6 Reasons Investors Are Eyeing Middle-Market Oil & Gas Companies Today

By David Mahmood

If you own a successful, middle-market oil and gas (O&G) company, investors want to talk with you.

While the economy has seen a slow and steady recovery, the O&G industry has witnessed exponential growth over the same time period. This factor, combined with the continued demand for fossil fuels and advances in O&G technology, has placed middle-market O&G companies squarely in the bull's-eye for eager investors.

This same set of market realities, combined with growing interest in O&G companies within the mergers and acquisitions (M&A) market, equates to new opportunities for O&G business owners. Growing demand for established, successful companies has increased competition among investors, resulting in a pool of buyers who are willing to pay more now than any other time in recent history.

According to Shama Kabani, CEO of The Marketing Zen Group and a Forbes contributor, "Recently, one such emerging trend has caught my eye—more businesses, especially middle-market, privately-held businesses, are getting better valuations when selling their company than ever before."

If you own a middle-market O&G business (annual revenues of $25 million to $500 million), now is a great time to review your options with an experienced O&G investment banker.

But why are investors eyeing middle-market O&G businesses today?

The Economy

Prior to 2009 (before the Great Recession), middle-market O&G companies were enjoying rapid growth associated with rising oil prices and an associated demand for related services. Business owners were not interested in selling because life was great as they focused their attention on what seemed to be endless opportunity!

The O & G market experienced first-hand what Sir Isaac Newton quantified in 1687: what goes up must come down. The industry tanked along with the rest of the economy. The world was inverted in the 2000s, and fewer businesses looked desirable to investors, even though there was plenty of M&A capital available to invest. Sellers had fewer options, and buyers suddenly enjoyed more leverage.

Today, our economy is slowly but surely on a path of recovery and so are profits of middle-market O&G companies. Those same businesses look good to investors, as profits are up and economic uncertainty is yielding to a restored confidence in the recovery. Sellers once again have more options and leverage is on their side. As market conditions continue to improve, more investors have been willing to loosen up their purse strings and get in the game.

Information is power, and while economic growth is fueled by optimism, market sentiments are fueled by statistics. The April 2014 Bureau of Labor and Statistics jobs report indicates both sustained growth and a budget deficit that hovers at a seven-year low accompanied by home prices that have risen for the past 24 consecutive months. We have a way to go to full recovery, and yet, investors are already confident that now is the time to be investing in this particular sector.

Money Available

There is more money on the sidelines today than at any time in U.S. history. According to Wall Street sources, there is approximately $1.1 trillion dollars waiting to be invested. I have seen that investors are looking for high-quality, successful companies they can purchase or invest in. More oilfield services companies are coming on the market this year than at any other time in the past.

Investors always want a good return on investment, and O&G services companies are very profitable right now. Investors who have a long-term vision can afford to ride out any potential downturn in oil prices and still make a nice return. That is why they are ready and willing to invest in these companies.

Buyers Willing to Pay More

Currently, there are not enough high quality companies for sale on the market. Whenever the demand for a product or service increases and the supply decreases, the value of that product or service will increase.

The value of most companies is determined by a multiple of the company's earnings. For example, if a company earns $5 million in profit or earnings before interest, taxes, depreciation and amortization (EBITDA), and the company sells for $30 million, the sales multiple would be six.

Recently, Allegiance Capital has seen an uptick in sales multiples. Last year, good O&G services companies were selling for multiples in the 4 to 5 range. This year, we have seen those increase to the 6 to 7 range with even higher multiples for companies that are technology-based, hold patents, or possess other special factors.

Even the Warren Buffet Indicator, a special Wall Street measure based upon the values of companies sold compared to historical values, shows middle market companies selling in the "significant premium" range now. As a comparison, companies sold immediately following the crash of 2008 were valued in the "significantly discounted range" on the scale.

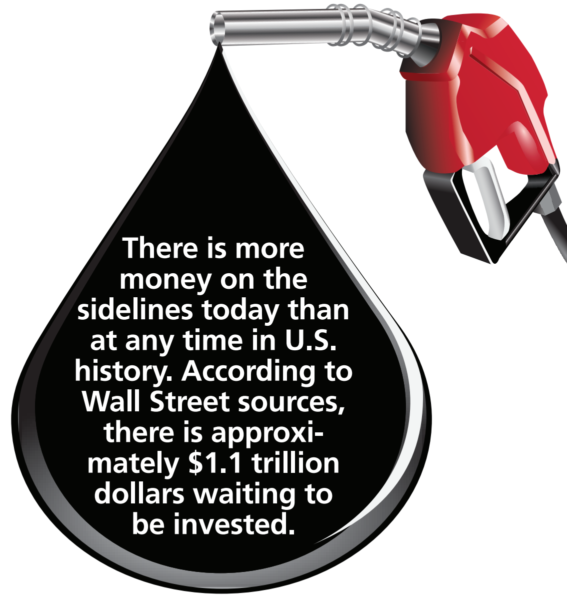
Thus, we have a perfect storm for sellers right now. There's an abundance of cash available to buy companies. There's a shortage of companies for sale, and the demand is high. That means owners can get a better price for their company and better terms right now than they could in the past.

Enduring Demand for Fossil Fuels

While the demand for renewable energy sources keeps growing, fossil fuels continue to provide a significant percentage of U.S. energy needs. A recent Energy Information Administration (EIA) forecast predicts that more than half of our energy needs will be fulfilled by oil and natural gas products through 2040 and beyond. There is little fear that demand will evaporate any time soon. In fact, the EIA is forecasting that we will produce more oil than we import in 2014.

High Value of New Technology

According to the American Petroleum Institute, the U.S. leads the world in technological innovations within the O&G industry. These innovations have not only improved O&G efficiencies but



have resulted in expanded production of domestic crude oil (29 percent since 2008) and natural gas (more than 33 percent since 2005) from shale deposits.

Foreign Investors Driving Higher Prices

The O&G boom is not limited to the U.S. There are shale fields being discovered and tapped worldwide. A small, independent exploration company with a gargantuan acreage position in central Australia is making final preparations to spud, or begin, its third test well in an unconventional formation that looks very similar to the Bakken and Eagle Ford shale plays half a world away.

Elsewhere around the globe, from Argentina to Quebec to Poland, North American independents are testing other shale gas and tight oil formations. Some are in the early stages of development with limited production possible by the end of this year or early next year. As these new shale fields amp up, the foreign demand for U.S. O&G technology will increase.

Foreign investors are looking for proven O&G technological advances to continue to help them cut costs, boost production, and increase profits. The fastest way to accomplish this goal is to purchase U.S. based companies that own proven O&G technology.

Case in point, my own Allegiance Capital helped Fiberod find a buyer in the UK for its innovative, fiberglass sucker rod. This new technology increases efficiencies in the pumping process, and the London-based Smiths Group, along with its Illinois subsidiary, John Crane, were eager to make a deal and paid a premium price to secure the technology.

Owners of middle market O&G services companies owe it to themselves to investigate the opportunity to cash in on the current M&A gold rush in the industry. Today, sellers are enjoying the perfect market for their companies. As we know, market factors can change rapidly and without warning. If the price of oil drops, the related value O&G companies will also fall. While oil prices are at or near all-time highs, nothing is guaranteed.

In my own experience, selling a successful, proven O&G services company normally takes 9 to 12 months, and if market conditions change while we are in the sales process, it could impact the final value of the company. Owners should take advantage of the current market. It just does not get much better than this. **N**

David Mahmood created and sold seven different businesses before founding Allegiance Capital in 1998, which provides mergers and acquisitions financial services to middle market business owners. Follow him on Twitter: @MiddleMktMandA