UNCONVENTIONAL-RESOURCE A&D

Shale-gas plays were hot zones of transaction activity in recent years. Can the Barnett, Fayetteville, Haynesville, Marcellus and Woodford shale plays survive declining gas prices?

ARTICLE BY
STEVE TOON

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Economics of the five leading U.S. shale plays are "pretty phenomenal," even in a lower price environment, according to XTO Energy president Vaughn Vennerberg. Following an intense acquisition spree beginning in mid-2007, XTO now holds about 1.7 million acres and a drilling inventory of up to 6,700 locations in these marquee regions.

XTO's buying adventure

If an award were given for most acquisitions in a year, Fort Worth, Texas-based XTO Energy Inc. would take the prize for 2008. The company closed 220 transactions in the period—within only nine months, in fact—totaling some $11 billion, capping the run with the $4-billion acquisition of legendary Dallas-based Hunt Petroleum. When XTO laid down its deal-making pen, the company had more than doubled in size. Most of these acquisitions involved significant acreage in the Big 5 shale plays, where XTO bolstered existing holdings and established new footholds.

"It's one of the most entrepreneurial times in the history of XTO Energy," says president Vaughn Vennerberg. "There are few times when such exceptional properties come on the market. We had to strike while we could. In 2009 and beyond, you will see the fruits of those labors and the wisdom of why we did it."

The economic-return opportunities on those properties, in particular the shale basins, were irresistible. Following those acquisitions, XTO now holds 1.7 million acres in the five leading shale plays with an inventory of 6,050 to 6,770 prospective drilling locations.

"Those plays were very hot plays. To be able to get a select position in a core area doesn't happen very often. It will give us a drilling inventory that we will be able to pursue through the ups and downs of the market."

Vennerberg sees the current price environment as undervalued and an anomaly. XTO looks five years out and prices its drilling at $7.50 gas and $75 oil. Even with $4 to $7 gas, he says, finding costs of $1 to $1.60 per Mcf result in realized returns of 30% to $100% on capital employed.

Economics in these plays are "pretty phenomenal," he says. The company calculates returns for the Barnett at 92% at $7.50 gas, and 47% at $5, factoring in a 20% reduction in well costs. Similarly, the Fayetteville returns 65% and 36%, respectively, and the Marcellus, 99% and 70%. "Economics are very good."

XTO rolled up a host of smaller sellers in the Barnett in 2008, bolt-ons for about $1.5 billion that "fit like a glove" over existing acreage. Vennerberg sees similar transactions as the template for A&D activity in the maturing Barnett shale.

"The driver in the Barnett for the next 18 months will be those operators that have undrilled leasehold that have expirations coming up. You'll see producers putting out packages, doing joint ventures or farming out acreage to hold leases. That will be the driving force."

In the Fayetteville, where XTO acquired 20,000 acres from Contango Oil & Gas and 55,000 acres from Southwestern Energy, Vennerberg believes divestiture activity will be quiet for awhile. "The Fayetteville is characterized by a handful of players and they seem to be doing business as usual," he says. "Everybody is focused on drilling."

With a drilling inventory of 1,600 to 1,800 locations in the Fayetteville, potential reserves of 2.5 trillion cubic feet and finding and development costs of $1.20 to $1.60 per Mcfe, "the economics are beautiful," he says. The company will drill 105 wells in the play this year.

Long-term lease terms will soften the urgency to move acreage in the Marcellus, where XTO gained a 152,000-acre foothold from Linn Energy and currently holds 280,000 acres total. Most leases are five years with five-year extensions, so "nobody is pressured by lease expirations." Consequently, A&D activity will be slow moving, he thinks. The company is running one rig in the Marcellus with 10 to 12 horizontal wells planned for 2009.

Activity in the Haynesville is presently hampered by a market adjustment as landowners and sellers swallow a changing price environment. Still, he says, the well economics are too good and the well results are too big to stifle activity for long. XTO holds about 100,000 acres in the play, with 40,000 coming from the Hunt transaction, mostly on the East Texas side. The company will drill 15 to 20 wells there this year.

The Woodford, however, should be active with transactions. "There are more small outfits in the Woodford shale than the other plays, where you have much larger independents. You'll see (packages from) some of these small operators that want to get out."

While XTO only registered about $200 million in acquisitions in the Woodford during its multibillion-dollar year, the play is "very much an emphasis for the company," Vennerberg stresses. "The opportunities were not there in the acquisition market, but we wouldn't be running three to four rigs in that area if we didn't like it. It's definitely a growth area for the company." It holds 160,000 acres there.

In spite of falling gas prices, Vennerberg believes resource plays will continue to thrive. "You see incredible reserve additions from these basins." By XTO's estimates, ultimate recovery per well for the Barnett is 3.3 Bcf; Fayetteville, 2.2; Woodford, 3.8; Marcellus, 3; and Haynesville, 6.5. "That makes the returns and economics very attractive, even in a lower price environment."

Following its aggressive acquisition run, might XTO need to sell any assets to raise cash?

"We're not in a position to need to do that," says Vennerberg. "Generally, we don't do that and we aren't interested in doing any joint ventures. We're in great shape. We have built this company to perform through the cycles and this year we're going to spend our time digesting those acquisitions."