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Garcia’s Take: Are Larger Energy Exits on the Horizon?

By Luis Garcia

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Large sales of oil-and-gas assets from private-equity firms to publicly traded producers are rare these days. But both firms and the producers are busy planting the seeds for potentially larger such deals in the future.

Stricter capital discipline among public U.S. oil-and-gas upstream companies is making them less inclined to buy assets from their private equity-backed peers. Instead, public producers are focusing on developing their core fields and generating higher returns for their shareholders.

Public energy companies still are open to large acquisitions, but the assets must come with substantial cash flow from producing wells. Only in a very valuable area would a large pure-land deal be on the table, industry executives said.

“The game has moved from acreage to production,” said Mangesh Hirve, a managing director at 1Derrick Ltd., a provider of business research for the oil-and-gas industry. “Now people have to show that they can produce and produce better.”

That leaves fewer exit opportunities for private-equity firms. Many of the sales of oil-and-gas assets that firms made to public producers this year as of July 18 were smaller deals in which the buyer was a lesser-known player, according to a list of 23 transactions compiled by 1Derrick.

The scenario was different a year earlier, when larger public producers bought many assets from private-equity firms. Parsley Energy Inc., for example, paid about $2.8 billion for about 71,000 undeveloped acres that Double Eagle Energy Permian LLC, an oil-and-gas company backed by Apollo Global Management LLC and Post Oak Energy Capital, gathered in the Midland Basin.

Private-equity firms quickly are adjusting their strategy to a new era of deals based more on production than on land. They, too, are finding it more advantageous to develop their oil-and-gas assets further in the hope of getting a better deal in the future.

For example, Double Eagle's management team—now leading Double Eagle Energy Holdings III LLC, which is backed by Apollo—have leased about 30,000 acres in the coveted Midland Basin, said a person familiar with the matter. This time, however, instead of looking for a buyer for the acreage, the company teamed up with FourPoint Energy LLC, a portfolio company of Quantum Energy Partners, to form DoublePoint Energy LLC.

DoublePoint, which will operate 70,000 acres in the Midland Basin, plans to take advantage of Double Eagle's and FourPoint's adjacent fields to drill longer, more productive horizontal wells, the person said.

As firms shift tactics, publicly traded producers are generating bigger profits and strengthening their balance sheets thanks to higher oil prices and a newfound focus on returns.

Energy-focused firms going forward will face the challenge of turning their oil-and-gas fields into attractive, cash flow-generating assets. Much will depend on the future behavior of oil prices and the capital firms have available. Those likely to succeed stand to be rewarded by financially stronger public buyers.

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