

# Burnt Rice

4 August 2017 | By [Lauren Silva Laughlin](#)

EQT is drilling too deeply to extract a rationale for its plan to buy Rice Energy. The U.S. natural gas producer unveiled implausible new possible synergies for the \$6.7 billion deal. Chief Executive Steve Schlotterbeck and his management team also are brushing aside an admitted conglomerate discount. It's dubious logic considering how they could reap healthy payouts simply for getting bigger.

Schlotterbeck has been aggressively selling the deal to skeptical investors since it was announced in late June. EQT's shares fell 13 percent following the news and pushy hedge fund Jana, which owns a nearly 6 percent stake, said it would vote against it.

On the company's latest earnings call with analysts, EQT touted up to \$7.5 billion in additional potential synergies, discounted to today's dollars, on top of the originally planned \$2.5 billion. Some \$2.5 billion of it would come from "best practices" and another \$2.2 billion from various sorts of "optimization." All told, if all such benefits were achievable, they would amount to 150 percent of the acquisition's price tag.

Despite the company's hedging – "It's probably a bit optimistic to assume we could capture all of that," Schlotterbeck said – disseminating the rosy scenario has gotten Rice investors more excited. There's now just a 3 percent gap between Rice's stock price and EQT's offer.

That narrowing spread also helps shrink another gap. EQT concedes that by being both an explorer and a pipeline operator, it trades at a lower valuation than its more singularly focused peers. Its own bankers outlined how a breakup could increase the company's value by 70 percent. Schlotterbeck nevertheless reckons it's wiser to expand first and then tackle the problem later.

Jana sent a second letter earlier this week urging him to deal with the matter sooner rather than use undervalued stock for an acquisition. One reason EQT may have different priorities is the executive compensation plan. A portion of it is tied to production growth that doesn't strip out acquisitions.

That may help explain why Schlotterbeck has been squandering cash to accumulate assets. Return on capital has been at or below EQT's weighted average cost of capital in five of the last six years, according to research outfit New Constructs. Buying Rice could well deliver more of the same.

## Context News

Activist hedge fund Jana Partners sent a letter to EQT's board on July 31, saying it remains opposed to the natural gas producer's \$6.7 billion deal to buy rival Rice Energy.

Jana, which in conjunction with some partners owns a 6 percent stake in EQT, called the company's newly released synergy estimates "dubious."

EQT said on June 19 it would use cash and stock to pay a 38 percent premium to Rice's undisturbed share price. Jana subsequently urged EQT's board to break itself up rather than pursue the acquisition.

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