Oil Mergers and Acquisitions: The Year that Wasn't
December 2, 2015

Low oil prices have forced U.S. drillers to make tough decisions on capital spending and staffing, but when it comes to mergers and acquisitions, the industry has remained stuck in wait-and-see mode.

Dealmaking in America's oil patch has been muted throughout the collapse in crude prices, with asset sales slowing to a trickle and corporate buyouts few and far between. Meanwhile, more oil and gas exploration and production companies than previously expected have opted for bankruptcy, and more restructurings are likely on the way, analysts told CNBC.

To date, about two dozen companies have reached restructuring deals with their creditors. Those have mostly been small players, but the list includes larger drillers such as Sabine Oil & Gas and Quicksilver Resources, as well as KKR's long-troubled Samson Resources.

Several of the companies now going through a recapitalization or restructuring were facing balance sheet challenges even prior to the oil downturn, said J.P. Hanson, head of the E&P group at investment banking firm Houlihan Lokey.

"Given the current commodity price environment and challenges that E&P companies are facing, there hasn't been a company to date that I've said, 'Oh, I didn't see that coming,'" he told CNBC. "Most of the companies that have been going through a restructuring were already in need of additional funds and/or a balance sheet recapitalization."

"Here's the problem with (exploration and production) players: They have no cash. So how are they going to make this deal unless they can buy for really cheap?"

- Kim Brady, Senior Managing Director, SOLIC Capital

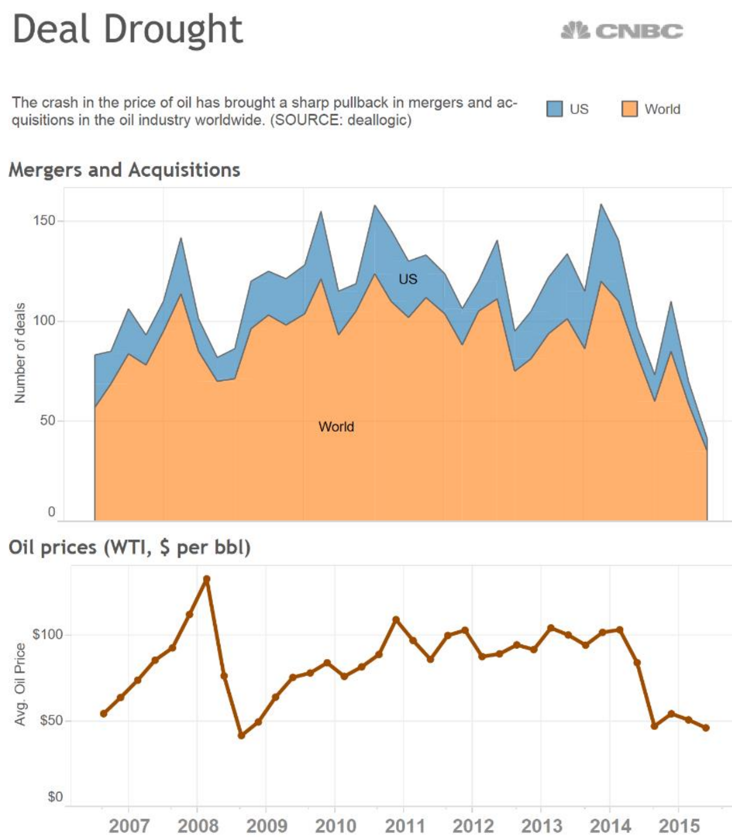
But prepackaged bankruptcies will presumably continue into 2016, especially if OPEC members agree to stick to a policy of maintaining output in an oversupplied market when they meet Friday, Kim Brady, Senior Managing Director at SOLIC Capital, told CNBC.

That approach has kept a lid on oil prices and pressured U.S. drillers, who face higher drilling costs.

"If the Saudis continue with the current policy (of aggressively pumping oil despite low prices) so that we still have robust supply, then I think you are going to have even bigger companies filing," Brady said. "I'm predicting more bankruptcies in the absence of Saudi intervention."

As restructurings pile up, one critical question is whether creditors have been too optimistic and underestimated the liquidity needs of U.S. shale drillers, Bill Derrough, co-head of investment bank Moelis & Co.'s recapitalization and restructuring group, told CNBC.

"The distinction will be whether or not the situation requires additional capital. It's liquidity, liquidity, liquidity," he said.



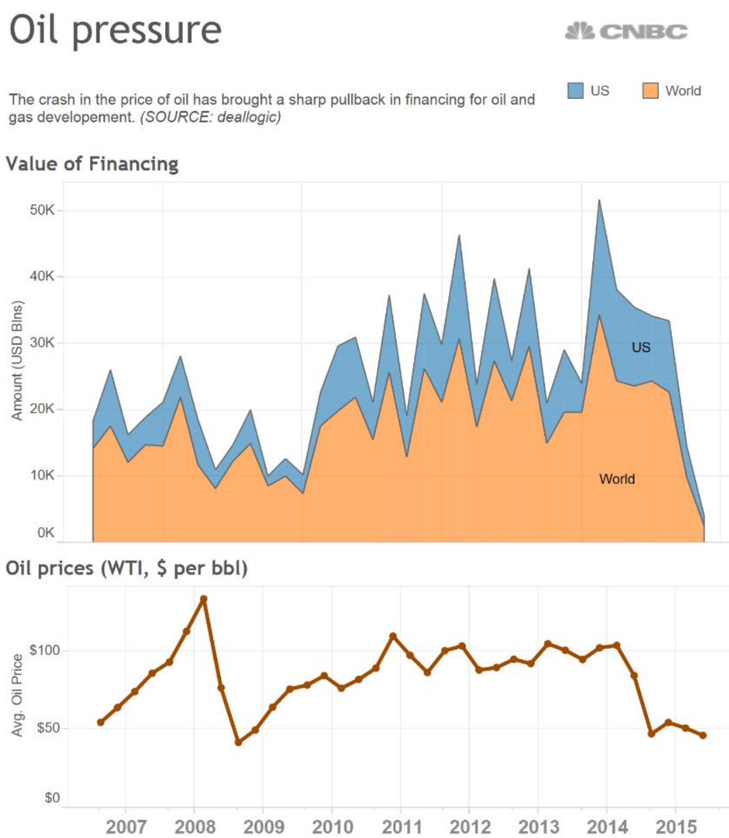
If the current arrangements turn out to be inadequate, companies could find it difficult to raise additional capital or wring further concessions from investors. Creditors who have already taken a haircut may be unwilling to write another check to keep the music going, Derrough said.

In the worst-case scenario, unsecured creditors would decide liquidating the company's assets may provide a better recovery than continuing to fund operations.

That would be one catalyst — albeit an extreme one — for M&A activity, which is down nearly 70 percent on the year through the middle of November, according to a CNBC analysis of data provided by Dealogic.

A more likely scenario is that the gap between what buyers will pay for assets and what sellers will accept begins to narrow. Currently, drillers remain loathe to part with their assets at fire-sale prices.

That could change once banks re-evaluate drillers' borrowing ability in the spring, said Mike Rowe, analyst at energy investment bank Tudor, Pickering, Holt & Co. This year's biannual redeterminations in April and October were easier on oil producers than many expected, leaving them with access to bank lending.



Already, equity and debt markets that kept cash flowing into energy firms earlier this year are closing.

U.S. drillers raised $10.8 billion in equity in the first quarter, but issuance fell to $2.3 billion in the August-to-October period. Bond issuance sunk 88 percent from $14.7 billion in Q2 to about $1.7 billion last quarter.

Without access to outside finance, exploration and production companies' balance sheets are too banged up to make purchases, and their stock market capitalizations have plummeted, making share deals untenable, Brady said.

"Here's the problem with E&P players: They have no cash," Brady said. "So how are they going to make this deal unless they can buy for really cheap?"

The most likely buyers might be private equity firms, many of whom are capable of keeping investments on their books for the several years many now anticipate it will take for the oil market to turn around.

But Brady cautioned that many private equity firms that picked up oil assets 15 to 18 months ago "got creamed" and may think twice about deploying more cash in the space.

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