THE AMERICAN OIL & GAS REPORTER®

MAY 2016

The "Better Business" Publication Serving the Exploration / Drilling / Production Industry

Noncore Properties Drive Increased Activity In Upstream Deal Making

By Chris Atherton

HOUSTON–The acquisition and divestiture market for oil and gas assets is in constant flux. In normal markets, the factors that motivate oil and gas property owners to sell assets are as varied as there are sellers. However, after several months of depressed commodity prices, the unfortunate reality in today's market is that debt, solvency and survival will be motivating factors for owners of assets to sell in the second half of 2016 and into 2017.

The good news is that buyers are well capitalized and looking aggressively for acquisition opportunities. There is an eagerness to acquire assets with significant upside reward, but there also is trepidation that prices could slip again.

Not only do potential sellers have to determine what and when to sell, but the options of how to sell have become more critical to achieving true maximum market value, as well as achieving certainty of close. Since no property owner wants to sell at the low point in a cycle, the moderate recovery of oil prices from the levels experienced in the first quarter may further encourage buyers and sellers to come together at the transaction table. It also gives buyers better opportunities to lock in hedges to ensure minimal rates of return on acquired properties.

While the broader merger, acquisition and divestment market was down some 60 percent in 2015 compared with 2014, the market for the lower-end spectrum of the A&D business (deals valued at less than $100 million) remained robust. Noncore asset sales, along with issuing equity or debt, are some of the main lifelines that oil and gas producers use to keep their heads above water during stormy markets. Noncore asset sales, by their nature, tend to be scattered properties that are valued at less than $100 million individually.

The sealed bid and auction transaction advisory business demonstrated resilience in what was otherwise a painful 2015 for the industry. In fact, EnergyNet closed on $285 million in oil and gas assets last year, which ranked as the highest annual total in the company's 16-year history, demonstrating the increased activity in the noncore asset space.

Majors and large publicly traded independents will be shedding noncore assets as they try to live within their cash flows. These companies are acting proactively.

Less fortunate, distressed companies also will be forced to sell assets. Many of the assets held by upstream companies that have filed for Chapter 11 bankruptcy protection have yet to come to market, meaning there will be a large volume of assets in late 2016 and early 2017. Many companies are drawing down their entire credit lines to have cash on hand as they ponder restructuring.

Seller's Market

The A&D market is not frozen, and the bid-ask spread between buyer and seller is not too wide to overcome. It may take extra finesse and skilled negotiation, but deals are getting done consistently.

Oddly, it still seems to be a seller's market, at least from a competition standpoint. Neophytes to the A&D space may think as long as they have the money to deploy, they can buy assets at will, but that simply is not the case.

The A&D markets have achieved tremendous efficiency, and many times these noncore assets will receive 10-15 offers from competing, qualified bidders ready to close. That means there are quite a few runner-up bidders.

In order to win the asset, many buyers feel they must pay a premium, even in this down market. In the sub-$100 million space, assets are not selling for fire-sale prices. Successful buyers, as always, must have a competitive edge.

While the prices of oil and natural gas have been depressed, the cash-flow multiples buyers pay for producing assets has held relatively steady. The key difference is that buyers are not focusing on a six- or 12-month average, but instead they are laser-focused on the most recent current month's net cash flow.

For example, in a more stable commodity market, an asset package that generated net cash flow of $4.0 million a month over 12 months might garner a 48-month payout. In today's market, that same asset may average $4.0 million/month over six months, but the most current month's net revenue may be only $1.5 million. Buyers will still pay a multiple of 48 months' cash flow, but it is based on $1.5 million/month not $4.0 million/month.

Depending on the quality of the assets, winning buyers are paying the net present values discounted between 8 and 12 percent of proved developed producing reserves, based on New York Mercantile Exchange strip pricing. Buyers pay for upside when the proved developed nonproducing and proved undeveloped reserves components are valid and attainable.

Unfortunately, many PUDs are not economic in this price regime. With the drastic drop in rig count to 440 as of mid-April, nonproducing, primary-term leasehold acreage packages are becoming difficult to sell, except in certain areas of the Midland and Delaware basins in the Permian, and in the Eagle Ford Shale.

Certainty of close is, many times, just as important to sellers as getting the highest value for a deal. A&D advisers work to achieve both by getting the highest value by preparing a complete and comprehensive data package, and then exposing the opportunity to a network of qualified, registered bidders and broader industry contacts. Maximizing exposure to the market of willing and able buyers creates competition to achieve the highest value for assets.

Keys To Success

There are more and more assets in the marketplace, inundating buyers with possible acquisition candidates. The assets that transact successfully are those that are presented in data rooms that are thorough, convenient and concise. The adviser must be diligent in qualifying potential buyers. Equally important, the seller must be vetted to ensure it truly is committed to selling into this market.

Maintaining a systematic and streamlined approach is critical to facilitating property transactions. In order to ensure that the deals close time and again, a platform framework must be in place with a clear set of rules for how the sales cycle works from start to finish. It must be fair for both buyer and seller.

Limiting the sales cycle to 35-45 days helps achieve certainty of close, as does predetermining many of the key aspects of a purchase and sale agreement, and having both buyers and sellers agree to the specified terms before a sale process begins.

SIZING UP A&D OPPORTUNITIES

Oddly, it still seems to be a seller's market, at least from a competition standpoint. A&D markets have achieved tremendous efficiency, and many times these noncore assets will receive 10 to 15 offers from competing, qualified bidders ready to close.

Chris Atherton
President
EnergyNet.com Inc.

Buyers and sellers are accustomed to doing deals in a variety of ways. When deal customs deviate widely, it can be very difficult to get to the finish line, even if both parties agree on price. Therefore, it is important for the party facilitating a transaction to standardize how a given deal will work by transparently defining what is expected of the seller and clearly defining the rules of engagement for bidders and buyers. All the rules of the game should be presented and agreed on before the process begins, whether a sealed bid, auction or private transaction.

Sellers of noncore, sub-$100 million assets will be largely majors, large independents and large private companies. The list of recent sellers includes Shell, Chevron, Devon Energy, BHP Billiton Petroleum, XTO Energy, Oxy, SM Energy, Parsley Energy, Yates Petroleum, EnerVest, Merit Energy, Newfield, Unit Petroleum, Continental Resources, Apache, BP, Noble Energy, WPX Energy, QEP Resources, and Memorial Resource Development.

Buyers include publicly-traded companies, large private independents, private-equity-sponsored management teams, and small- to medium-sized regional operators. The large publicly traded and larger private independents are acquiring primarily bolt-on assets to existing core assets or acreage swaps.

Private-equity-sponsored management teams are a large component of the buyers in the sub-$100 million asset space. Newly minted private-equity-sponsored operators are armed with capital from the likes of NGP, Quantum, Kayne Anderson, Encap Investments, and Denham Capital, and they are taking the place of struggling or bankrupt companies. Luxe Energy, Scala Energy, Balidor, Bison, Rebellion, Colgate, Percussion, PCORE II and Terra Energy Partners are among the private-equity-sponsored names entering the A&D space.

Participants in the oil patch are an optimistic lot, and many industry veterans see this downturn as a buying opportunity. Buyers are trying to be patient and conservative, but the fear of missing the low point to buy assets has many buyers scrambling to consummate deals.

In addition, small- to medium-sized regional operators typically were less involved in shale development and are not as highly leveraged in many cases, so they see this market as an opportunity to acquire great assets at lower prices. ❒

CHRIS ATHERTON *is president of EnergyNet.com Inc., a transaction advisory firm that specializes in sealed bid, auction and private transactions of producing fields, operated and nonoperated working interests, overrides, producing royalties, nonproducing minerals, and nonproducing leaseholds. He also serves as team lead to EnergyNet's business development representatives. Before joining EnergyNet in 2002, Atherton worked in the power and gas origination group at Enron. He is a past chairman for the Society of Petroleum Engineers Gulf Coast Section's business development study group. Atherton holds a B.S. in business administration from Texas State University.*