Next for Oil: Mergers, Layoffs and 'Death Spirals'
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The oil industry may be getting pinched by falling prices, but the next year could be a busy and lucrative time for private equity firms and restructuring specialists working in energy.

An idled pump jack, once used to extract crude oil from the ground, sits above a well on the edge of a farmer's field near Ridgway, Ill., Jan. 21, 2015.

With crude prices nearly 60 percent off their highs, experts foresee a wave of corporate restructuring and acquisitions playing out over the next 12 to 18 months. Oilfield services companies are set to absorb smaller firms, while exploration and production companies could face a "death spiral" as their access to debt dwindles.

In December, Deutsche Bank analysts projected that U.S. shale producers "could be entering a zone of deep distress" once oil dipped below the $60 to $55 range.

"If prices were to stay sustainably below these levels for a few months/quarters, chances of a broad sector restructuring increase materially," they wrote.

U.S. crude first settled below $60 on Dec. 11 and fell below $55 the following week. U.S.-traded West Texas Intermediate was near $44 on Thursday, while internationally traded Brent crude was close to $49.

"You're pretty much in the top half of the first inning in the oil and gas sector," George Koutsonicolis, managing director at SOLIC Capital Advisors, told CNBC. "Definitely, I expect there to be a pretty significant round of restructuring."

That restructuring will come not just in the form of layoffs and cost cutting, but in capital restructurings in possible bankruptcy court cases, he said.

The job cuts have already begun to roll in from big oilfield services companies.

Last week, Baker Hughes announced it would lay off 7,000 employees, or about 12 percent of its workforce. The same day, Halliburton told investors to expect more reductions on top of a previously announced 1,000 cuts. Earlier in the month, Schlumberger said it would shed 9,000 jobs.

BP announced in December it would spend $1 billion and shed thousands of positions as part of a restructuring.

How and where it's likely to play out

SOLIC now has its eye on oilfields services companies with high debt and poor capital structures.

The large oilfield companies are likely to scoop up weaker middle-market players, Koutsonicolis said. They will be on the hunt for firms with overlapping regional operations and back-office functions, two factors that will immediately add to earnings.

The fate of those firms is tied in part to exploration and production companies, for whom they provide infrastructure, specialized equipment, transportation and other services. Cost-cutting and reductions in revenue-generating activities among E&P companies eventually bleed into the oilfields services sector, forcing them to take similar measures.

Capital investment in the energy industry has decreased by about 23 percent, according to SOLIC.

Exploration and production companies have largely funded growth by borrowing on the high-yield debt market. The energy sector accounts for 17.4 percent of the high-yield bond market, up from 12 percent in 2002, according to Citi Research.

Now, the value of E&P firms' primary asset is depleting, so banks are willing to lend them less money, and liquidity is drying up.

"Given the situation we're in, the access to that high-yield debt will be somewhat impeded for some players," Koutsonicolis said. "It's kind of a death spiral for some of these firms."

Exploration and production companies will typically restructure as a last resort, said John-Paul Hanson, head of Houlihan Lokey's exploration and production practice. Instead, he told CNBC, they will try to weather the low commodity price market through financing and mergers and acquisitions activity.

The companies undergoing restructuring and bankruptcy filings at this point in the cycle lacked liquidity or had balance sheet constraints prior to the decline in commodity prices, he said. Low commodity prices effectively pushed them into restructuring because other solutions—such as tapping senior secured debt or selling assets—were not possible.

Hanson expects an uptick in M&A activity, but said sales of assets such as oilfield rights are more likely than outright buyouts of companies. That is because the value of E&P companies is in the underlying assets, not their corporate entities.

"The difficulty with oil and gas is you're tied to the underlying commodity. E&P businesses really are just asset businesses," he said.

While some companies may embark on mergers to achieve economies of scale, firms are more likely to sell noncore assets and unproductive oilfield acreage to increase cash flow and alleviate the cost of keeping them on the books. Those assets may find a home with another company that considers them core to their operations.

In the end, however, some oil and gas companies may not have a choice but to restructure, as they find it increasingly difficult to maintain cash flow while the cost of crude remains low, but while land-leasing and corporate expenses persist.

"The longer that we stay in a protracted, depressed price environment, the more likely it is that restructurings will be pervasive," Hanson said.

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