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Shell Grabs Crucial Shale Gas Deposits With \$4.7 Billion Deal

BY **KERRI SHANNON**, Associate Editor, Money Morning

Royal Dutch Shell PLC (NYSE ADR: RDS.A, RDS.B) announced Friday it would pay \$4.7 billion in cash for U.S.-based East Resources, Inc. to obtain a sizeable stake of "high-potential" North American shale gas acreage.

Shell, Europe's largest energy producer, gets 1.05 million acres of gas properties in the northeastern United States and Texas. About 650,000 acres gained in the acquisition are part of the crucial Marcellus Shale, a tight gas property with shale formations estimated to hold up to 262 trillion cubic feet of recoverable gas.

The remaining acres are part of the Eagle Ford Shale area in South Texas. The deal brings Shell's total U.S. tight gas acreage up to 3.6 million acres.

"The opportunity now is to consolidate our tight gas portfolio, divest from non-core positions across North America, and to invest for profitable growth," Peter Voser, chief executive of Shell, told **The New York Times**.

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The move into shale gas allows Shell to remain competitive with industry giant Exxon Mobil Corp. (NYSE: XOM), which in December paid \$31 billion for XTO Energy Inc. (NYSE: XTO), the largest U.S. natural gas producer. The deal will increase Shell's daily gas production by 7.5%.

The purchase comes in a year when Shell already planned extensive spending, and the added pressure to its balance sheet could prevent the company from increasing its dividend over the next couple years.

"Although this is a good move it will put further pressure on the balance sheet, which is weakening with the high level of organic capital expenditure the group has committed to, and this has seen the balance sheet weaken over the past two years," Panmure Gordon analyst Peter Hitchens wrote in a note to investors.

But Shell needs to increase its resources as the BP Gulf oil spill has stalled some offshore drilling production. Shell's plans to start drilling for wells off the coast of Alaska this summer are now being reviewed by the U.S. government.

Shale gas accounts for 15%-20% of U.S. gas production, but that number is expected to grow to four times as much in coming years.

BP PLC (NYSE ADR: BP) chief executive Tony Hayward has called shale gas a "complete game changer."

"It probably transforms the US energy outlook for the next 100 years. It's yet to be seen if it can be applied globally," Hayward said at the World Economic Forum earlier this year.

Shale gas has offered the United States a greater energy supply with a smaller carbon footprint. It attracted companies even when prices and energy demand were higher, and now technological advances in drilling capabilities have made the gas more easily attainable.

"The U.S. tight gas resource base has allowed it to become self-sufficient in natural gas supply long-term," Jason Kenney, oil and gas analyst at ING, told **The Times**. "A couple of years ago that wasn't the case. The technological boundaries have been pushed back."

Natural Gas Prices Positioned for Climb

Natural gas prices are historically low due to a supply surplus. Front month gas prices are down more than 22% this year. U.S. natural gas supplies stood at 2.3 trillion cubic feet the week ended May 21, which is 16% above the five-year average.

The growing trend of developing shale gas reserves has kept prices low.

Companies scrambled for a piece of shale rock acreage when prices were high and are now sitting on reserves that aren't as profitable as originally predicted. Small to mid-size companies can't always afford to produce the deposits they access because the extraction process is pricey and gas prices remain too low to offset production costs.

"Now many of those companies are being forced to continue drilling plans formulated for a much higher market price in order to protect those leased investments," Neal Ryan from Ryan Oil & Gas Partners LLC told **MarketWatch**.

If companies don't drill a well on a lease within 3-5 years they lose control over the mineral rights. They drill to hold the land, which keeps supply high and prices low.

But those who hold on to gas resources will be ready to cash in when prices do rally, which many analysts believe they will.

"The volatility of the market is relatively low," said Darin Newsom, senior analyst at Telvent DTN. "This could possibly draw in additional noncommercial buying as this group looks for markets with the magic combination of being undervalued and having low volatility."

Steamy weather will also play a part: Meteorologist Joe Bastardi of AccuWeather.com predicted this summer to be the "hottest summer since 2005 for much of the nation," meaning increased gas demand for cooling.

Money Morning Contributing Writer Kent Moors forecast in October that natural gas prices would be pushed higher by increased demand in industrial and power generation.

"Natural gas is the principal fuel to benefit most directly from increasing production," said Moors. "The location of the Marcellus also

positions its production well for efficient supply to an industrial sector needing the energy - especially in Pennsylvania, where an expiring electricity price cap threatens an already vulnerable employment base."

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Chris | June 1, 2010

I wonder if this will affect the company MGLG.pk which owns alot of wells in Tennessee and Oklahoma?

Reply

C Neth | June 1, 2010

Did they buy up a company or just buy all the wells in that area? It seems they would have reported buying from an actual company. If they buy out another company what happens to the company that they buy out....does it not exist anymore or do they become part of this company?

Reply