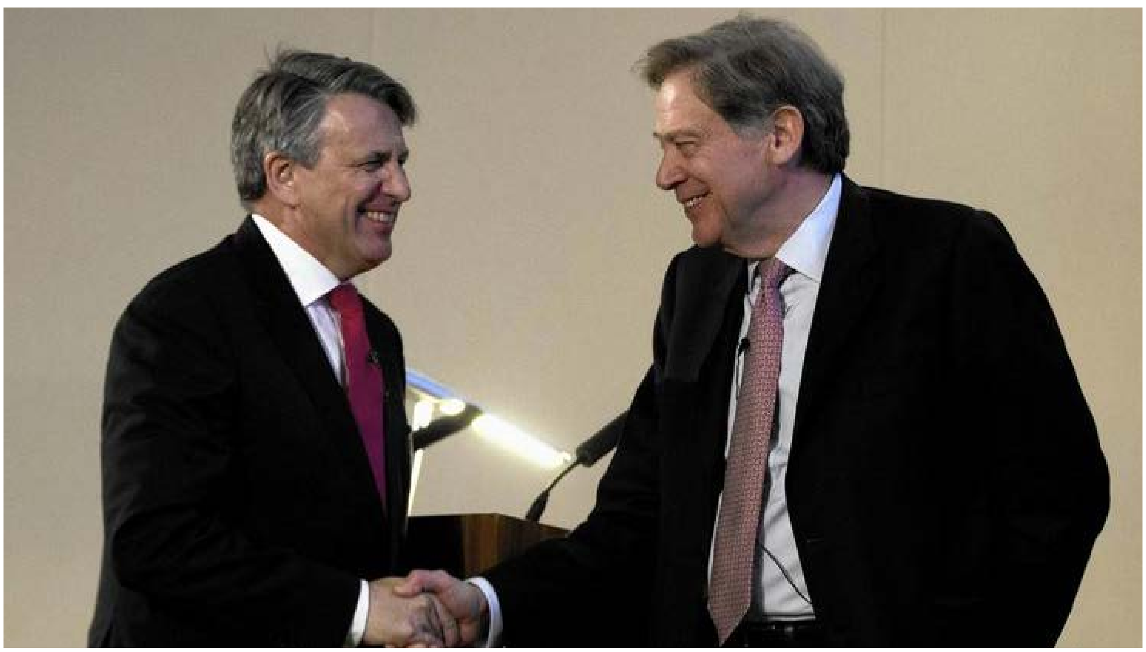
Business

Shell-BG deal could fuel more oil and gas industry consolidation



Ben van Beurden, CEO of petroleum giant Royal Dutch Shell, left, shakes hands with the chairman of BG Group, Andrew Gould, in a news conference announcing a $70-billion deal that could inspire copycat deals in the oil and gas industry as companies struggle to adjust to months of collapsing crude prices. (Alastair Grant / Associated Press)

By TIFFANY HSU

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Royal Dutch Shell

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- Shell-BG agreement comes after two decades of steadily intensifying consolidation in oil and gas sector
- Shell said with BG's resources it could deal better with crude oil prices that have plunged to historic lows

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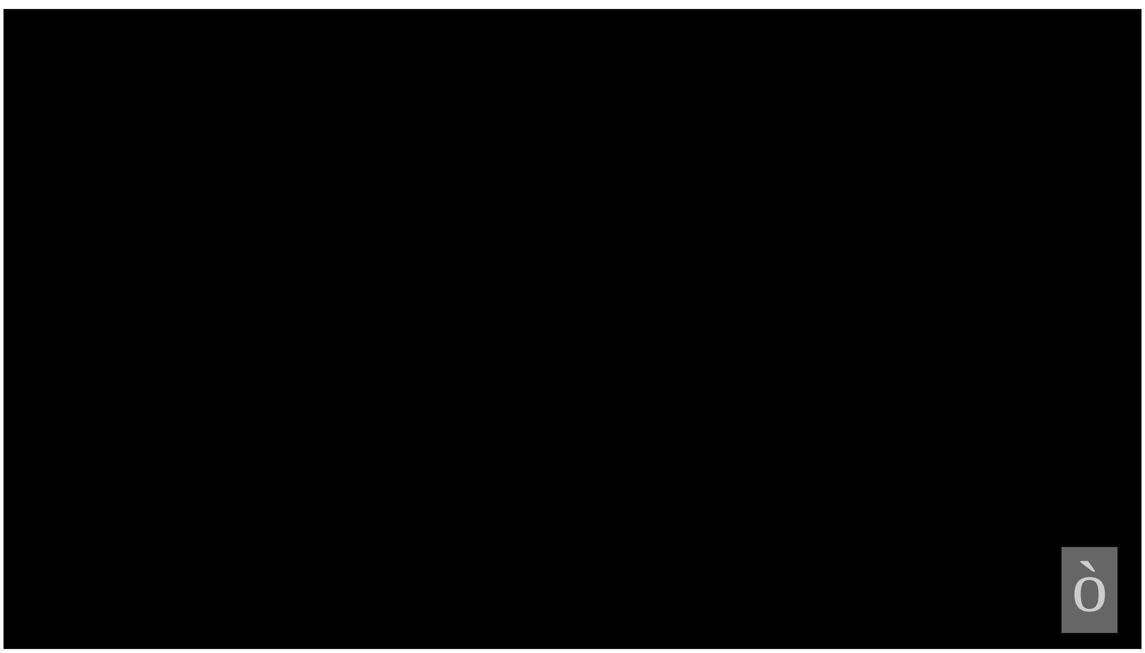
Petroleum giant Royal Dutch Shell's $70-billion pact to buy British rival BG Group may inspire copycat deals in the oil and gas industry as companies struggle to adjust to months of collapsing crude prices.

The agreement, the second largest on record for the sector, comes after two decades of steadily intensifying consolidation.

Smaller, more nimble competitors are shaking up the market using new technologies such as horizontal drilling and hydraulic fracturing while legacy giants try slowly to phase out older equipment, some analysts said Wednesday.



"These larger and larger dinosaurs are combining so they have more market power and a better chance at controlling price and output," said Robert McCullough Jr., managing partner at Oregon energy consulting firm

McCullough Research.

The combined firms would be able to reduce costs by consolidating overlapping operations, an advantage at a time when oil is selling for about 50% less than it was last summer.

An oversupply of natural gas and crude oil means that experts aren't too concerned about European behemoths, such as a joint Shell-BG, boosting electricity bills and pump prices in the U.S. But in the future, a shrinking pool of competitors in the industry could be concerning, they said.

"In the short run, we don't see this as a problem," McCullough said. "But bigger doesn't seem to be better — market concentration is not our friend."

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Shell, which is based in the Netherlands and incorporated in London, said it would pay 47 billion pounds for BG if cleared by regulators and shareholders of both companies. The price amounts to $20.41 in cash and stock for each BG share — a 50% premium on BG's closing price Tuesday.

Only one other oil and gas merger or acquisition had a larger value — when Exxon said in late 1998 that it would purchase Mobil for $81.7 billion, according to research firm Dealogic Inc.

The Shell deal might fuel more consolidation, but most agreements probably will be relatively small, experts said.

The number of global oil industry deals has risen steadily since 1995, when there were 256 mergers or acquisitions. Last year, there were 1,513 agreements. Already this year there are 247 pacts, according to Dealogic.

Shell and BG made a "strategic and timely" pact given their complementary assets, Cowen Group Inc. analyst Asit Sen wrote in a note to clients. The deal was "a perfect marriage" that may not be easily replicated, he wrote.

"While low oil prices have historically led to oil industry consolidation, we do not foresee another round of mega-mergers, as most heavyweights don't have to get bigger to compete," he wrote.

By absorbing BG, Shell would become the largest producer of liquefied natural gas globally, it said Wednesday. The company said it would have better access to production projects in Australia and Brazil and be able to swell its oil and gas reserves 25%.

Shell indicated that, with BG's resources, it would be better equipped to deal with crude oil prices that in recent months have plunged to historic lows because of a glut of supply.

Benchmark Brent crude slid from well over $100 a barrel during the summer to less than $50 at the beginning of the year. From June to March, U.S. companies in or related to the oil industry recorded nearly 52,000 job cuts, including thousands from oil field services companies Schlumberger and Halliburton Co.

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>
> - Robert McCullough Jr., managing partner at McCullough Research

But Morningstar analyst Stephen Simko said several conditions make the Shell-BG deal potentially dicey. The U.S. Energy Department predicted this week that the price of Brent crude will plunge to $59 a barrel this year from $99 last year before gradually improving to $75 in 2016.

Shell has also burned through capital by making massive bets on shale gas and overspending on major projects.

Shell Chief Executive Ben van Beurden, who took over from predecessor Peter Voser last year, has implemented major restructuring efforts, but Simko believes that the company will continue to "struggle mightily" as long as oil prices stay depressed.

"Shell faces what amounts to an almost existential crisis: Even when oil prices were $100, its portfolio was strewn with problems," he wrote in a note to clients, warning that investors "should not expect miracles."

"There's clearly a risk that this turns into yet another instance of an oil major over-promising and under-delivering on its future targets provided to investors." Simko wrote.

The massive size of the deal also requires regulatory and antitrust approval from multiple entities, including Brazil, China, Australia and the European Union. If the purchase is approved, BG shareholders will own 19% of Shell after the transaction closes early next year, as anticipated.

Shell shares fell $2.12, or 3.4%, to $59.83 in New York. BG stock soared 27% in London.

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