MIDSTREAM Monitor

DECEMBER 7, 2018 | VOLUME 36 | ISSUE 47

DUG MIDCONTINENT

… But Where It's Wanted

PAUL HART
HART ENERGY

OKLAHOMA CITY— One of the biggest challenges in the oil and gas industry today is not those highly desired hydrocarbon products but water. It is both sought after and avoided, two midstream executives told attendees at Hart Energy's DUG Midcontinent Conference & Exhibition here Nov. 15.

How important is it? Water can make or break a play.

"The rig count correlates with water source needs," Michael Dunkel, vice president-water for the engineering firm Jacobs, emphasized in his presentation. If a region lacks water-handling assets then development slows to a stop.

Drillers need water to complete hydraulic fracturing of unconventional wells while producers must have the means to dispose of produced water. And in many plays, shale wells produce multiple times the volume of water as oil and gas.

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“Companies need to know they can get enough water [to drill] and means for disposal,” Dunkel said.

“Cost has been the driver since cost is the big deal with water” at both ends of the drilling and production chain, Dunkel added. That means putting water-dedicated pipelines in place that, once in service, can handle water for a fraction of the cost of trucking.

The issue is so important that the midstream has seen the rapid emergence of firms that are pure-play water handlers, he noted. That trend has positives and negatives.

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On the plus side, dedicated midstream firms reduce costs, minimize producer capex, allow producers to complete more wells and better balance supply and quality. But there are negatives, including control concerns, firm commitments from area producers, water mixing and system complexity.

“Each region has unique characteristics that impact water management,” Dunkel said, which makes procuring and disposing of water tricky. The water question can’t be answered with a one-size-fits-all answer. “It’s a complicated story,” he emphasized.

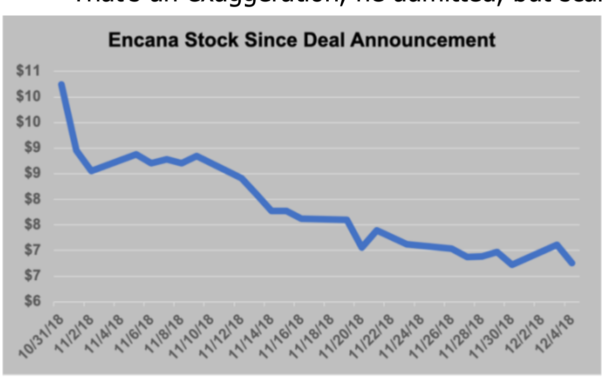
Sourcing water suitable for frack jobs can be particularly tricky in areas where both water quantity and quality are problems, he said. The semi-desert country of West Texas and southeastern New Mexico are particularly challenging for Permian Basin firms. Comparatively dry South Texas presents similar challenges in the Eagle Ford.

M&A Experts: In This New Wave, Bigger Is Better

OKLAHOMA CITY—How big does a company need to be these days to compete?

“We talked to a number of the hedge funds who said every one of the sub-$1 billion public companies should not exist,” said Nick Woodruff, managing director at RBC Richardson Barr during an M&A roundtable at the recent DUG Midcontinent Conference. “And, in fact, every one of the sub-$5 billion companies should not exist.”

That’s an exaggeration, he admitted, but scale is the preeminent theme among investors and members of the panel expect a slew of consolidations to take effect in the next two years.



“You need efficiencies from resources and people and capital allocation,” Woodruff said. “We’re seeing consolidation both in the private equity portfolio teams and the publics that we can talk to.”

Since the price downcycle, companies have focused internally to find efficiencies and cost savings, said Stephen Beck, senior director for upstream at Stratas Advisors.

“In the last 12 months, I’d say that we’ve pretty much closed the gap on harvesting that low-hanging fruit of additional efficiencies,” he said. “What it says is, ‘if the easy stuff is done internally, I need to start looking outside,’ and that ushers in a period of additional M&A activity.”

Stratas forecasts capex of about $10 billion in Oklahoma alone during the next 24 months. That takes deep pockets to address, Beck said, and the solution is consolidation.

At issue during the discussion was the **$5.5 billion all-stock deal** in which Encana Corp. (NYSE: **ECA**) took over Newfield Exploration Co. (NYSE: **NFX**). Encana also assumed $2.2 billion in Newfield debt. The panel was unanimous that the transaction was a harbinger of transactions to come.

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Jay Salitza, managing director for oil and gas investment banking at KeyBanc Capital Markets, said the deal featured scale and free cash-flow generation. **—JOSEPH MARKMAN** | HART ENERGY

FRAC SPREAD

It's The Most Volatile Time Of The Year

JOSEPH MARKMAN | HART ENERGY

Your neighbor's over-the-top holiday light display does more than keep you awake and blind Russian spy satellites. It also influences the late-year electricity market and, by extension, the market for natural gas that fuels power generation facilities.

CURRENT FRAC SPREAD (CENTS/GAL)				
DECEMBER 7, 2018	Conway	Change from Start of Week	Mont Belvieu	Last Week
Ethane	23.52		31.53	
Shrink	29.28		30.19	
Margin	-5.76	-41.12%	1.34	-60.59%
Propane	64.33		70.24	
Shrink	40.45		41.71	
Margin	23.88	-6.31%	28.53	-14.66%
Normal Butane	73.85		72.50	
Shrink	45.79		47.22	
Margin	28.06	-7.20%	25.28	-22.66%
Isobutane	86.60		85.65	
Shrink	43.98		45.36	
Margin	42.62	-10.15%	40.29	-7.28%
Pentane+	98.02		100.08	
Shrink	48.97		50.50	
Margin	49.05	-16.16%	49.58	-11.35%
NGL $/Bbl	24.35	-2.55%	26.10	-4.55%
Shrink	16.13		16.64	
Margin	8.22	-4.89%	9.47	-15.98%
Gas ($/mmBtu)	4.42	-1.32%	4.55	3.45%
Gross Bbl Margin (in cents/gal)	18.29	-4.88%	21.98	-16.18%
NGL Value in $/mmBtu (Basket Value)				
Ethane	1.29	18.25%	1.74	-3.22%
Propane	2.23	-3.23%	2.44	-4.76%
Normal Butane	0.80	-3.64%	0.78	-7.44%
Isobutane	0.54	-5.87%	0.53	-1.89%
Pentane+	1.26	-9.35%	1.29	-4.45%
Total Barrel Value in $/mmbtu	6.13	-1.11%	6.78	-4.41%
Margin	1.71	-0.58%	2.23	-17.27%

Price, Shrink of 42-gal NGL barrel based on following: Ethane, 36.5%; Propane, 31.8%; Normal Butane, 11.2%; Isobutane, 6.2%; Pentane+, 14.3%, Fuel, frac, transport costs not included. Conway gas based on Midwest region, Mont Belvieu based on Houston region. Shrink is defined as Btus that are removed from natural gas through the gathering and processing operation.

"In years past the industry estimated that we saw as much as a 10% increase in power demand near Christmas and the New Year from decorative lighting," said **EnVantage Inc.** in a recent report. "As time passes, this impact is diminishing due to the adoption of LED decorative lighting. We are still in the replacement cycle of older incandescent lighting but the ultimate impact over time is that the 'bump' we see every December will take on a diminished role."

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The analysts admit that it is difficult to gauge how illuminating armies of Frosty the Snowman affects natural gas supply and demand. Natural gas prices have been volatile, though EnVantage sees strength in the fundamentals.

How volatile? The Permian Basin price at Waha crested at $3.85 per million British thermal units (MMBtu) on Nov. 13. Two weeks later the price had collapsed to 30 cents/MMBtu. As of Dec. 4, it had rebounded to $1.36/MMBtu. The December basis closed at -$4.56/MMBtu on Dec. 4.

EnVantage explained the wayward price movements as stemming from the startup of Plains All American LP's Sunrise Pipeline expansion from Midland to Colorado City and Wichita Falls, Texas, with connections to Cushing, Okla. The crude oil pipe allows for greater production of oil from the Midland Basin, but also for greater production of associated gas, in fact an estimated 750 million cubic feet per day. Of course, there's nowhere for the gas to go because of natural gas pipeline constraints in the region, hence the plunging price at Waha.

The NGL outlook is to some extent dependent on the status of the Mariner East 1 and Mariner East 2 pipelines. Residents of Chester County and Delaware County, Pa., petitioned to shut down Mariner East 1 and prevent startup of Mariner East 2, arguing that Sunoco Logistics was in violation of state laws on the safe operation of utilities.

On Dec. 4, **a report** commissioned by Delaware County declared that residents living directly adjacent to the pipelines were more likely to die from falling down the stairs than a rupture of either pipe. Opponents of the projects remain unconvinced.

VIDEO

Forty Under 40: Jacob Nagy, Petrie Partners

Jacob Nagy, partner and managing director of Petrie Partners LLC, is today's Forty Under 40 featured honoree.

As an energy investment banker, Jacob has packed a lifetime's worth of accomplishments into his 11-year career.

Jacob began his career as an analyst in Merrill Lynch's Global Energy Group, which eventually merged with Bank of America. He later spent time as an associate before partnering with his former investment banking colleagues to form the Denver-based boutique energy investment banking firm Petrie Partners in 2011.

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During that time, Jacob has worked on more than 80 merger, acquisition, divestiture, joint venture, restructuring and financing transactions totaling $50 billion in consideration. —HART ENERGY STAFF

Headlines: All Eyes On Vienna, Oil Cut Agreement

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All eyes on Vienna this week as OPEC and its partners engage in two days of meetings to determine just how much they'll cut oil production to help bring the markets back in balance and stem falling oil prices. Where do we stand as of now? A bit in limbo as OPEC members await a decision by Russia before deciding on exact volumes of reduction. Russia's Energy Minister flew back to Moscow to consult with Russian President Vladimir Putin before his expected return Friday when we'll presumably find out Russia's stance.

In the meantime, OPEC members have agreed to a tentative cut reportedly in the neighborhood of a million barrels per day. The numbers so far are short of expectations and oil prices on Thursday fell 5% on the reports. We'll have ongoing coverage including updates on Friday's OPEC –plus meeting on Hart Energy's family of websites.

In Mexico, new President Andres Manuel Lopez Obrador has thrown down the gauntlet to oil majors. The leftist president said he won't cancel any contracts issued to foreign and national oil companies by his predecessors, but challenged them to pump oil quickly or no further oil fields will be offered. Lopez Obrador took office December 1st and promised to increase the government's role in the energy industry. How he handles the energy industry will be one of the biggest challenges to is six-year term. He promised to raise oil production from historic lows but has not fully clarified how. —JESSICA MORALES | HART ENERGY

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