# Oil and Gas Industry M&A Update for Q4’2020 and FY’2020

**Corporate and Investment Banking Practice**

# Situation Overview

The COVID-19 pandemic overwhelmed the world in 2020. No one anticipated the social and economic scenarios that unfolded in 2020. However, 2021 started on a positive note, with the rollout of the first phase of COVID-19 vaccination programs across many countries.

Though the effectiveness of these programs may still need some time to reach their full potential, the development of vaccines has improved business sentiment and instilled confidence in global economic recovery.

According to the IMF's Jan 2021 outlook, the global economy will likely grow by 5.5% in 2021 and 4.2% in 2022, from an estimated dip of -3.5% in 2020. The effects of this rebound can be seen in the oil & gas sector, with prices increasing almost daily over the last couple of months. Oil prices have increased by ~33% to USD60 per barrel (/b)* as of February from USD45/b at the beginning of Dec 2020.

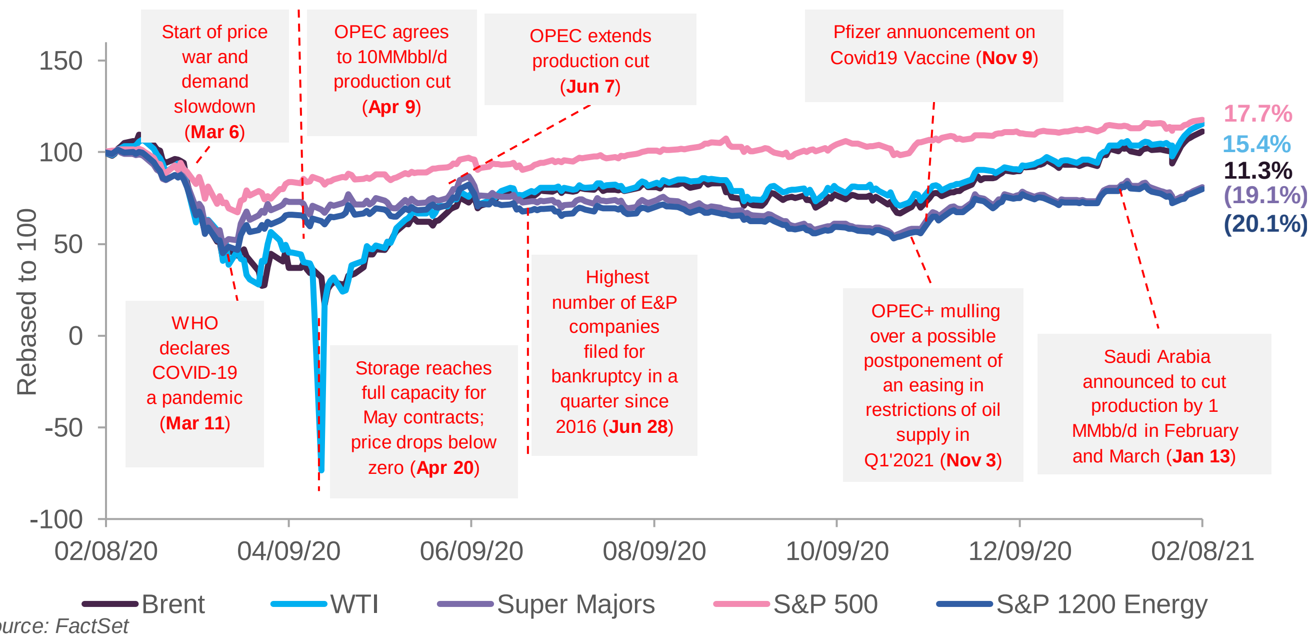
Nevertheless, it is still too early to predict anything. There still is some uncertainty around economic growth, as consumer behavior in response to the vaccination programs will likely dictate the whole scenario. Furthermore, following the emergence of a new strain of the virus, a few countries such as the UK, Belgium, Portugal, Israel, and Denmark have implemented stricter lockdown measures.

According to the Energy Information Administration (EIA), the gap between global consumption and production in December 2020 (1.73 MMbbl/d) was lower than that in October 2020 (3.25 MMbbl/d). The gap decreased due to an increase in production level in response to a rise in oil prices in last two months. However, at the beginning of 2021, OPEC members and Russia agreed to roll over production cuts for the next two months to avoid any excess oil supply amid rising oil prices.

According to the EIA, US crude oil production fell from 12.2 MMbbl/d in 2019 to 11.3 MMbbl/d in 2020 and will likely dip to 11.1 MMbbl/d in 2021. However, it is expected to increase to 11.5 MMbbl/d in 2022. A steady increase in oil demand has buoyed crude oil prices and narrowed the price performance gap between major oil & gas companies and the S&P 500 in Q4'2020, compared with Q3'2020.

Furthermore, the new presidential regime in the US has fueled price increases with an expectation of fresh stimulus in the sector. We believe the sector is showing signs of recovery and will remain on a steady path in 2021.

**LTM Share Price Performance: Super Majors vs. S&P Oil and Gas vs. S&P 500**




*Source: FactSet*

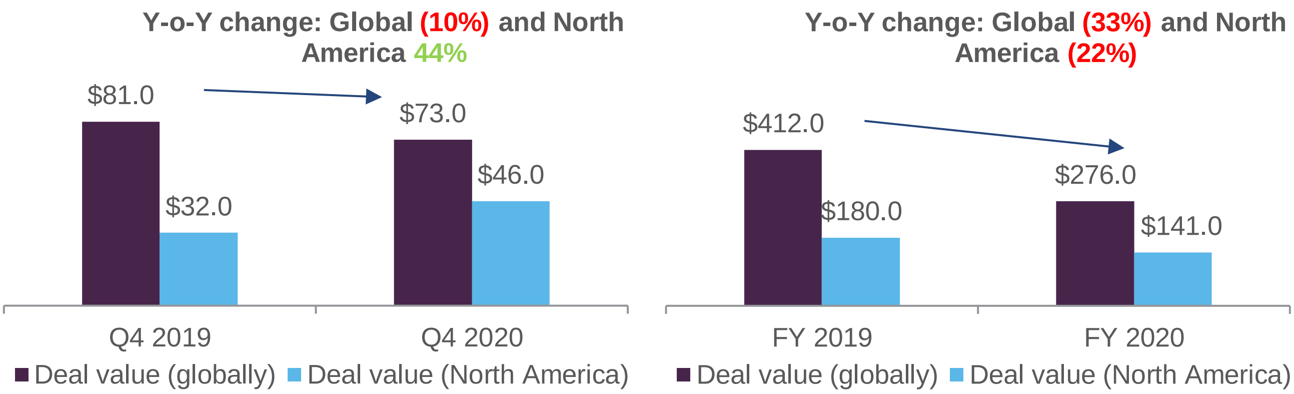
*Note: Supermajors include Exxon Mobil, Royal Dutch Shell, Chevron, BP, Total, Eni, and Equinor*

# FY2020 M&A Scenario

1. **Deal activity declined in 2020**: According to GlobalData, 535 oil & gas deals (worth USD73bn) were announced globally in Q4'2020, down 53.9% (value terms) vs Q3'2020 and 21.8% vs the average value (USD60.3bn) in the last four quarters. In FY'2020, 1,680 oil & gas M&A deals were announced, down 15.5% from 1,987 deals in FY'2019. Deal value decreased by 33.0% from USD412.0bn in 2019, to USD276.0bn in 2020.

Some of the key deals in Q4'2020 include Conoco's acquisition of Concho Resources for USD13bn; a USD7.8bn merger between Cenovus Energy and Husky Energy; Pioneer Natural Resources' acquisition of Parsley Energy; and China Oil & Gas Pipeline Network's USD6.2bn acquisition of PetroChina Beijing Gas Pipeline and PetroChina Dalian LNG. In Q4'2020, 181 oil & gas deals worth USD46.3bn were announced in North America.

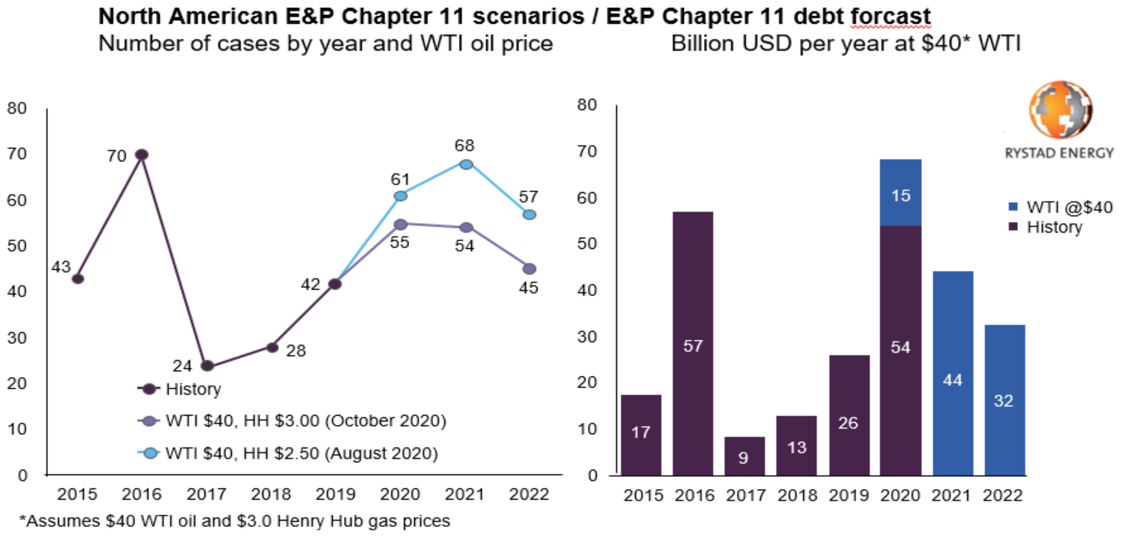
**M&A Deal Value (USD bn)**




*Source: GlobalData*

2. **Rise in bankruptcy and restructuring filings in the upstream and services sectors**: According to a survey by Dallas Federal Energy, shale oil producers require to achieve a per barrel breakeven oil price range of USD48–54 to generate a decent bottom line. As per the EIA's Short-term Energy Outlook, January 2021, WTI prices will likely average at USD49.7/b in 2021. This is a positive sign for oil producers. Furthermore, spot prices of Brent crude oil averaged USD50/b in December 2020, up by USD10/b from the average in October 2020. Brent crude oil spot prices are expected to average USD53/b in 2021 and 2022, compared with an average of USD42/b in 2020. The upside in oil prices will likely reduce the number of bankruptcy filings for the time being. Nonetheless, companies must remain cautious and take steps so that they do not reach the 2020 levels. In October 2020, Rystad Energy reported that 84 E&P and OFS companies had filed for Chapter 11 bankruptcy protection, which was lower than the highest number of bankruptcies (142) filed in 2016. Some of the major companies that filed for Chapter 11 bankruptcy in 2020 are Chesapeake (debt: USD11.8bn), California Resource (debt: USD6.3bn), Ultra Petroleum (debt: USD5.6bn), Chaparral Energy (debt: USD3.5bn), Whiting Petroleum (debt: USD3.6bn), Oasis Petroleum (debt: USD2.8bn), and Denbury Resources (debt: USD2.5bn). According to Rystad, if the WTI average remains around USD40/b and Henry Hub price around USD3/MMcf, an additional 55 North American E&P companies may file for bankruptcy protection by the end of 2020.

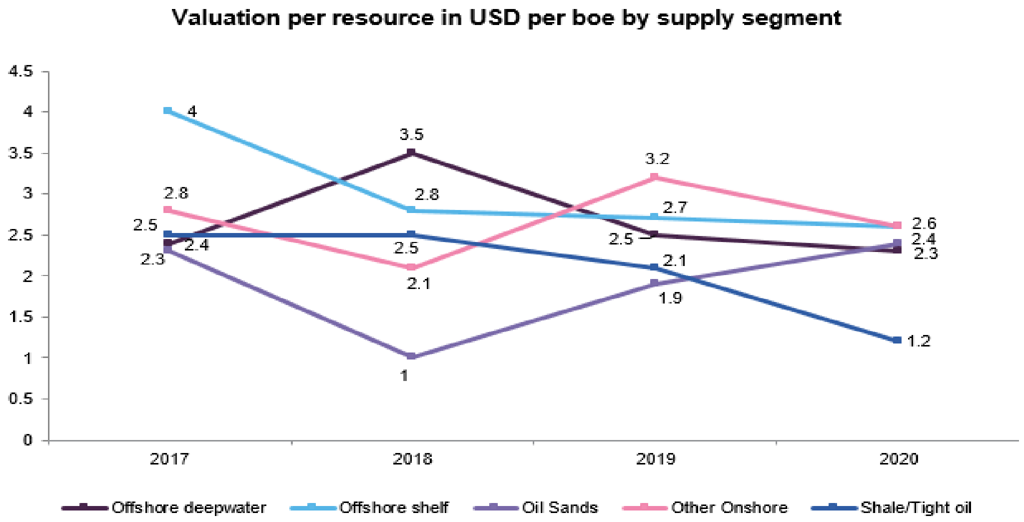
**North American E&P Chapter 11 Scenarios, by Year and at Different WTI Oil Prices**




*Source: Rystad Energy's research and analysis*

3. **Leading financial institutions exiting the O&G sector**: In 2020, some of the leading financial institutions had announced their exit or planned to exit the oil & gas sector due to the current scenario. The Central Bank of France has announced to limit its exposure to the sector by 2024. In December 2020, the Bank of Montreal announced to exit its oil & gas investment banking business in the US and would divert its resources towards assets in Canada. According to the Institute for Energy Economics & Financial Analysis, in October 2020, ~50 global financial institutions were identified to have restricted the financing of oil sands and / or Arctic drilling projects. Some of these institutions are HSBC, Banco Santander, Deutsche Bank, Goldman Sachs, JPMorgan Chase, Citigroup, Wells Fargo, and Morgan Stanley.

4. **Plummeting shale oil valuation in 2020:** According to a report by Rystad Energy, the global deal value of upstream M&A activity in 2020 dropped to USD87.9bn, the lowest in over a decade, largely due to the pandemic. The valuation of the shale industry's acreage was the worst hit. It was valued at USD1.2 per barrel of oil equivalent (boe)* – a historical low – and was cheaper than any other resource type. The number of field acquisitions declined from 349 in 2019, to 188 in 2020. The number of license acquisitions remained stable, with 92 deals in 2020, compared with 98 in 2019.



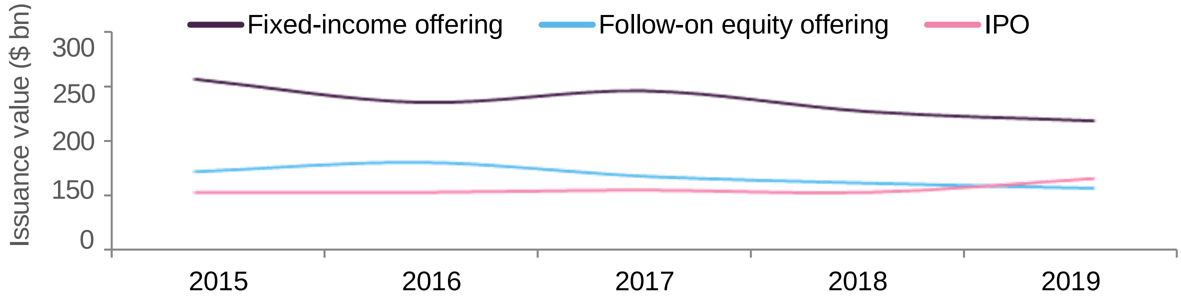

*Source: Rystad Energy's research and analysis*

## Factors affecting M&A Situation

In terms of deal focus, nothing much has changed since Q3'2020. Although oil prices have somewhat revived, oil & gas companies are only focusing on M&A deals that can add value to their business in the long run without stretching their balance sheet. Given the volatile nature of the sector, the following are a few factors that could affect M&A activity in the future:

1. **Selective M&A focus amid operational cost-reduction pressure**: Many large oil & gas firms are cautiously choosing their targets, keeping in mind long-term growth strategy but without compromising on operational efficiencies that reduce costs.
2. **Though tough to raise capital for deals amid working capital needs, ultra-low interest rates can provide a push for M&A**: COVID-19-induced uncertainties and considerable variations in capital needs across various sectors have compelled investors and capital providers to focus on their investment sectors. Furthermore, lockdown measures across the globe since Q2'2020 have led to a liquidity crisis, as companies / individuals started saving cash to meet their future capital needs. All these factors have strained capital markets, which were already declining over the past few years (as shown in the chart below). The IPO market has dried up in the last five years, and there is limited availability of other financing routes (equity and debt). Nonetheless, the current economic recession has forced global banks to maintain ultra-low interest rates in 2021, e.g., bank rates in developed countries such as the US, the UK, and Canada, range from 0.1% to 0.25%, while that in developing nations such China, India, and Russia range from 3.75% to 4.25%. This situation will likely be advantageous for the sector. Smaller players are likely to have access to cheap capital, while larger players with strong leverage management backed by proven reserves and yielding assets can focus on M&A using debt capital. In fact, many large companies raised a considerable amount of debt in April 2020 and continued to do so till now. For example, Exxon raised USD9.5bn in April and USD5.1bn in June 2020, Equinor raised USD5.0bn in April and USD1.5bn in May 2020, Shell raised USD7.1bn in April and USD2.5bn in September 2020, and BP raised USD12.5bn to date since April. Traditionally, the key objective behind raising funds was to ensure liquidity for operational needs; however, it is now also being used for M&A activity.

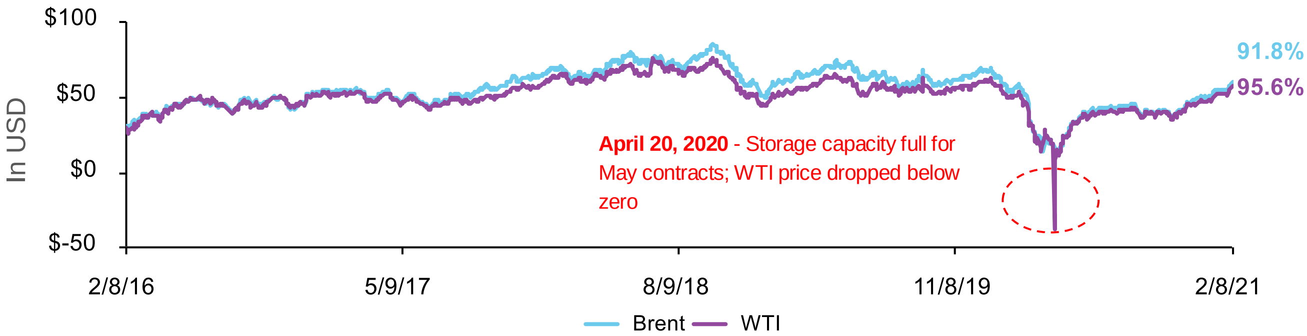
### Financing Markets in Oil and Gas Sector Since 2015




*Source: Data and analytics provided by S&P Global Market Intelligence*

3. **Limited M&A activity by smaller upstream players**: Although oil prices are higher than what they were in Q2'2020 and Q3'2020, prices are not yet at a level that can encourage independent oil producers to venture out in M&A territory. Rather, independent oil producers are using this opportunity to streamline operations for some profitability. This trend has been consistent over the last few years (as shown in the chart below). Low oil prices and high capex involved in finding new wells have simultaneously strained the topline and bottom line of smaller upstream players. These factors have stretched their books and reduced their fundraising capacity and interest in any M&A activity.

### Last 5 years' Price Performance: WTI vs. Brent




*Source: FactSet*

4. **Paradigm shift in investment focus and going green motto in private equity sector leaves little room**: Unlike earlier, when private equity investors focused more on early-stage shale oil producers, investors now are focusing on companies with large proven reserves that are less susceptible to oil price fluctuations. This indicates fewer M&A opportunities for energy-focused funds. This paradigm shift has been triggered by the fact that US oil & gas-focused funds have been among the lowest yielding asset classes for private capital over the past 10 years (according to Preqin), with a median internal rate of return that is about 5 percentage points lower than that of comparable buyout firms. Furthermore, the transition from non-renewable to renewable energy is impacting the sector. As per 2019 LP surveys, ~40% of private equity firms are planning to reduce their oil & gas allocations over the next 5 years.

# M&A Outlook – Consolidation and Value Buying Trend to Continue

The rise in oil price in the last couple of months has provided an impetus to the struggling oil & gas sector. Oil is trading at around USD60/b and the expectation of a further rise in price will certainly fuel more M&A activity in 2021. In H2'2020, companies have looked towards consolidation and value buying and are expected to follow the same trend in FY'2021. The following trends have emerged in the M&A space in 2020:

1. **Consolidation activity to continue:** A rise in economic activity and the rollout of vaccination programs have instilled hope among players in the sector. The effects of COVID-19 have put many companies in distress. Thus, larger players in the sector are planning to acquire these companies to strengthen their position in the sector. Some companies are undergoing mergers to strengthen their position in the M&A market. Some of the key examples include ConocoPhillips' acquisition of Concho Resources for USD13bn in October 2020; Chevron Energy's acquisition of Noble Energy for USD13bn; the merger of Devon and WPX (resulting in an enterprise value of USD12bn for the combined entity); and the USD7.8bn merger of Cenovus Energy and Husky Energy (completed in January 2021).
2. **Divesture trend in downstream**: The ongoing prevalence of remote working has weighed on the demand for oil. This is forcing refiners – both integrated and independent – to divest assets that are not fully utilized. Many retail deals were announced in 2020. For instance, Marathon Petroleum divested its filling station and store business Speedway to retail chain 7-Eleven for USD21bn in August 2020 and Casey's General Stores announced plans to acquire Buchanan Energy, owner of Bucky's Convenience Stores, in an all-cash deal for USD580mn in November 2020.
3. **More stock deals or asset swap deals**: Large-cap and mid-cap firms are likely to go for stock deals or asset swap deals, especially in this tough credit environment. A recent study by Rystad stated that the energy transition trend, combined with the current market condition, could push oil majors to swap oil and gas assets worth more than USD100bn in 2021. For instance, in December 2020, Diamondback Energy announced plans to acquire QEP Resources, an E&P firm, in an all-stock transaction of about USD2.2bn
4. **Infrastructure asset deals focus on midstream:** Many large midstream companies are focusing on acquiring infrastructure assets from upstream and downstream companies that have midstream assets. This will likely strengthen their position in the sector and help them meet their inorganic expansion goals.
5. **M&A focused on portfolio optimization and debt reduction:** Supermajors and large oil companies with varied asset bases have started selling their non-core assets to improve their liquidity position and reduce debt. The world's top eight largest oil companies, Exxon, Chevron, Shell, BP, Total, Equinor, Eni, and ConocoPhillips are expected to sell assets with resources of around 68 billion boe for an estimated value of USD111bn – resources which are equivalent to around two years of existing global oil demand, as per Rystad Energy. These players have acquired high-quality assets to meet their new strategic needs. Some of the big-

ticket transactions in 2020 because of portfolio optimization are listed below.

a. In July 2020, Dominion Energy sold almost all Gas Transmission & Storage segment's assets to an affiliate of Berkshire Hathaway for USD9.7bn to focus on its utilities segment.

b. In July 2020, Occidental Petroleum sold its energy assets in Africa and the Middle East to Indonesian oil and natural gas company PERTAMINA for USD4.5bn.

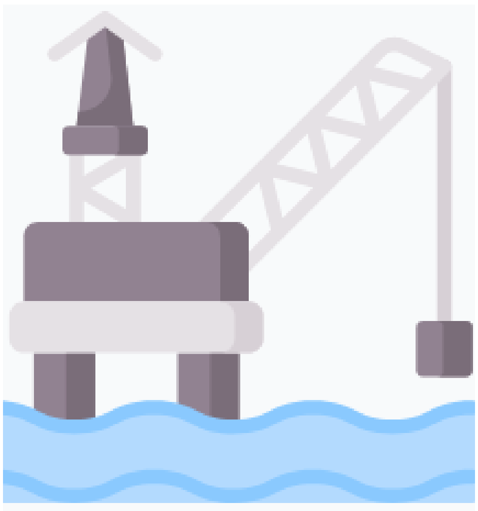
c. In June 2020, Abu Dhabi National Oil Company (ADNOC) divested its 49% stake in gas pipeline assets to a consortium of investors for USD20.7bn.

6. **Smaller upstream companies may act as distressed targets:** The fall in oil prices in 2020 destabilized the upstream sector. Many smaller players had to shut down operations, as is evident from the fall in rig count in the US – 373 in January 2021 vs. 790 in January 2020 (as per Baker Hughes). The decrease in rig count has brought several distressed assets with discounted valuation into the market. In November 2020, Bonanza Creek signed an agreement to acquire restructured HighPoint Resources for USD376mn. Ameredev Texas won a bid to acquire Lilis Energy for USD46.6mn in cash, as part of Lilis' Chapter 11 bankruptcy proceedings.

7. **Private equity players will start investing in the sector:** According to a Bain Capital report in 2020, private equity players are holding onto a lot of dry powder (USD2.5tn for all fund types, including USD850bn for buyouts). In Q2'2020, private equity players did not indulge in M&A as they expected the industry to bottom out given that many portfolio companies in various PE firms had started declaring bankruptcies. Raising funds from public markets is not easy in the current scenario. Thus, most companies are looking to access the private capital market for their funding needs. According to Pitchbook, US PE fundraising will likely reach an all-time high of USD330bn in 2021. This provides an opportunity for PE firms to increase their investments.

M&A activity in the sector is showing an uptrend. We expect some more major deals in 2021. The deals are expected to revive the sector from the effects of the pandemic. Large US producers and foreign buyers could go on acquisition sprees once the market is stable.

***Digital initiatives for better integration among various divisions, increased automation aimed at workforce safety and flexibility, as well as new hedging techniques across the energy value chain – upstream, midstream, downstream and OFS – can help O&G companies in achieving improved efficiency.***



## Author

**Piyush Mittal**

Group Manager, Evalueserve

Piyush's team supports the oil and gas team of a bulge bracket investment bank. He has more than 7 years of experience in the energy sector.

Evalueserve's Corporate and Investment Banking practice works with bulge bracket banks, commercial banks and boutique advisory firms. Our key practice areas include Sector and Product support, Lending & Credit support, Business Information / Library Services, Presentation Support services and Business Reporting. Our proprietary technology platform helps streamline and automate workflows, re-use work products through knowledge management and automate repetitive tasks. For more information, please visit: https://www.evalueserve.com/industry/financial-services/

## ABOUT EVALUESERVE

Evalueserve is a leading analytics partner to Fortune500 companies. Powered by mind+machine™, Evalueserve combines insights emerging from data and research with the efficiency of digital tools and platforms to design impactful solutions. A global team of 4,000+ experts collaborates with clients across 15+ industries.

## CONNECT WITH US

Evalueserve Insightsfirst: www.evalueserve.com/insightsfirst

Evalueserve's Investment Banking Practice Overview: https://www.evalueserve.com/solutions/investment-banking-support/

Connect with us on LinkedIn