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Pressure building for vigorous second half in energy sector
by Chad Watt
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Energy deal activity in the second half of 2018 is set to ignite following a slow, smoldering start to the year.

Public oil and gas companies in the US are more motivated to sell as they face Wall Street demands to produce free cash flow and focus attention on a single region, said Jeff Gifford, an M&A attorney with **Dykema**.

“I think it’s going to be quite big,” Gifford said. “You’ve got an overabundance of quality assets out there ready to move.”

While many of those energy assets had been available earlier this year, oil prices only recently rallied, he noted. (West Texas Intermediate Crude has only stayed above the USD 70 per barrel threshold since late June.) And indications of a tightening oil supply internationally mean higher prices long-term, Gifford said.

The energy deals in the works are led by the potentially 10bn divestiture by **BHP Billiton** [LON:BLT, ASX:BHP] of its US shale holdings. In addition, **QEP Resources** [NYSE:QEP] is looking to sell assets in the Bakken and Uinta formations to focus on its Permian Basin assets, and **Pioneer Natural Resources** [NYSE: PXD] plans to sell its Eagle Ford holdings in order to also focus on the Permian, the companies have stated.

This new service and others have indicated that **BP** [LON:BP], **Chevron** [NYSE:CVX], **Royal Dutch Shell** [NYSE: RDSB], **Blackstone Group** [NYSE:BX] and others are interested in bidding for the BHP assets.

Neal Bakare, a finance attorney in Houston with **Foley Gardere** noted that current oil prices have recovered well, but long-term price outlooks remain less certain. A confident four to five-year outlook will be necessary “before you see a true M&A euphoria,” he said.

Charlie Shufeldt, managing director for Dallas-based energy investment firm **IOG Capital** said PE-backed companies are facing a rationalization of their capital structure: sponsors are not investing additional capital, so portfolio companies need to find an additional partner to supplement the private equity commitments.

Getting creative with deal structures could be one resolution. Shufeldt said IOG aims to complete additional drillco deals this year, which involve IOG providing drilling capital in exchange for a minimum rate of return, rather than equity or debt.

IOG in July executed a sale from a drillco partnership with private operator 1836 Resources, to **Sumitomo**-backed **Summit Discovery Resources**. For its part, Summit Discovery Resources met with 55 operators before executing the deal to buy assets from IOG and 1836, Chief Operating Officer Jamie Benard said.

International buyers may also acquire additional US energy assets this year, said Shufeldt. As an example, **Osaka Gas** in June signed a deal to acquire natural gas assets in East Texas from **Sabine Oil and Gas**.

While energy dealmakers wait for public company deals to develop, the long dormant Gulf of Mexico and energy royalty spaces have seen significant transactions and could see more, said Brian Lidsky, senior director with **DrillingInfo**, an energy industry information service.

Two of the largest deals in the second quarter involved the acquisitions of US Gulf of Mexico assets: privately held **Cox Oil** and **Talos Energy** [NYSE:TALO]. Similarly, two of the largest 2Q deals involved public royalty companies as buyers: **Osprey Energy Acquisition** [NASDAQ: OSPR] and **Kimbell Royalty Partners** [NYSE:KRP].

Energy royalty companies are yield-focused operations, and have the support of Wall Street, Lidsky said. That reflects the key, unfamiliar driver public investors want from oil and gas companies — producing free cash flow — which will lead to more deal activity.

“Free cash flow — that is a new paradigm among energy executives,” Lidsky said.