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Pioneer Natural Resources to Buy Parsley Energy for $4.5 Billion

Deal is latest combination in hard-hit U.S. shale-oil patch, but some warn consolidation may be limited to top-tier firms

Pioneer Natural Resources Co. PXD -2.15% has agreed to buy Parsley Energy Inc. PE -3.95% for $4.5 billion, the latest in a flurry of U.S. oil tie-ups as companies seek to weather low prices brought about by the coronavirus pandemic.

The all-stock deal, which values Parsley at a 7.9% premium to its closing value Monday, would solidify Pioneer's place as one of the largest producers in the Permian Basin of Texas and New Mexico, the top American oil field.

The long-anticipated string of transactions is expected to continue for healthier companies in the country's most prolific oil fields, investors said, while many smaller, debt-burdened companies that are hoping for a deal may draw few offers.

Pioneer Chief Executive Scott Sheffield said in an interview Tuesday that size and scale would be key to surviving as an independent oil-and-gas producer as the world moves away from fossil fuels, and would help his company return more cash to shareholders. But he said additional combinations of industry players may take time.

"I do not see much more coming until these other companies can deliver with excess cash flow over the next two or three years," he said.

The Wall Street Journal reported Monday that Pioneer and Parsley were in talks to combine. Shares in Parsley increased about 5% on Tuesday, as Pioneer's stock fell around 4%.

"The combination of Parsley and Pioneer creates an organization set to thrive as we forge a strong new link at the low end of the global cost curve," Parsley Chief Executive Matt Gallagher said in a statement. He is poised to join the combined company's board of directors

The deal comes a day after ConocoPhillips COP -4.24% agreed to buy Concho Resources Inc. CXO -4.29% for $9.7 billion. Last month, Devon Energy Corp. DVN -2.23% agreed to a $2.6 billion merger with WPX Energy Inc., WPX -1.91% while Chevron Corp. CVX -1.14% in July agreed to buy Noble Energy Inc. for about $5 billion. All of them were all-stock deals with premiums of 15% or below.

The targets are among a relatively small group of U.S. oil-and-gas companies considered healthy enough financially to attract buyers, investors said.

Only about a quarter of major U.S. shale operators were attractive acquisition or merger targets based on their financial and operational strength, the Deloitte consulting firm said in a recent report. Less-attractive possibilities made up about half of the sector and a significant portion of U.S. oil and gas production. Deloitte deemed the rest as either risky investments or attractive largely to private-equity firms.

In addition to having poor returns, many companies accumulated steep debts during the fracking boom, while only a few have managed to operate with lower costs that allow for better returns when oil prices recover, said Ben Cook, portfolio manager at BP Capital Fund Advisors.

Though the industry is in a consolidation phase that will likely extend beyond the Permian Basin into other parts of Texas as well as North Dakota, Mr. Cook said, "I don't think [M&A] happens for everyone."

All told, U.S. shale drillers have generated net negative free cash flows of about $300 billion since 2010, Deloitte said. Since 2015, at least 248 North American oil and gas producers have filed for bankruptcy, according to Dallas law firm Haynes & Boone. The industry's bankruptcy cases have involved more than $175 billion in debt, the firm said in a recent report.

This year, operators including Chesapeake Energy Corp. , Whiting Petroleum Corp. and California Resources Corp. filed for bankruptcy as the coronavirus pandemic crushed energy demand.

There is no market for about 80% of the roughly 500 oil and gas producers in North America, according to Adam Waterous, the founder of Waterous Energy Fund, a private-equity firm. Mr. Waterous said many companies bought up unproven assets during the boom, most of which have proven to be unprofitable without high oil prices.

"It's not as simple as smashing together some private equity [oil and gas] companies that have no buyer," said Mr. Waterous, who was previously the head of investment banking and energy at Bank of Nova Scotia. "The vast majority of these are not good assets."

Still, absent a jump in prices to $50 or $60 per barrel, deals in the oil patch should continue to flow, said Ben Dell, managing partner at private investment firm Kimmeridge Energy Management Co. U.S. benchmark oil settled around $41 a barrel Tuesday.

"There's a palpable feeling of being left behind now and that the business model has changed, and that's resonating with management teams," Mr. Dell said.

Mr. Sheffield, Pioneer's chief, is the father of Parsley's executive chairman, Bryan Sheffield. Pioneer Chairman J. Kenneth Thompson said in an interview that neither Scott Sheffield nor Bryan Sheffield was allowed to participate in deal negotiations.

Scott Sheffield said he was also barred from discussing the acquisition with executives.

Pioneer said it expects the combined company to realize roughly $325 million in savings annually by reducing administrative expenses and other costs.

The deal, which is expected to close early next year, is subject to approval from the shareholders of both companies. The companies said that Quantum Energy Partners, Parsley's largest shareholder, with a 17% stake, backs the combination.