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BOONE PICKENS, COMPANY HUNTER

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COUPS AND CATASTROPHES OF THE YEAR

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PROFILE/PETER NULTY

BOONE PICKENS, COMPANY HUNTER

■ "Who is Pickens anyway?" asks Harold Hammer. "Everything he says is horse—— and hot air." Not likely. If T. Boone Pickens Jr., chairman of Mesa Petroleum in Amarillo, were only bluster, Gulf Oil's otherwise dignified executive vice president would not feel compelled to launch scatological missiles toward Texas. A trailwise company hunter, Pickens has terrorized the oil industry with tender offers, proxy fights, closed-door deals, and talk of restructuring. He has brought home more money for little Mesa (1982 revenues: $375 million) than corporate pelts. This time, with the largest critter yet in his sights (Gulf's 1982 revenues: $28 billion), Boone Pickens may bag his prey in the end.

When he's not gunning for deals, *Boone Pickens likes to hunt quail.*

Pickens doesn't look like a swashbuckler. At 55 he is a fine racquetball player and golfer, but there is little hint of the athlete in his unimposing 5-foot 10-inch frame and boyish face gone to jowls. For business he dresses in conservative suits and polished wing tips—no silver buckles or snakeskin cowboy boots. He has ten-gallon ambitions, however.

Starting in October, Mesa bought 8.3% of Gulf's stock and, as head of a consortium called Gulf Investors Group, Pickens has voting control of an additional 4.1%. He and his allies—they include G. Michael Boswell, chief executive of Sunshine Mining, and Canada's Belzberg brothers—were still buying in December. He wants to force Gulf to place part of its domestic oil- and gas-producing properties in a royalty trust and issue trust units to Gulf shareholders. (For an explanation of trusts, see page 58.) The trust's cash flow, after operating expenses, state severance taxes, and the inescapable windfall-profits tax, would all be paid to unit owners. Pickens figures that between the surviving company and the trust, the market value of his Gulf holdings would increase from a recent $44 a share to at least $60—a nifty $219-million profit.

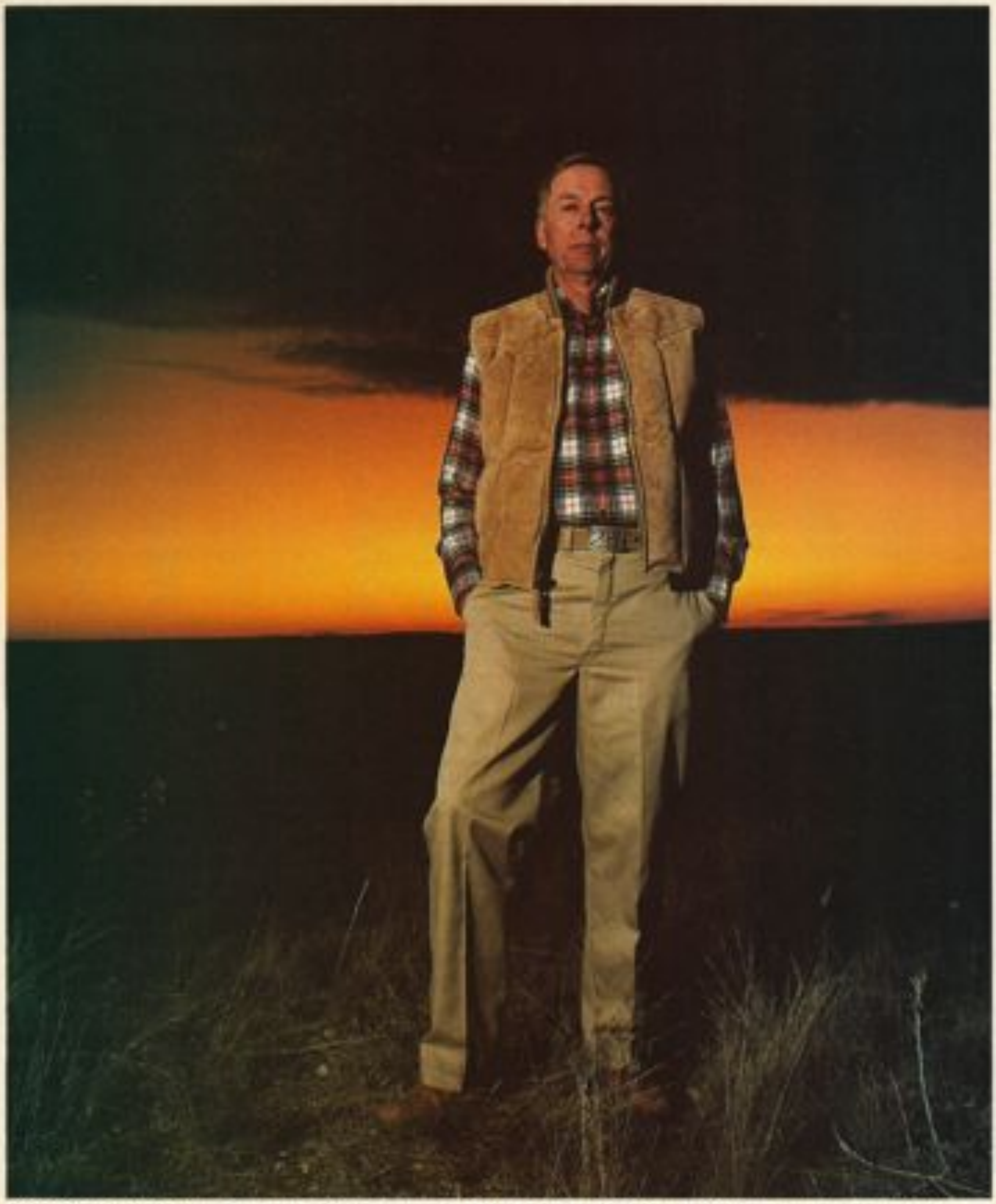
Hammer, 63, designated by Chairman James Lee as Gulf's field commander, says the royalty trust is "a dumb idea that would mutilate Gulf Oil." To head Pickens off, Gulf called a special meeting of stockholders December 2 to reincorporate the Pennsylvania company in Delaware. Under Delaware rules, Gulf could curb Pickens's power to elect board members, call special stockholder meetings, and submit charter amendments to shareholders. Gulf figured that Pickens planned a proxy fight for a showdown at the annual meeting next spring. The special vote was intended in part to throw off Pickens's timing. Said Hammer: "I wanted a referendum on Boone Pickens taken at a time not of Boone's picking." So many stockholders turned up that the meeting had to be shifted from a Pittsburgh hotel to the convention center. Afterward the company said it hopes to announce the outcome by December 22.

Whatever the tally, the game will not be over. If Gulf loses, Lee and Hammer will be under heavy pressure to do something fast, perhaps acquire another company with stock, thus diluting Pickens's voting strength. One possible mate might be Petro-Lewis, a Denver oil company (see "The Mysterious Money Magnet in the Oil Patch," September 5). Petro-Lewis has retained Salomon Brothers to seek what it calls "new financial opportunities." Gulf has retained Salomon to help battle Pickens. A little corporate matchmaking would be right up the investment banking firm's alley.

If Gulf wins, the pressure will be on Pickens. The stock was sell-

RESEARCH ASSOCIATE *Michael Rogers*

PHOTOGRAPHS BY ARTHUR MEYERSON



In the wide-open spaces *north of Amarillo, Pickens runs some 2,500 head of cattle on a 40,000-acre ranch. He gets there mostly on weekends.*

Inspecting his ranch, *Pickens spends a lot of time in the saddle, but modestly says he's not much of a rider.*

Gulf C.E.O. James Lee, *61, first met Pickens at a Yellowstone Park gathering. They fished, played cards, and sang "God Bless America."*

ing for $36 a share before his massive purchases drove up the price: Pickens and his group paid an average of just over $44 a share for their $903-million stake. A Gulf victory would dim the prospect of a quick bonanza, and Gulf shares might drop. Pickens would have two obvious ways to stave off a financial misfire—seek to keep suspense alive and the stock price up by extending the proxy battle, or try to sell his shares to Gulf at a premium. In November he promised shareholders whose proxies he was seeking that he wouldn't make a separate deal. But if shareholders didn't follow his lead on December 2, Pickens could declare the promise null and void.

Reaching a deal with Lee and Hammer wouldn't be easy. For two years Lee pruned Gulf in a painful attempt to revitalize one of the weaker of the Seven Sisters. He sold off most European refining and marketing operations and cut 14,000 people off his payroll. Just when he thought the worst was over, along came Boone.

Proxy fights are like a war, Hammer says. "You can take a high road or a low road and I'm taking the low. I'm going after Pickens's record because he's got nothing to offer." Hammer is also mad at the banks, led by Citibank, that have backed Pickens's group. When Salomon Brothers invited Hammer to play in its annual tennis tournament in November, Hammer accepted because Walter Wriston, Citibank's chairman, would be in the tournament. "I want to beat that little ——," said Hammer after a harrowing day of anti-Pickens strategy sessions in New York. "And if I don't, I'll jump across the net and cram my racket down his throat." (Hammer, teamed with tennis pro Clark Graebner, won the tournament.)

Until Pickens showed up, the oil majors were thought to be boats

When she isn't traveling with Boone, *Beatrice Pickens (above) is the working manager of the ranch.*

Company	Date in-date out	Investment in millions	Gross profit in millions	Net profit in millions
General American Oil	11/76-3/83	$31.7	$43.6	$25.3
Supron Energy	3/78-3/82	$11.4	$32.5	$22.2
Cities Service	6/79-6/82	$182.4	$44.2	$12.7
Superior Oil	2/83-9/83	$135.7	$31.6	$13.7
Gulf Oil	8/83-?	$604.4	?	?
Seven other companies	Not applicable	$50.1	$7.8	$1.6
Total	Not applicable	$1,015.7	$159.7*	$75.5*

* Excluding Gulf

Boone's Biggest Deals

Boone Pickens has made a lot of money for Mesa Petroleum by investing in the stock of other oil companies. He started small in the early 1960s. Not all his deals were profitable, but he was undeterred. The $604.4 million shown for Gulf includes investments through December. So far this year Pickens has generated $39 million in securities gains. "Is he an oilman or an investment banker?" asks Harold Hammer of Gulf.

too big to rock. So what gives the rambunctious man from Amarillo such power? The common wisdom is that he has an uncommon desire to make money and a nose for good deals. But that's true of many entrepreneurs who don't have Seven Sisters executives dialing with trembling digits for their lawyers. What sets Pickens apart is the passion he brings to the hunt. He identifies his own interest, Mesa Petroleum, with what he claims is the interest of a downtrodden constituency, the stockholders of other oil companies. He is a rebellious populist of the shareholder class.

Right now Pickens thinks the U.S. oil industry is ripe for a shareholder uprising. Domestic reserves of oil and gas have declined in the last ten years. As long as prices were skyrocketing, oil companies found their assets increasing in value even as they decreased in quantity. But prices have fallen since 1981. In Pickens's view, some companies are frittering away the huge cash flows from yesteryear's discoveries in high-cost exploration for new reserves that are increasingly hard to find. In some cases, he claims, the companies wasted money on non-oil diversification—he points to Mobil's purchase of Marcor and Exxon's purchase of Reliance Electric—or on propping up unprofitable refining and marketing operations.

The stock market appears to agree with Pickens that something is out of whack. According to the engineering and consulting firm of John S. Herold Inc., shares of exploration and production companies with small reserves are priced at an average of about 90% of asset value. The giants, which have massive reserves, are priced around 40% or less of asset value. Pickens argues that several big companies, whether they admit it or not, are in a "state of liquidation," because they can't consistently replenish their reserves. He would have companies "liquidate efficiently" by pipelining more cash flow to shareholders as a return of capital, and less to exploration and diversification. This, he argues, would force the market to price the stocks closer to true value. Many oil executives agree that prospects for reversing the shrinkage of U.S. reserves are bleak. But they argue that the industry is not liquidating. Prices will go up eventually, they say, and there are other energy sources for companies to develop. And even as oil discoveries dwindle, a few lucky winners will still make big finds.

Naturally, all oilmen see their companies among the winners. Says Lee of Gulf, with at least the appearance of undaunted optimism, "We have shifted our U.S. exploration strategy to the high-potential offshore frontiers. We're looking for a Prudhoe Bay. In the next two or three years we will replace reserves." With remarkable candor and an implied nod to Pickens, he adds softly, "If we are unsuccessful we would probably be much more receptive to looking at other things to do with assets and cash flow." Whether to pay more to shareholders now or put the money into exploration is an issue, says John Swearingen, former chairman of Standard Oil of Indiana, "on which men of good conscience can disagree."

Pickens might be regarded as an out-and-out opportunist if it weren't for his record. In 1959, having founded Mesa's predecessor company in 1956, he invested $35,000 in Canadian oil and gas properties, which he sold in 1979 for $600 million, before Canada slapped burdensome restrictions on foreign oil operators. In the mid-1970s Mesa discovered a field in the North Sea that Pickens named after his wife, Beatrice. He sold the field for $65 million in 1979, just before British tax laws started siphoning off profits.

Trained as a geologist at Oklahoma State, after a year at Texas A&M, Pickens has demonstrated a flair for finance. He formed the first large, publicly traded oil royalty trust in 1979, using Mesa properties and issuing stockholders one trust unit per Mesa share. He formed a second trust last year. When the first trust was announced, Mesa stock was selling for $40 a share. The market value of a share of that stock, plus trust units, reached a high of $183.50 in 1980 and now is about $92. Standard & Poor's index of similar production companies has lagged well behind Mesa's performance.

In 1981, as oil prices slipped and demand for natural gas weakened, Pickens foresaw that Mesa might be in for some lean years.

continued

THE ROYALTY TRUST ARGUMENT: WHO GETS THE CASH?

■ Mutilation. Dismemberment. Death. That's how Gulf Oil executives in Pittsburgh think about royalty trusts. But the actual royalty trust issue is cash flow and how it's divvied up. When producing properties are put into a trust, the company's management is no longer able to decide how to spend the cash flow from those properties.

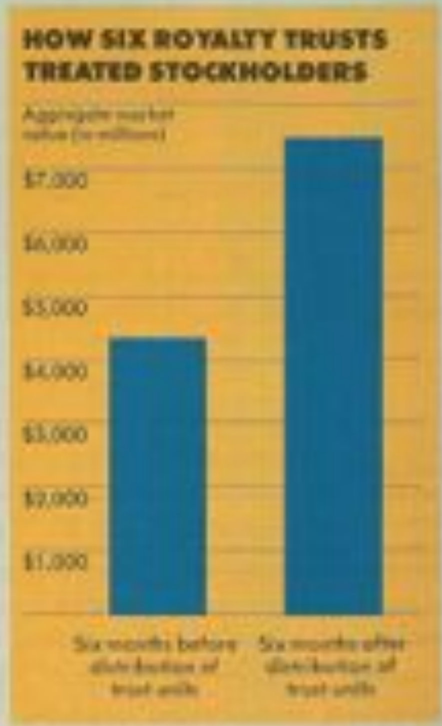
The cash flow of properties held in a royalty trust is distributed to stockholders. Gulf Oil, by contrast, distributes about 15% of its $3.2-billion-a-year cash flow as dividends and reinvests the rest in company operations. History indicates that the stock market values properties in a trust higher than when they were part of the larger company (see chart). Prices of big publicly traded oil trusts—there are eight—range from five to 16 times cash flow, depending on whether the included properties are long- or short-lived, oil or gas, exploratory or developed. Gulf shares sell at about 2.3 times cash flow.

The market discounts many oil stocks to as little as 40% of true asset value because of what security analysts call reserve depletion. After a company creates a trust, however, it has fewer reserves than before and therefore a better chance of discovering or buying enough oil or gas properties to replenish them. Together the establishing company and the new royalty trust have a better chance of being fully valued.

The tax consequences of all this are intricate—for example, the royalty trust avoids double taxation, but few oil companies pay much corporate tax. If the distributing company has retained earnings, the Internal Revenue Service taxes the spinoff of a trust as it would a common-stock dividend. Congress has talked about acting to discourage formation of trusts, fearing loss of tax revenue. Pickens argues that the federal take from oil and gas properties might well rise when the properties are put into a trust—but the unit holders will have more money with which to pay their taxes.

An independent study by the brokerage house of Oppenheimer & Co. estimates that if half of Gulf's U.S. oil and gas properties—the most profitable assets—were put in trust, Gulf stockholders would get $700 million more a year after development costs, and Gulf's annual cash flow would fall from $3.2 billion to $2.2 billion. That would leave more than enough to maintain the company's U.S. exploration budget at the $400 million spent in 1982. Had a Gulf trust been created in 1982, what was left of the company would have found new reserves equivalent to 107 million barrels of oil during the year and produced only 97 million barrels. The Oppenheimer study concludes that Gulf shares would sell for $34 each and the trust units for $32. The total is almost twice the pre-Pickens price of Gulf shares.

Gulf Chief Executive James Lee still doesn't like the idea. "If you want to play in the big leagues, you'd dad-gum better be integrated," he says. That means keeping control of all the cash flow you can for refineries, exploration, and development. Lee adds: "Pickens thinks we're worth more dead than alive, but I'm not ready to throw in the towel yet." The hombre from Amarillo replies, "If they create a trust, they'll be a lot more alive than they are now."



The Quick Response: Up

Creating royalty trusts sharply increased the composite market value of six public companies (above). The calculation (by Mesa) combines stock and trust unit prices. Mesa attributes 30% of the gain to general stock market trends.

About 80% of the company's reserves are of natural gas, and much of its gas-producing capacity is shut in. The record of his celebrated string of stock transactions since then reads like the campaign diary of a modern Geronimo: the battles of Cities Service, Superior Oil, General American Oil of Texas, KN Energy. Even when Pickens has not achieved his primary purpose, Mesa has profited handsomely (see chart, page 57).

Some investments, such as the $136 million he put into Superior, were pure speculation, but others were bold takeover attempts. When Pickens went after Cities Service, 23 times Mesa's size, he narrowly escaped losing Mesa when Cities put out a counter tender for Mesa stock. He was saved by Lee and Hammer, of all people, who agreed to merge Gulf with Cities Service. (Gulf later backed out and Cities was acquired by Occidental Petroleum.) The $100 million that Mesa gained from his financial dealings in the last two years won Pickens admiration on Wall Street.

PICKENS WORKS his Wall Street constituency with care, scoring points like a polished veteran of the hustings. He likes to keep it simple: "I took Gulf stock from $35 a share to $45. If I lose, it will go back to $35. If I win, we'll all be richer." Occasionally, the battle fatigues of a guerrilla insurgent show beneath his pinstripe suits, as when he declares: "The industry is due for revolutionary changes. Big institutional investors are learning that. Small shareholders don't know yet. Someday they'll get together and that's when it will happen."

In November he set up a meeting in the Empire Room of New York's Waldorf-Astoria to explain his plans for Gulf. It was an afternoon of pouring rain, but over 200 financial analysts and money managers endured squishy shoes to show up. Pickens took 15 minutes to work his way from the door to the stage, shaking hands and answering questions while strobe lights flashed. Once on the podium, he introduced his wife, the bright-eyed Beatrice, who often travels with him. "Bea's here to catch any soft fruit that comes my way," he said in a gentle drawl. None did. Then he announced he wouldn't cut any separate deals with Gulf. That was what the audience wanted to hear. Asked what he would do if Gulf tendered for Mesa stock, Pickens replied, "If they offer a premium, they've got it." (Laughter.) And how was he promoting his royalty trust plan to Gulf shareholders? "Door to door, shaking hands." (Laughter.)

For all his down-home charm, Pickens can be iron tough. According to one former Mesa executive, "He always has to be in control." On his way out the door one afternoon after issuing orders to his secretary, several vice presidents, and assorted aides, Pickens turned to a visitor and confided, "They're glad when I'm gone."

His penchant for discipline, he says, comes from women in his family. His mother and grandmother "had to have everything right." During World War II his mother was in charge of issuing gasoline-rationing stamps in Holdenville, Oklahoma. One day a man complained that he'd lost 100 gallons of gas when a pump nozzle fell on the ground. She listened sympathetically until the man asked for additional stamps. "Have I done anything," she said, "that would lead you to believe I would make good on *your* mistake?"

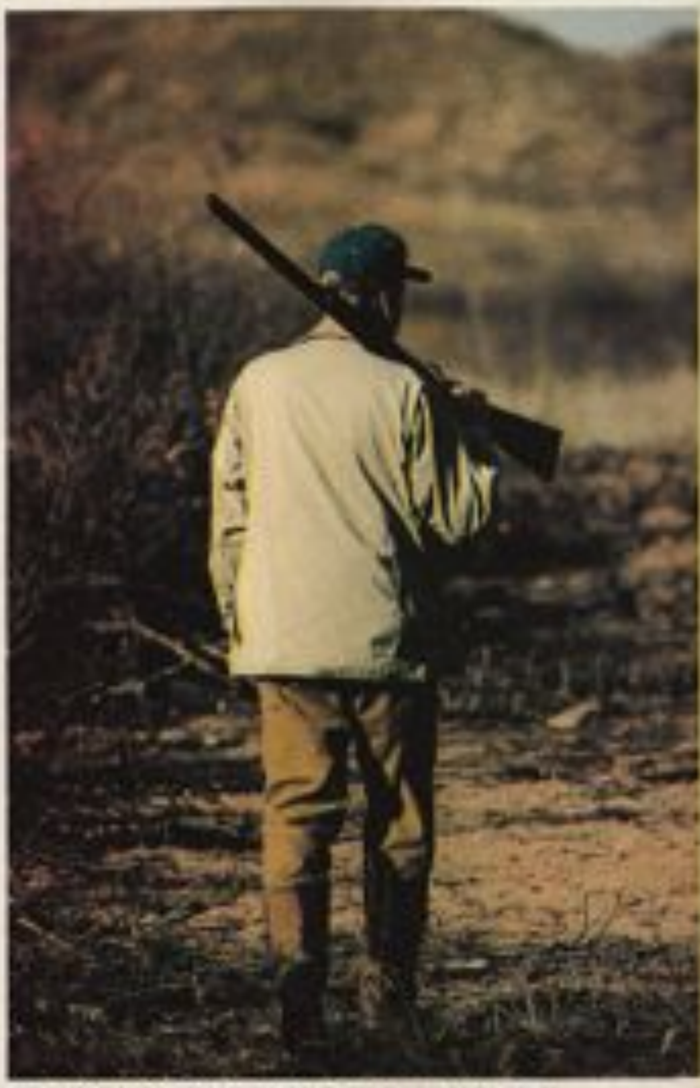
Pickens, an only child, did not escape an occasional sting of disapproval. His Aunt Ethel, who lived next door to his family, taught Pickens geography in grade school. "I got A's in almost all my papers and tests," he recalls, "but she wouldn't give me an A in the course. She told my mother I wasn't living up to my potential." Aunt Ethel also told Mrs. Pickens that little Boone's imagination would get him into mischief.

Aunt Ethel was right. Pickens has always had a yen for pranks. Pat E. Sasser, who played basketball with Pickens at Amarillo High School, says Boone was the showboat of the team, passing the ball behind his back during games and throwing water-filled paper bags from hotel windows while at tournaments. Today Pickens likes to play gin rummy and frequently takes Ed Watkins, an Amarillo orthodontist, "the only man who can consistently beat me at cards," on his business travels. On a trip by corporate jet to Toronto, Pickens told Watkins they were bound for San Francisco. Watkins had never been near either place and didn't discover the ruse until he set off in downtown Toronto to find Fisherman's Wharf.

Pickens argues that he is not up to mischief at Gulf. He says he doesn't want to run Gulf Oil and isn't gunning for Gulf management. "I am fighting as an investor to create value for Gulf shareholders," he says, "and I am shocked at the hostile reaction of Gulf. I can't figure out what they're afraid of."

Lee, who once played a few hands of rummy with Pickens, claims he thinks Mesa's chief is "a nice fella." But Lee must wonder if Pickens is as disinterested an investor as he claims—or if his proposal to create a royalty trust might turn into a blind for further corporate adventuring, a little like an invitation to San Francisco.

■ Proponents of change are often controversial and in the heat of battle sometimes look more threatening than they are. Pickens may or may not turn out to be a boon for the oil industry. But he is forcing oilmen and investors to think hard about how the oil patch might be made to pay off better. ■



Pickens's credo: *"Never shoot anything you can't eat."*