A&D R&R

The sky did not fall, but it may seem a lot closer to the ground now. It is an understatement to say that E&P asset-buyers and -sellers at EnergyNet's cyber-auction do not see eye to eye since the financial meltdown. There are several reasons, starting with oil and gas prices in free-fall and credit having all but seized up.

But those are not the only forces in play. The "Obama factor" resulted in a wave of divestitures in 2008, driven by sellers' concerns about higher, long-term capital-gains taxes and the potential for a windfall-profits tax, based on the candidate's stance on these issues and his possible presidential victory. These concerns are now even greater. Many asset-owners decided to divest to assure that sales were funded in 2008. This impetus to sell is pervasive, in spite of the commodity-price collapse.

Many sellers have also made the decision to wait on price recovery and take a chance on taxes. The good news is that buyers are perhaps more acquisitive than they were pre-crash, although they are more selective. The savvy ones have plenty of "dry powder" to apply to acquisitions. Many can't find a better place to invest the money they exited the stock market with than in oil and gas properties.

While many negotiated deals aren't closing or aren't going onto the market, the auction market is more active than ever with an extraordinary number and value of properties listed in fourth-quarter 2008 and planned for first-quarter 2009. The adage that "quality sells in any market" has come to the fore since the crash.

Many buyers believe that $6 natural gas and $55 oil are as artificially low as $13 gas and $140 oil were too high. They are willing to bet on reasonably higher prices—$70 to $100 for oil and $7 to $10 for gas—and demand resumption as long as they can convince themselves the property has the reserves and upside to take advantage of the better times ahead.

Buyers are applying multiples of cash flow similar to what they have used in the past, but they are using recent-month cash flow rather than an average of the previous six, and then adding more nominal value for proved-plus-probable (2P) and proved, probable and possible (3P) reserves as necessary to be competitive. The same holds true with regard to dollars per daily production, or flowing barrels of oil equivalent.

EnergyNet's deal-closing ratio dropped from 90% to 70% between mid-October and mid-November 2008 due to the widening gap between buyer and seller expectations and the sharp, rapid decline in commodity prices.

Many asset-owners have made the decision to clean up their portfolios by selling small, non-core properties in the near term while waiting for credit markets to re-energize. Some are actually relieved to have a period to catch their breath and methodically rationalize holdings. It is painfully apparent that, until credit loosens, capex will be reduced, leasehold acquisitions slowed and some large divestitures delayed.

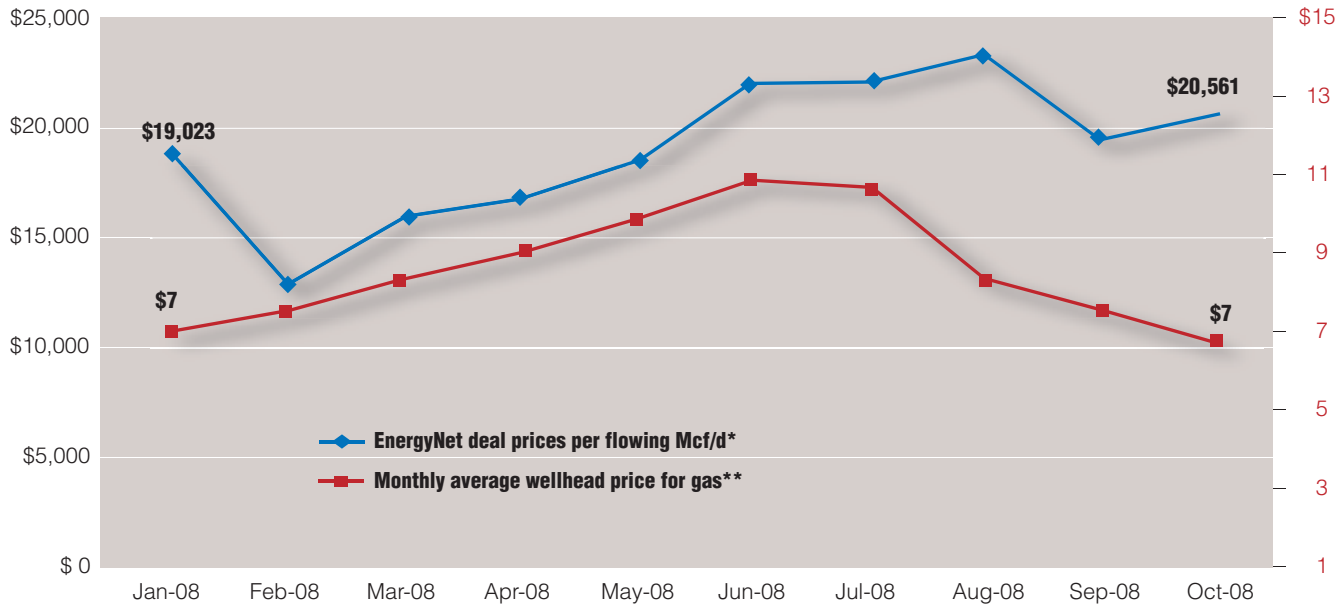
Both buyers and sellers are looking forward to a resumption of demand growth and a lag in supply growth due to the high rate of first-year decline rates from unconventional-gas wells and reduced capex for drilling replacement reserves and production. Meanwhile, unconventional-resource players will continue to raise funds through the sale of mature, conventional properties to bolster leasehold positions and concentrate efforts in their shale plays.

As development timelines are necessarily extended in these plays, leasehold prices have declined, so lease purchase prices will become more attractive. Nowhere is that more evident than in the Haynesville shale play. It's hard to believe that Haynesville leases were fetching $30,000 per acre in July and were reduced to $5,000 or less within a month or two, and astounding that oil and gas—at $140 and $13 in second-quarter 2008—fell more than 50% within 100 days.

So while the sky has not fallen, the business has suddenly become much more rational and the froth has been swept out of producing-property and leasehold valuations. Prospective buyers that have been focused on liquidity are enjoying the best buying opportunity of their careers.

—Bill Britain, president and chief executive officer, EnergyNet Inc.

2008 EnergyNet Auction Price-Metric Trend*



* Converted at 6:1 Mcf/bbl and including all producing-interest types of properties. **As quoted by the EIA. Source: EnergyNet Inc.