

Palm Springs Petroleum (PSP) Negotiating Game

A Case Study in Valuation & Negotiation for Unconventional Onshore Oil Reserves

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Abstract

Proven oil reserves and growing production are critical factors in oil company valuation. Faced with existing field decline rates of 5-10%, major oil companies struggle to replace their production with new reserves. Smaller companies who have successfully explored for new fields can become highly valued entities. But is buying one of these new players a “value creating” activity? That will depend upon many things, including the outlook for future prices, one’s technical ability to extract the “oil in place,” and a firm’s cost of capital. This case provides students with an opportunity to try their hand at buying and selling reserves in one of North America’s hottest plays, the Bakken shale play in North Dakota.

The game involves two companies. Palm Springs is a young independent producer with an attractive Bakken reserves position. Flagler Petroleum is an oil major that produces in excess of 3 million oil equivalent barrels per day. Palm Spring’s Founder has some personal reasons that might favor selling out. Flagler, like many of the majors, is always on the lookout for attractive reserve acquisitions. Palm Springs will be looking at recent “comparable” transactions that suggest their holdings are very valuable. Flagler historically uses conservative price and volume assumptions to avoid overpaying.

Can these two firms agree on valuation and a sale price? Students on each side of this negotiating game will be asked to arrive at a “fair” valuation using standard financial techniques, and then devise their negotiating strategy. The world may look different to each side, i.e. Palm Springs and Flagler may have different views of future prices and recoverable production. Such differences may facilitate the two parties reaching agreement; on the other hand, different outlooks may result in an unbridgeable gap. That will be for the student teams to determine.

This case is based on actual data provided by an independent producer with significant Bakken holdings. The case provides relevant information on Bakken production techniques, volumetric outlooks and pricing trends.