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Oil Deal Unites Father And Son To Form Permian Basin Powerhouse

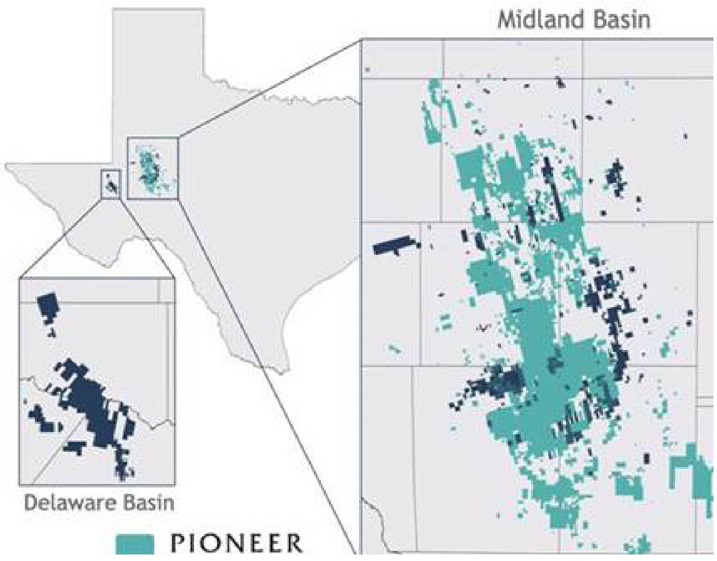
The mergers and acquisitions are coming hot and heavy in the wasteland of the busted oil and gas sector. The consolidation wave began in earnest with Chevron's CVX -1.4% $13 billion acquisiton of Noble Energy NBL +1.4% in July. Then in recent weeks, Devon Energy DVN -0.6% has acquired WPX Energy, for $6 billion, ConocoPhillips COP +0.3% bought Concho Resources for $9.7 billion, and Pioneer Natural Resources PXD +2% bought Parsley Energy for $7.6 billion. Then, over last weekend Canadian operator Cenovus agreed to acquire Husky Energy for $8 billion (in that deal, Hong Kong billionaire Li Ka-Shing, who held about 70% of Husky, will get about $2 billion in new Cenovus shares).

So, is this just a lot of rearranging deck chairs on the stricken Titanic of the global oil industry? No, more like fashioning sturdy lifeboats. What all these deals have in common thus far is asset quality. Even at a stubborn $40 per barrel, all these companies have at least some fields that can still generate positive cash-on-cash returns. "This M&A is entirely defensive," says Adam Waterous, CEO of Waterous Energy Fund. "The industry got over capitalized. It was way too big and now it has to shrink." That's why we're seeing all-stock deals with very small premiums. "The future looks tough — sellers are waving the white flag."

One story so far stands out among the M&A — Pioneer buying Parsley, for which it will issue $4.5 billion in stock and take on $3.1 billion in debt. This represents a kind of fairytale ending for father and son Scott and Bryan Sheffield, who are the CEO of Pioneer and founder of Parsley, respectively. These princes of the Permian have witnessed nearly the entire history of the basin, made a lot of money in the process, and now consolidate their family interests in what will be one of America's pre-eminent shale fracking champions, producing 550,000 barrels per day.

Scott Sheffield, 68, ran Parker & Parsley in the 1980s, which turned into Pioneer. From roots in the Permian basin, Pioneer began to explore. "They spent 20 years evaluating every play in the world except the Permian basin," says Phillip Z. Pace, an investor with Chambers Energy Management. "I chased them to Alaska, Argentina, Tunisia." No one could believe it, when, at the dawn of America's shale fracking boom, Pioneer engineers began figuring out that they had been sitting on the moderlode all along, in the form of thin layers of oil-soaked rock waiting deep beneath the conventional reservoirs they had drilled decades before.

Bryan (now 42) after some early training at Pioneer, started his company to operate 100 decades-old oil wells drilled by his grandfather Joe Parsley. In the brief oil recession of 2009 Bryan raised funds for Parsley to buy up huge amounts of acreage in the Permian at deeply discounted prices — a tiny fraction of what it later came to be worth. In 2014 Parsley's IPO raised $750 million. That same year shares in Pioneer topped out at an all-time high of $221 (they are $83 today).



The new Pioneer will have a commanding presence in the Midland Basin portion of the Permian.

Both companies could have kept growing fast, had oil prices cooperated, but in 2016 a first oil bust put the breaks on the industry, and its go-go share prices which had made Bryan a billionaire on his Parsley shares. Since the peak, Parsley has lost 70% of its equity value, while Pioneer is down 60%. Early to recognize the need to consolidate, a year ago Parsley bought Jagged Peak Energy for $2.27 billion.

Scott Sheffield initially retired in 2016 to a ranch in Sante Fe he bought from Jane Fonda. While in 2018 Bryan also retired, handing the reins to Matt Gallagher, now 36. But Scott couldn't stay away, and last year he returned to the CEO job.

"Buying Bryan's company raises eyebrows," concedes Phil Pace, one of the earliest investors in Parsley and long a friend of both Sheffields. "But acreage overlap is good enough and consistent enough," that there won't be much objection from shareholders. Pioneer is paying just an 8% premium in the all-stock deal.

Sheffield and Gallagher went on CNBC last week to tout the deal to Jim Cramer. "It's all about putting the two best Permian companies with the best inventory together, and creating a larger company with a better free cash flow profile," said Sheffield.

This will be the trend in oil mergers for a while, says another early backer of Parsley. Today investors don't care about growth. They are disillusioned with poor returns on capital. Thus cash is king. Pioneer's revamped business model has it living within cash flow at virtually any oil price, and returning capital to investors with variable dividends. The new Pioneer will have at least a dozen years of drilling inventory on its 920,000 acres (with no federal land holdings).

Once the deal goes through, Bryan will be a leading shareholder in Pioneer with a roughly 2% equity stake. Wil Van Loh, chairman of private equity giant Quantum, Parsley's biggest holder, will own 4%.

Talking to analysts last week, Scott Sheffield proclaimed Pioneer's fortitude: "I just think that there's only going to be three or four really survivors, independents, and that's going to be probably most likely ConocoPhillips, EOG and Pioneer and maybe Hess long term."

Indeed it's important for executives who have survived this year's Covid-caused oil bust to keep in mind that it could happen again. David Johnston, oil consultant at E&Y says executives will be well served to remember what Covid-19 did to their businesses. "It's one of those things you don't want to forget. Everyone has short memories, that's why there are bubbles."