Even at $30 oil, M&A activity and shale plays look promising in ’16

Jason Spiess

Dr. Loren Scott talks future with Jason Spiess

Over the past year, while oil prices and interest rates remain low, the oil and gas industry has been hot with M&A activity.

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For Bakken Breakout Weekly

According to recent data from Thomson Reuters, 2015 will go down as the biggest year ever for mergers and acquisitions, with an announced total of $4.7 trillion — an amazing number, up 42 percent from 2014, and surpassing the previous record of $4.4 trillion in 2007.

Dr. Loren C. Scott, president of Loren C. Scott & Associates, Inc., a 34-year old economic consulting firm whose clients include such large national firms as BP, Capital One Financial, Entergy, Exxon-Mobil, J.P. Morgan Chase, Nucor, Sasol, Chesapeake Energy, and a diversity of others, is sensing an even greater 2016 for megadeals in oil and gas.

“What you find happening when you go into a slump like the one we are experiencing right now, is one of the ways companies deal with a downturn is these mergers and acquisitions,” Scott said. “Number one it is a way to reduce overhead costs, you don’t need two accounting departments and you don’t need two finance departments. There’s a lot of overhead savings you can have.”

Scott has seen this economic behavior before. In fact, he is one of the 32-member National Business Economic Issues Council, which meets quarterly to discuss issues of state, national, and international interest. This group has experts who cover international trade, Washington economic policy, retail trade, trucking, steel, chemicals, oil, gas and other drivers of the economy. Dr. Scott serves as an energy specialist on the NBEIC.

Scott continued explaining how other major deals can happen in oil and gas.

“The second thing is that firms that do not have a lot of debt and are looking at the longer term, may find some low hanging fruit to pick off here for people who don’t have the financial wherewithal to hang in there for the longer term,” Scott said. “So it is possible to pick up some good stuff if you are financially able to hold on for a while.”

Holding on and maintaining business is easier said than done. According to Scott, trying to predict and offer guarantees in the energy sector is nothing short of foolishness.

“Anyone who is involved in the energy sector, anything involving oil and gas at all, just knows this is like riding a roller coaster at an amusement park. It is just like that all the time,” Scott said. “It is not a nice straight upward going line. One of the things that is characteristic of this industry is a high degree of volatility.”

Looking back at history, companies and deals of this magnitude have occurred every forty to fifty years. Before horizontal drilling, horizontal mergers created monopolies in steel and oil. Fifty years later, diversification created new giants in manufacturing and deregulation created titans in finance and telecommunications. To this author, it would appear we are entering an era where the final stages of globalization are taking hold with new mega-companies in energy and lifestyle development.

Scott, however, sees this lull of low prices as an opportunity.

“That’s one of the things you have to learn to live with in this industry,” Scott said. “When we first went into this back in the late 70’s and early 80’s we saw oil go from $3-a-barrel to like $35-a-barrel, and one of the things that was happening was the lenders and the capital market was just shoveling money into this area. Anybody and everybody could get money.”

One could agree this period in the energy timeline is nothing short than a learning curve. Only the definition of learning curve is more about what was learned during other low price periods.

“Then when we had the big crash between 1982 and 1986, everybody got smarter and everybody said wait a minute, this can happen again, and suddenly you find that only the really well run firms had survived.” Scott said. “Number two you found out the capital market no longer shoveled money out like they did in the late 70’s and early 80’s. Everybody got smarter and everybody started running their ship a lot tighter. And the lenders got much tighter with lending money out.”

Scott transitioned to another portion of the energy economy, the labor force. A large portion of a company’s overhead is labor. Seeing long term trends that favor solving a labor issue is good news for many energy economists across the planet.

“So when we go through a downturn like we are going through right now, it is tough, it is hard, and you are seeing a lot of layoffs, but let me tell you something: you are not seeing anything like the layoffs we experienced from 1982 through 1986,” Scott said. “That period of 1982 through 1986, for example, Louisiana, went from having a 103,000 people working in oil and gas extraction to around 45,000. We were like an unopened parachute.”

Scott continued connecting the dots in energy era economics.

“Now what happened was, when oil prices started to recover, even when we got into the $100- barrel-of-oil, employment in oil and gas still stayed around 48 - 49,000. It never went way back up again because people were smarter,” Scott said. “We can experience something exactly like we are experiencing right now. What you have is most of the firms in the industry are pretty tightly run.”

On the flip side, some are not tightly run. Scott knows some companies will go out of business, sell their assets or merge with another company — all parts of the energy economy.

“Some of them will get into a little bit of trouble and they just can’t hold on for the long haul, and you will see the mergers and acquisitions there, but I just don’t think we are going to experience anything like we saw between 1982 and 1986.”

Technology seems to be the one constant bright star in the energy economy. Scott has seen unbelievable advancements in his forty-plus years in oil and gas.

“That’s the neat thing about watching this industry, is the people in this industry are remarkably clever. And remarkably quick on responding to the market,” Scott said. “For example, just what they are doing in the deep waters of the Gulf of Mexico, their ability to drill two miles deep than five miles deep in the bottom of the ocean. Technology that is more difficult than landing a person on the moon.”

Technology and energy extraction appear almost vital in North Dakota for the foreseeable future, and Scott sees the industry just beginning to bud.

“Well there’s no question oil and gas is very important in states like North Dakota,” Scott said. “I mentioned the sharp decline curve; you are going to see a decline in production in the Bakken play because you are not drilling nearly as many wells as you did in the past.”

The drastic change in wells over the past couple of years indicates a drop in barrels should follow; however, the increase in production has proved the drop in wells is maintaining a viable industry rather than a bust.

“I think the peak the Bakken was around 192 and today they are around 60, and when you have that deep of a decline in drilling and given the steep decline curve, the combination of those two things means your output is going to start to fall,” Scott said. “But 60 rigs is still a significant industry in the Bakken area. And there is still a lot oil to be pumped there and the people who work in this industry know that the price does swing the other way.”

Scott sees the drop in wells as a trend veterans tend to watch closely and become prepared to be nimble as the energy alphabet game takes hold.

“We’ve gone down one side of the ‘V’ and there’s always another side of the ‘V’ in the future, it’s just a question of when is that other side going to come and how far up is it going to go,” Scott said. “You just have to learn to live with the uncertainty of it.”

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