OIL & GAS MONITOR

Independents Reshape the Playing Field – Why It's a Good Thing

August 6, 2014

We'll soon see big changes in Oil and Gas. Risky exploration, spearheaded by emerging independents, is the inevitable future of this industry that has spent years exploring only existing reserves.

One of the most talked about trends of the last decade has been the rise of the independents. According to a recent audit by EY, U.S. oil and gas reserves increased 9 percent last year and almost all of it was due to independent exploration and production (E&P) companies — not the large integrated oil companies.

Wedged between investor demand and the high cost of exploration, supermajors are incentivized to focus on short-term financial results. Their long-term strategy relies on established oil and gas reserves and producing wells operating long enough for supermajors to squeeze – or buy out – independents.

This is a thinly veiled long-term strategy. While many independents will fail (or run out of financing trying), some will stick around. Those that remain will have found new oil and gas reserves at a time when the supermajors have no Plan B. I think we all know who holds the power in this scenario.

Without a doubt, executives from Big Oil are realizing that they've fallen behind in the search for new deposits and the resultant consequences. Extensive exploration is fraught with substantial risk, and the hand of public ownership is a heavy one – especially when it means writing blank checks for an unknown amount of time.

It's the appetite for and ability to manage these inherent risks that separates independent E&P companies from supermajors. The independents are not just technically savvy, as evidenced by their embracing of new exploration technologies, they have established rigorous decision making processes necessary to chase high risk projects. Immense risk is built into their business plan in a way supermajors cannot mimic.

Independents are emerging with a level of entrepreneurial discipline that will only help them as they grow into public ownership.

What This Means

While it may seem that supermajors should pursue riskier exploration in an effort to get ahead, I don't see this actually happening for several years. Supermajors will need shareholder support to back an appetite for risk, and without a core group of large shareholders with the same appetite for risk, that's a difficult conversation. There's too much uncertainty for the average investor.

What is clear: any oil and gas company that wants to be successful will need to be riskier with exploration than companies have been in the past. Competition, increasing demand, and cutting-edge technology are changing the landscape.

When the day comes of supermajors feeling their exploratory lag, they'll look to buy out independents, some of whom will have maxed out their spending to get ahead. Certain independents will sell at a high premium, trading their independence and control for a solid balance sheet. Supermajors will get the results of exploration while having minimized their exploration risk.

And yes, this will come at a high price for supermajors – likely higher than the cost of exploration itself. It's easier to answer to shareholders with proven reserves and oil already in the rig.

In other words: there is a future of high-value M&A.

This will result in a dual-path approach to exploration. One side of the business will be as it always has been – buying up existing reserves. The second path will be pursuit of high-risk exploration, led by lean independents who will ultimately be acquired by or partner with supermajors. The industry will at long-last have a short and long-term strategy.

By George Koutsonicolis, Managing Director at SOLIC Capital Advisors

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George Koutsonicolis is a Managing Director with SOLIC Capital Advisors and specializes in capital restructuring, operational restructuring, mergers and acquisitions, divestitures, and capital raising initiatives on behalf of the firm's clients. Koutsonicolis possesses significant experience in the energy sector.

Prior to joining SOLIC, Koutsonicolis served as a Director at Navigant Capital Advisors, LLC, supporting numerous restructuring and investment banking mandates. He was previously an associate with Scotia Capital's Energy & Utilities Group and a financial analyst with ComEd, where he structured energy derivatives and commodity electricity transactions. He has an M.B.A. from the University of Chicago and a B.S. in Chemistry from Loyola University in Chicago.

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