News
Targa asset buy adds to Permian frenzy

Harry Weber, John McManus
825 words
24 January 2017
Platts Gas Daily
GASD
2
ISSN: 0885-5935, , Volume 34, Issue 15
English

ANALYSIS Targa Resources is paying up to $1.5 billion to Outrigger Energy to expand its oil and gas gathering and processing capability in the Permian Basin at a time when the potential for making money there is greater than any US shale play has offered in more than two years.

The company said Monday it is buying assets in both the Delaware and Midland subregions of the basin that stretches across West Texas and southeastern New Mexico for an initial payment of $565 million and up to $935 million in additional payments in 2018 and 2019 based on performance of the assets, which are supported by long-term, largely fee-based contracts.

The Houston-based company joins ExxonMobil, Noble Energy, SM Energy and other producers and midstream operators that are making a big bet that the Permian's future will be as bright as it has been amid the commodity price volatility of the last two years.

In January, a typical well in the Permian Delaware had an estimated internal rate of return of 39.7%, the highest for any US play since December 2014 when a typical well in parts of the Anadarko and Bakken plays yielded a return above 40%, data compiled by Platts Analytics' Bentek Energy show. The Anadarko Basin spans western Oklahoma and the Texas Panhandle, while the Bakken includes areas of the Dakotas and Montana.

“Everybody wants to be there, which means it's really nutty,” Michelle Foss, chief energy economist at the University of Texas at Austin's Bureau of Economic Geology, said of the Permian. “There's nothing else going on anywhere else.”

The Permian, an oily play that also includes large volumes of associated gas, offers lower costs than some of the other US plays, which can translate into bigger returns by comparison regardless of whether oil and gas prices are high or low. The fee-based contracts amount to an additional piece of leverage for midstream players like Targa that process, gather and transport the output producers are lifting out of the ground.

Gas production trends higher

The US Energy Information Administration recently forecast gas production in the Permian will rise in February by over 100 MMcf/d to an average 7.61 Bcf/d, as the number of operational rigs continues to rise. The number of drilled but uncompleted wells in the Permian also has grown, a sign that future production may continue to be robust.

“We have continued bias that the Permian Basin is just about the best place to be in the hydrocarbon business in the world,” Targa CEO Joe Bob Perkins said during a conference call with investors to discuss the acquisition from Outrigger.

The transaction, which is expected to close in the first quarter, will boost Targa's gross processing capacity to about 2 Bcf/d across the Permian by the end of the year, and the company will be able to connect the assets to several of its existing gathering systems, including Sand Hills and WestTX.

The purchase from Denver-based Outrigger includes gas gathering and processing and crude gathering assets in Loving, Winkler and Ward counties in the Delaware section of the shale basin. Those assets are supported by producer commitments with an average contract life of 14 years that involve more than 145,000 acres, Targa said in a statement.

The Midland gas gathering and processing and crude gathering assets Targa is acquiring are in Howard, Martin and Borden counties, and they involve more than 105,000 acres and producer contracts with an average life of 13 years, Targa said.

Crowded group of players betting on Permian

Targa has wedged itself between a growing field of players in the red-hot shale play.

Earlier this month, ExxonMobil said it would spend up to $6.6 billion to more than double its position in the Permian, while SM Energy said it would exit the Williston Basin in North Dakota as it focuses more on the Permian.

Sendero Midstream Partners said recently it will build a natural gas gathering and processing system in New Mexico as it sets its sights on the Permian, and Santa Fe Midstream said Monday, the same day as the Targa announcement, it would form a joint venture with Vermilion Cliffs Partners to develop oil, gas and water infrastructure in the Permian Delaware. Over the last year, Noble Energy, EOG Resources, Concho Resources and Centennial Resources also have made moves in the Permian.

While the Permian frenzy has the potential for future rewards, there also are risks, especially if wells in some of the outer areas of the shale play that producers are venturing into don't live up to expectations, University of Texas' Foss said.

“The potential for losing money is huge, too,” Foss said.

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Major US Plays' Sensitivity to Gas Prices|graph Source: Platts Analytics' Bentek Energy

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