We are more excited about it today than we ever have been.

Robert Christensen - ***Drexel Hamilton - Analyst***

Two more questions I guess, please, related to this JV. Number one, do you think you could take in any cash from entering into a JV?

Clay Gaspar - ***WPX Energy, Inc. - SVP, COO***

I would say that's certainly a clear possibility, not an absolute requirement, but I would say it's a likely scenario.

Robert Christensen - ***Drexel Hamilton - Analyst***

And then the final question if I may. From the pad that you've drilled these spacing tests on, presumably it's going to enter the production equation here in the next 90 days. Should we expect a commensurate surge in production as these wells come on here in the second quarter? It would seem to be like eight, nine wells that would all get brought out at once, but certainly didn't contribute in the fourth quarter but could contribute here in the second quarter. Or should I think that way about a surge in production pads coming on?

Clay Gaspar - ***WPX Energy, Inc. - SVP, COO***

I sure hope you see a surge in production. If not, we are not doing something right. So, yes, the way we have this geared up, as I said in my notes, we have a -- we are drilling the wells out now. We are doing some early flow-back testing. They will be on kind of full-speed the last week in March, first week in April, somewhere in there. We should see some very significant production that will greatly benefit second quarter. We've tried to telegraph, as you guys have subtly picked up throughout the messages, that we have a few wells coming on in the first quarter, but the second quarter should be really very significant. So when we talk to you again in May, we will have some of the same comments and we will be able to talk much more about what the current activity is and our excitement level around this new nine-well pad.

Robert Christensen - ***Drexel Hamilton - Analyst***

That's excellent. Thank you Clay.

Operator

Michael Glick, JPMorgan.

Michael Glick - ***JPMorgan - Analyst***

At Stateline and maybe more broadly in the Delaware overall, how much of your acreage is amenable to 1.5 and 2 mile laterals? And could you talk a bit about the opportunity set to grow your average lateral length via swaps, leasing, and bolt-ons? And can you leverage your infrastructure at Stateline to grow your average lateral length there?

Clay Gaspar - ***WPX Energy, Inc. - SVP, COO***

Yes. So, for our 2017 program, we have about 40% of the wells will be long laterals. That's either 1.5 or 2 mile laterals. We haven't talked about plans beyond that because we are actively doing a lot of the things that you are talking about. We are completing one-for-one trade opportunities. And I can tell you these are incredibly mutually beneficial deals that we are working with many other peer companies in the area, making some really good progress there. I would say we've made more progress in the last few months than we had in the prior 12 months. Things are really starting to flow.

One of the challenges we've had in making more meaningful concentration is that we haven't had a lot of acreage that we've wanted to trade out of. And so I think, as we kind of come to terms with, okay, would we be willing to give up this piece for that piece, I think that's really helping get some of these deals done and I think you'll continue to see much progress.

So, as of today, I would say it's a relatively low number to where it will be in the next six to 12 months. We will continue to make very strong improvements, and that's clearly our objective, is to drill as many 2 mile laterals as we can. We continue to see and we believe in the economics there.

Michael Glick - ***JPMorgan - Analyst***

Got you. And maybe are you answering this with your rig count, but how do you think current returns compare across your three asset areas, just given kind of strong results across the board?

Clay Gaspar - ***WPX Energy, Inc. - SVP, COO***

It's interesting. I love that we have three assets -- three great asset teams. And those teams are very competitive for capital. When you're comparing the 1 mile laterals we are drilling for the most part in the Stateline and in the Permian, they are very competitive with what we are drilling in the 2 mile laterals at the Williston, the 1.5, typically 1.5 miles in San Juan. So we've got this internal competition for capital which I think is incredibly helpful. These teams very much feel that they need to keep each other honest. They don't hesitate to give each other a little pat on the back or kick in the butt when necessary. Ultimately, we are very transparent that there is a dichotomy in the amount of inventory. Without question, the growth of the Company and the future of the Company is in the Permian asset, so when you start thinking about materiality and the thousands of wells of opportunity, the Permian is really our -- certainly our crown jewel.

Michael Glick - ***JPMorgan - Analyst***

Got you. Thank you very much.

Operator

Gail Nicholson, KLR Group.

Gail Nicholson - ***KLR Group Holdings, LLC - Analyst***

Good morning everybody. In regards to the comment that Rick mentioned earlier about the one- to three-rig count acceleration on a per annum basis being modest, what do you think would be an aggressive rig count acceleration? And what do you need to see, either from efficiency gains, well cost standpoint, and/or commodity price movements to be more aggressive in that rig tempo acceleration?

Rick Muncrief - ***WPX Energy, Inc. - Chairman, President, CEO***

I think the term "aggressive" is a relative term. I think, for us, an aggressive -- when I look at our inventory, I would say an aggressive for the San Juan is adding one more rig. And the reason I say it, it doesn't sound much until you realize we are drilling these wells with a 7,500 foot lateral and one is under six days from spud to rig release. So you start thinking about that. So one rig there, I would say two in the Bakken, and probably five down in the Permian. We've got the assets, we've got the abilities to do that. I think that is not the right thing to do and that's why I am going to go back to something that's very -- I want to make sure everybody understands is we are going to see rapid growth. When you start talking about 30% growth this year on crude oil volumes and 60% in 2018, I think that's some pretty significant oil growth, and we are doing it in a very disciplined way. But we could, to answer your question, we could lean in, in all three of our asset areas, a little more. I just don't think it's quite the thing to do right now.

Gail Nicholson - ***KLR Group Holdings, LLC - Analyst***

Okay, great. And then in regards to the spacing test in the Delaware, when you look at kind of overall the drilling, the efficiencies that you thought you could potentially achieve utilizing pads, did you achieve those efficiencies and was there any outperformance versus the initial expectations on that spacing test?

Clay Gaspar - ***WPX Energy, Inc. - SVP, COO***

Yeah we did. We didn't highlight it in the notes today, but certainly we saw some great efficiencies in pad drilling. We are actually drilling some of these Wolfcamp A wells in about 16 days as compared to our 22, 25 that we have built into the pads -- in the plan. So yes, we definitely see efficiencies in that. The rigs are getting better. The crews are getting more in sync. Remember some of these rigs that we brought in are fresh to us. Some of them stack, some of them are working for other companies. So those teams need some time to really kind of gel, and I see us continuing to improve beyond the current records we have today.

Gail Nicholson - ***KLR Group Holdings, LLC - Analyst***

Okay, great. Thank you.

Operator

That's all the time we have for questions today. I'd like to turn the call back to Mr. Rick Muncrief for any closing remarks.

Rick Muncrief - ***WPX Energy, Inc. - Chairman, President, CEO***

We want to -- I know it's a busy time of the year, certainly with investors and with analysts, and we've taken quite a bit of time this morning to go through a plan, not only our results for the fourth quarter that we're extremely proud of and a full-year 2016 that we are extremely proud of, but we are excited about what lies ahead in this year 2017 and as then we go into 2018. So thank you very much for your time this morning. Have a great day.

Operator

Ladies and gentlemen, thank you for participating in today's conference. This concludes today's program. You may all disconnect. Everyone have a great day.

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