Sink or Swim as Oil Prices Continue to Fall

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As Warren Buffett once wrote in a 2002 letter to the shareholders of Berkshire Hathaway, Inc., "you only find out who is swimming naked when the tide goes out." Well, the tide is going out for many in the oil and gas industry with oil prices plummeting over the last five months to a mere $75 per barrel as of November 19, and it is not a pretty sight...for most.

The State of Louisiana, for example, is expecting a $171 million shortfall in this year's tax and fee collection, the main culprit for which is lower oil and gas royalties. In response, the state's leaders will have to make mid-year budget cuts, with higher education and health care budgets typically taking the brunt of such funding reductions.

Within the industry itself, exploration and production companies are demanding lower prices from oilfield services companies as their profit margins are shrinking, and big and small oil companies alike are even cutting back on exploration and extraction projects altogether.

For example, Halliburton Co. recently announced a proposed $34.6 billion merger between it and Baker Hughes Inc. – the world's second and third largest oilfield services companies behind only Schlumberger Ltd. – wherein Halliburton would pay $78.62 per share of Baker Hughes stock. Supporters of this merger argue that, *if* approved by regulators, it will eliminate redundancies, and therefore costs, allowing a new Halliburton to offer its customers lower prices and likely surpass Schlumberger Ltd. as the global market leader in oilfield services. The merger also creates opportunities for the competition as Halliburton has pledged to divest up to $7.5 billion worth of business to get regulatory approval. Regardless of the outcome of the merger, cost containment is clearly here to stay after months of declining commodity prices.

This transformational merger and its impact on the industry will continue to be monitored by all stakeholders.