UNCONVENTIONAL OIL & GAS CENTER

Framework For Founding A Commercial Gas Business

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BRISBANE, Australia -- A blueprint in terms of key strategic and financial variables to consider in striving to make a successful commercial gas business were outlined by Lachlan Hughson, Antero Resources' finance director, at Hart Energy's recent DUG Australia conference.

Hughson identified five key metrics that he considered paramount in creating value and achieving best-in-class performance. These were: scale, helping to generate optionality and momentum; reserve and production growth, which drives net asset value (NAV); capital efficiency, which increases internal rates of return (IRR) by driving finding costs down; operating efficiency, enhancing margins; and credit profile, in which liquidity plays a vital role.

Hughson highlighted the value creation that potentially exists in unconventional plays if an integrated approach is used to optimize each stage of the value chain: the upstream, incorporating land, geology and production; the midstream, focusing on gathering, processing and end products; and takeaway, involving issues of firm sale and firm transportation agreements.

“Integration of these stages will facilitate the highest returns from a given hydrocarbon assets,” said Hughson, noting upstream value may be at risk if the path to market is not well laid out.

“What will be interesting in Australia is how investors want to deal with the integrated nature of the value chain. Do they want companies to go a little further downstream, or do they want companies to focus on doing a great job upstream and they have other more midstream-type companies to do the processing and the takeaway?”

In terms of scale, Hughson said greater size provided low-cost growth and NAV support, as well as, importantly, creating optionality. As examples he cited first-mover access to rigs and frack crews, the volumes needed for midstream and takeaway infrastructure, and potential joint venture funding.

“Scale is critical. That gives you optionality. That gives you the chance to build momentum. Without that, investors don't really have a reason to invest with you.”

Hughson described reserve and production growth as “ultimately the lifeline of a resource company.” Also critical was capital efficiency, as E&Ps strive to be at the low end of the cost curve, which ultimately would determine resource size and production timing. With a greater resource, “the more likely it is that a midstream company will step up and be willing to invest capital in a new or evolving play.”

Over time, however, the most important variable is probably a company's credit profile and liquidity, especially for younger companies, according to Hughson. Without the liquidity needed to provide a line-of-sight to NAV creation, private equity and public market investors will tend to assess an opportunity based only on its “option value” as opposed to a substantially higher “intrinsic value.”

“The most important piece of the puzzle comes down to liquidity,” he said. “Liquidity is what drives value. You can have a great project, you can have great some assets, but if investors can't see a path to funding that development then the probability of success is going to be very close to zero, independent of what the intrinsic value may be, which means your share price is going to trade at something a lot more akin to an option value.”

Generally, Hughson favored small companies partnering with larger entities rather than having a more concentrated position in an asset with few other investors.

“It's better to have a decent-sized part of a big pie than a very big bit of a very small pie,” he said.

Given the size of acreage positions in Australia, giving consideration to the type of joint venture partner you have may make sense in terms of raising capital in an efficient manner, he noted.

“If it is going to very highly dilutive going back to the equity market, because equity investors don't really understand your story and they don't see a line-of-sight to the production growth and cash flow generation that you see, then working with a strategic partner may be the best opportunity to gaining access to the capital you need,” he said.

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