State of the Industry

Market Description for Energy Acquisitions and Production of Income Producing Wells

The oil and gas industry is currently seeing a shift in both exploration and acquisitions as it relates to traditional energy trends. With record setting prices being paid for both raw oil and natural gas at the well head, it has allowed this industry to revitalize itself with internally generated profits and capital. The exploration side of the energy sector has experienced everything from supply shortages in manpower, tools, equipment, services, tangibles, rentals, chemicals, drilling rigs, seismic data, intellectual assets and virtually all aspects of exploration. This situation, coupled with the prices for such elements, has prompted the cost of exploration to rise nearly threefold in the last three to four years. The cost increases have allowed the industry to shift its focus from new exploration to the value that can be derived from asset acquisitions of existing reserves. Although the exploration will not cease, regardless of the ongoing shortages in supplies and the significant increases in overall costs, more companies will look to utilize their capital to acquire existing reserves. This shift from intended exploration funding to acquisitions will diminish the overall thrust to develop new reserves and the replacement of domestic reserves.

Every dollar that would formally be intended for exploration is now being decreased in its effectiveness due to the increased cost associated with all components of the E & P sector. In addition to cost increases, the industry must now face the statistical decrease in overall exploration success. The combination of rising costs coupled with lower success rates behind the drill bit will allow for fewer domestic wells to be drilled. Fewer U.S. wells will be drilled, more capital will be utilized to drill these wells and the reserves found will be less. As negative as this may sound, this is why commodity prices are on the constant rise.

All of these elements create a window of opportunity for those seeking to acquire reserves. Reserves purchased during this opportunity will continue to escalate in value due to the demand for reserves and the decreased success rate in identifying such reserves. Numbers indicate that the industry continues to fail at decreasing the spread between demand and U.S. supply. This provides for a fairly stable pricing model and healthy future valuation for those that hold and possess U.S. reserves. In the short-term market, owning reserves in the United States appears to be an effective hedge against rising costs for oil and natural gas. All elements considered, existing reserves are favorable to rise in value or at least maintain their core value for some period of time.

The energy industry recognizes the value of timing as it relates to getting product from well head to user. Many exploration ideas are long-term and can take up to ten years to monetize the success of the investment. This also effects the price paid to owners of domestic oil and gas reserves, in that, the ability to produce reserves in shortened delivery time from well head to market is worth a premium.

Many publicly traded companies and Master Limited Partnerships have shifted funds that otherwise would be available for exploration to the purchasing of reserves or the outright acquisition of smaller E & P companies to gain access to the reserves that are in place. This shifting of capital and the overall strategy suggest that the energy industry is willing to pay for reserves in a way not seen in prior market shifts.

Exploration expenses have tripled over the last three to four years.