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Schlumberger Eyes Drilling Future With $11 Billion Smith Deal
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By David Wethe and Edward Klump

Feb. 22 (Bloomberg) -- Schlumberger Ltd., the world's largest oilfield-services provider, said its $11 billion purchase of Smith International Inc. will broaden its service offerings and strengthen its competitive position as advances in drilling technology spur oil and natural gas production.

Smith stockholders will get 0.6966 Schlumberger share for each Smith share they own, a value of $44.51 a share based on Feb. 19 closing prices, the companies said yesterday in a statement announcing the all-stock transaction.

Future supplies of fossil fuels are increasingly dependent on breakthroughs in drilling techniques to access deposits in difficult-to-reach areas, such as crude oil in ultra-deep water or natural gas locked in hard shale rock, Schlumberger Chief Executive Officer Andrew Gould said in the statement. The company is based in Houston and Paris.

"The next breakthrough will be through engineered drilling systems that optimize all the components of the drillstring, allowing our customers to drill more economically in demanding conditions," Gould said. "Smith's drilling technologies, other products and expertise complement our own, while the geographical footprint of Schlumberger means we can extend our joint offerings worldwide."

Smith, which owns the M-I Swaco drilling fluids joint venture with Schlumberger, is the second-biggest provider of drill bits, a "critical link" for Schlumberger in offering a full range of drilling products and services, RBC Capital Markets said Feb. 19 in a note to clients.

Biggest Merger

The acquisition, Schlumberger's largest, would be the biggest U.S. merger this year, according to Bloomberg data. It's also the biggest purchase of an oilfield-services company since Bloomberg began tracking merger statistics more than a decade ago.

"If anyone was going to buy Smith, Schlumberger was the logical buyer," said Dan Pickering, an analyst at Tudor Pickering Holt & Co. in Houston. "It was really integrating the bits together with fluids and the other Schlumberger product"
lines, he said yesterday in an interview.

Schlumberger and Smith have talked off and on about merging over the years, a person with knowledge of the matter said. The two companies came close to reaching a stock-for-stock deal last year, only to have the talks fall apart after Smith's shares declined following a drop in its earnings, said three people with knowledge of the talks.

Falling Profit

Schlumberger reported Jan. 22 that its fourth-quarter profit dropped 31 percent to $795 million compared with a year earlier. Smith posted a 90 percent slide in net income to $20.1 million in the same period.

A takeover of Smith may prompt antitrust regulators to force asset sales to prevent Schlumberger from having too much market share in certain categories, said Philip Weiss, an analyst at Argus Research in New York. Areas of overlap between the companies include directional drilling and logging of well results, Tudor Pickering said in a Feb. 19 note to clients.

The takeover may lead Schlumberger to sell Smith's distribution business, which provides a range of supplies including pipes for energy companies and had $1.8 billion of sales last year, said Kurt Hallead, an analyst at RBC Capital Markets in Austin, Texas. He rates the shares "outperform" and doesn't own any himself.

National Oilwell Varco Inc., the oilfield equipment maker, has expressed interest in the business in the past, said two people with knowledge of the matter. One of the people said that Schlumberger may opt to keep the business.

Brand Dilution

Schlumberger said it expects to see pretax savings of $160 million next year and $320 million in 2012. The purchase of Smith, which also is based in Houston, will add to earnings in 2012.

The purchase may dilute Schlumberger's brand as a technology provider with high margins, Scott Gruber and Ben Dell, analysts at Sanford C. Bernstein & Co., wrote Feb. 19 in a note to investors.

"Smith's products are manufacturing intensive and broadly generate lower margins," the analysts wrote in the note.

At the same time, Schlumberger benefits by gaining sole ownership over the M-I Swaco venture it shares with Smith, Weiss said. Smith has a 60 percent interest in the joint venture, which generated about half of Smith's $8.2 billion of revenue in 2009. Schlumberger had sales of $22.7 billion last year.

Schlumberger has valued its acquisition of Smith at $45.84 a share, a 37.5 percent premium based on the companies' Feb. 18 closing prices. That was before reports of a potential deal caused Smith to jump 13 percent a day later, or $4.35, to $37.70 on the New York Stock Exchange. That same day, Schlumberger dropped $1.91, or 2.9 percent, to $63.90.

The deal is expected to close in the second half of this year, Schlumberger said. Schlumberger was advised on the transaction by Goldman Sachs Group Inc. and Baker Botts LLP, while UBS AG and Wachtell Lipton Rosen & Katz advised Smith.

(Schlumberger will host a conference call at 8:30 a.m. New York time. To access the call, go to http://www.slb.com.)

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