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## Oil, gas sector ripe for picking as mergers surge

### Shale resource plays contribute to merger & acquisition boom

By Myra P. Saefong, MarketWatch



Ruhrfisch/Wikipedia

Tower for drilling horizontally into the Marcellus Shale Formation for natural gas. Interest in shale gas exploration and attractive prices have spurred a mergers boom for energy firms.

**SAN FRANCISCO (MarketWatch) — Mergers and acquisitions in the energy sector have reached a fever pitch this year, as booming interest in shale gas exploration, attractive valuations and the growing need for energy infrastructure lures buyers — and the frenzy is not likely to end anytime soon.**

Market conditions have become attractive for mergers and acquisitions, said Charles Perry, chief executive officer of energy-consulting firm Perry Management.

“Capital is available, either as equity, cash reserves or some borrowed funds,” he said. Plus, the assets are going for reasonable prices and “investors are looking for growth investments after two years of a stagnant market for equities,” he said.

## Global oil and gas M&A deals



In 2010, there were a total of 1,717 M&A deals in the global oil and gas sector — the largest number ever, according to Dealogic, which valued those deals at about \$322 billion. This year, as of Wednesday, the sector has seen 1,508 mergers valued at around \$211 billion.

“Many public companies can now be purchased at prices that are far less than even just a few months ago — and at prices that are, arguably, substantially less than the value of their underlying assets given current and forward commodity prices,” said Dan Gundersen, vice president of energy finance at Sandstorm Metals & Energy Ltd. (CVE:CA:SND) .

“Market conditions have created an opportunity for stronger companies with long-term vision to grow and expand into new areas through acquisition,” he said.

### Mergers spike

Energy companies have certainly been taking advantage of that opportunity.

“M&A activity has been brisk in the E&P (exploration and production) space as smaller producers with large inventories of shale acreage need external financing to keep up strong production growth rates that the market desires,” said Matt Adams, portfolio manager of the Franklin Natural Resources Fund (MFD:FRNRX) .

Shale gas is natural gas trapped in shale deposits. New drilling techniques have opened up fields once considered too expensive to develop.

“The obvious partners are deep pocketed [international oil companies] looking to accelerate their own production growth and facing a reduced number of opportunities offshore and overseas,” he said.

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### Exploration invigorated by shale

WSJ's Ryan Dezember discusses the changing shape of oil and natural gas exploration in the U.S. brought on shale and the process known as fracking.

On Oct. 16, Kinder Morgan Inc. (NYSE:KMI) said it would buy El Paso Corp. (NYSE:EP) in a deal valued at about \$21 billion to create the largest natural-gas pipeline system in the U.S. [Read about the KMI/EP merger.](#)

El Paso and Kinder Morgan agreed to merge to “dominate the natural-gas transportation space,” said Ben Smith, president of energy data and information provider First Enercast Financial.

Investment has been “flooding” into shale gas development since 2005, he said, and he expects the “support infrastructure and oilfield services sector to be quite active with investment and M&A for some time, as there is a frenzy to build out the necessary infrastructure to support a larger natural-gas market.”

Other notable M&A deals in the energy market recently include Statoil ASA's (NYSE:STO) announcement on Oct. 17 that it'll buy Brigham Exploration Co. (NASDAQ:BEXP) in a deal valued at around \$4.4 billion to strengthen its foothold in unconventional oil and gas resources. [Read about the STO/BEXP merger.](#)

On Oct. 10, Superior Energy Services Inc. (NYSE:SPN) said it would acquire Complete Production Services Inc. (NYSE:CPX) in a \$2.7 billion deal that expands its shale drilling services. [Read about the SPN/CPX merger.](#)

And over the summer, BHP Billiton Ltd. (NYSE:BHP) announced a \$12 billion acquisition of U.S. shale gas company Petrohawk Energy Corp. [Read about the BHP/Petrohawk merger.](#)

Generally, the “goal of all of the recent energy mergers as a whole is of course greater profit, power, performance — more specifically though, it's general capacity enhancement” both production and distribution, but mostly the latter, said Seth Rabinowitz, a partner at management consulting firm Silicon Associates.

## Contributing factors

The energy and exploration sector's rising interest for unconventional resources such as shale and tar sands has played a major role in the merger spike.

"The oil and gas industry in North America has changed dramatically over the past decade," said Sandstorm's Gundersen. "Conventional oil and gas exploration and development is now dwarfed by development of unconventional reservoirs" that historically would have been deemed uneconomical.

Production of natural gas from shale has become "more mainstream with advances in horizontal drilling and fracturing techniques that enable wells to touch more of the source rock and recover more of the natural gas in place," said Franklin Templeton's Adams. [Read an archived story on shale gas.](#)

Shale has been the major driver of U.S. natural-gas supply growth — putting downward pressure on natural-gas prices, he said.

Natural gas futures have dropped to around \$3.60 per million British thermal units from a peak above \$13 in 2008.

"We've seen a glut of natural gas on the market, which has kept prices low," Rabinowitz said. "It's not because of lack of demand, but because of inadequate distribution" — and those distribution limitations are fueling the mergers of late.

Despite the fall in gas prices, however, "equity prices for some of the natural-gas producers have remained resilient ... mainly due to M&A activity and the market's expectation for more of it," said Adams.

Shares of Chesapeake Energy Corp. (NYSE:CHK) , for example, have climbed 5.4% year to date as of Thursday, while November natural gas (NMN:NG11X) has fallen about 25% this year so far.

"Shale plays in the United States have revolutionized the domestic energy picture," said Neal Ryan, managing partner at Ryan Oil & Gas Partners LLC. "Regardless of if the government ever clues in on the ability for energy independence via domestic supply, the market has — and the M&A activity will only continue to increase."

## Target characteristics

The recent M&A deals offer a good sampling of what sorts of characteristics companies are looking for in potential merger targets.

Companies with assets in unconventional resources such as shale are a standout, and natural gas companies in general appear to be sought-after targets as well.

"Shale reserves and the abundant amount of crude oil from Canadian tar sands will cause more mergers to occur especially amongst the small and medium size E&P drilling companies like the Brigham/Statoil deal," said Bob van der Valk, a petroleum-industry analyst based in Terry, Mont, adding that "shale oil is king right now in Eastern Montana and Western North Dakota."

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RRC **73.98**, +1.35, +1.86%

SWN **40.25**, +0.28, +0.70%

COG **70.29**, +1.42, +2.06%

NG11X **3.65**, +0.02, +0.41%

Speculation over a buyout of natural gas and oil company Range Resources Corp. (NYSE:RRC) spiked recently with Morningstar Inc. in September including it in a list of top takeover candidates, given its large acreage position in the Pennsylvania Marcellus Shale. [Read about the RRC speculation.](#)

Southwestern Energy Co. (NYSE:SWN) and Cabot Oil & Gas Corp. (NYSE:COG) have also been seen as potential merger targets. [Read more about potential energy merger targets.](#)

Eventually, natural gas prices will rebound and "attain the



correct economic returns to justify the multitude of M&A activity,” said Ryan Oil & Gas’ Ryan.

Gundersen noted that on an energy equivalence basis, gas in North America trades at about a quarter of the cost of oil and at a substantial discount to most other world markets. That is a “relatively temporary phenomenon,” he said.

There’s a “big push into natural gas and many existing and new utilities are converting quickly from coal power generation to natural gas generation for green solutions,” said John O’Donnell, chief knowledge officer for Online Trading Academy.

“Shale deposit gas is the ‘new normal asset’ to exploit by the energy industry as the world wants to move to green solutions and the USA is the Saudi Arabia of natural gas deposits in the Northeast region,” he said.

So, while it’s “painful” to see such a low gas price at present, “these are all decades-long strategic moves and will pay off considerably down the road as producers begin long-term development plans,” Ryan said.

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