Presenting and Evaluating an A&D Upside Opportunity

Brian Tuffs
(Brian.Tuffs@sinopecdaylight.com)
Sinopec Daylight Energy Ltd.

Most of the value in an acquisition is found in proved, probable and possible reserves. Most companies will bid on the engineering report usually found in the dataroom and, unless a company has a unique view of base production and reserves, bids will be close with a slight advantage to those with core operations in the area.

The difference that determines the winning bid is the value an evaluating company will place on the upside opportunity. The upside potential arises when the evaluating company has both a thorough understanding of the asset and the financial capacity to develop it that the vendor does not have. In some cases, the vendor may have identified this upside potential through flow tests, log indicated pay, offset production or geological analogues. The evaluating company must verify the data, conclusions and implications and determine what they can afford to pay for the acquisition and how much they need to pay for the asset.

Generally the unbooked upside forms the key strategic driver behind an acquisition. The seller often has constructed a technically reasonable and achievable development plan and is expecting to be compensated for a portion of it. Several companies will likely be bidding on the asset so it is important that a company have a high degree of technical confidence in upside reserves and resources so it can "pay up" for the upside opportunity. Data rich, risk-adjusted decisions are necessary.

The upside opportunity presents itself in many ways.

- Rate acceleration through infill drilling
- A more optimistic view of the recovery factor than the seller
- Recognizing that the reservoir is more complex and heterogeneous than the seller, leading to a different development plan that achieves higher recoveries
- Waterflood potential and improving current waterfloods
- Identifying by-passed pay which was uneconomic at the time the well was drilled or had not been implemented
- Subtle, low contrast pay
- Pool and field extensions

The upside opportunity might not only be related to reserves and production. Opportunities exist to debottleneck or consolidate plants, to acquire ownership of plant and equipment avoiding rental charges, adding compression or artificial lift to increase flow rates and recovery factor and adding deep cut facilities to extract more valuable components. The opportunity may also be financial. Some development plans require so much capital, sellers are unable to secure financing to execute their development plans. Buyers with deep pockets or significant tax pools can afford to pay more for the asset than their competitors who are not so advantaged.

A clear understanding of the strategic purpose of the acquisition is critical. The quantification of goals is very important whether it be production and reserve growth, re-balancing oil and gas reserves, addressing reserve life index or reducing production and reserve concentration.

The A&D marketplace is busy and competitive. Clear corporate objectives, focus and a realistic assessment of organizational skills and competencies is necessary to eliminate “non-starter” deals which provides time to do the necessary work required to submit a winning bid that a company can afford.