

An Overview of the A&D Process

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Whether it is to expand a core area or to free up capital for resource development, there are many reasons why companies engage in acquisition and divestiture activities. A&D is an integral part of the petroleum business and allows companies to focus on what they do best. Some companies are adept at identifying, capturing and appraising new plays and prospects but lack the capital and expertise to exploit what they have found while others excel at developing and marketing resources at a low cost. For many reasons, properties are bought and sold at various times in their life cycle.

Acquiring, divesting or swapping an asset generally follows the same process: defining, assessing, and analyzing the asset and negotiating, drafting, signing and closing the transaction. Asset definition is critical because the value of an asset is correlative to production, reserves and infrastructure while marketing and transportation arrangements, contractual obligations and environmental issues may enhance or reduce value. It is very important to know what is being purchased or sold.

Properly assessing the asset will confirm current and forecasted production. The reserve report should match production forecasts and PIIP estimates. Lease operating statements provide a historical perspective on production, revenues, royalties, expenses and netbacks. This is a reality check.

Evaluating the undeveloped potential of the asset is essential when acquiring and must be credible when selling. Type wells must be operationally and statistically valid, the number of wells and recompletions in the marketed inventory should be reasonable, the drilling and recompletion schedule achievable and capital and operating costs aligned to historic AFEs and lease operating statements. The seller must ensure the development plan is reasonable in order for the buyer to "pay up". The buyer must convince their management or financiers that the opportunity is viable.

Once the asset has been defined, assessed and evaluated, the asset is then analyzed financially. Existing reserves of the asset are combined with its undeveloped potential upside to generate a cash flow profile and net present value. Various metrics are compared to other similar, historical transactions and sensitivities to commodity price, operating costs, capital costs and burdens are run. At this point, the buyer will have an understanding of the asset's value to them, what they can afford to pay and will their bid be competitive. The seller will know what how the expected bid price compares to the retention value of the asset. The buyer and seller begin negotiations, usually through an intermediary, to arrive at an acceptable purchase and sale agreement. Once signed, a closing period ensues during which title and license transfers, contract assignments and other conveyances are made.

Unfortunately, few companies perform look-backs on their acquisitions so it is difficult to calibrate their evaluations and analyses. Sellers almost never spend the resources to monitor assets they have sold to see if their former assets were above or below their forecasts.