EVALUESERVE

M&A Activity in Oil and Gas Sector

Corporate and Investment Banking Practice

June 2022

Geopolitical tensions and new COVID-19 variants are creating imbalances amid positive outlook for O&G sector

Geopolitical tensions and COVID-19 are weighing on economic recovery

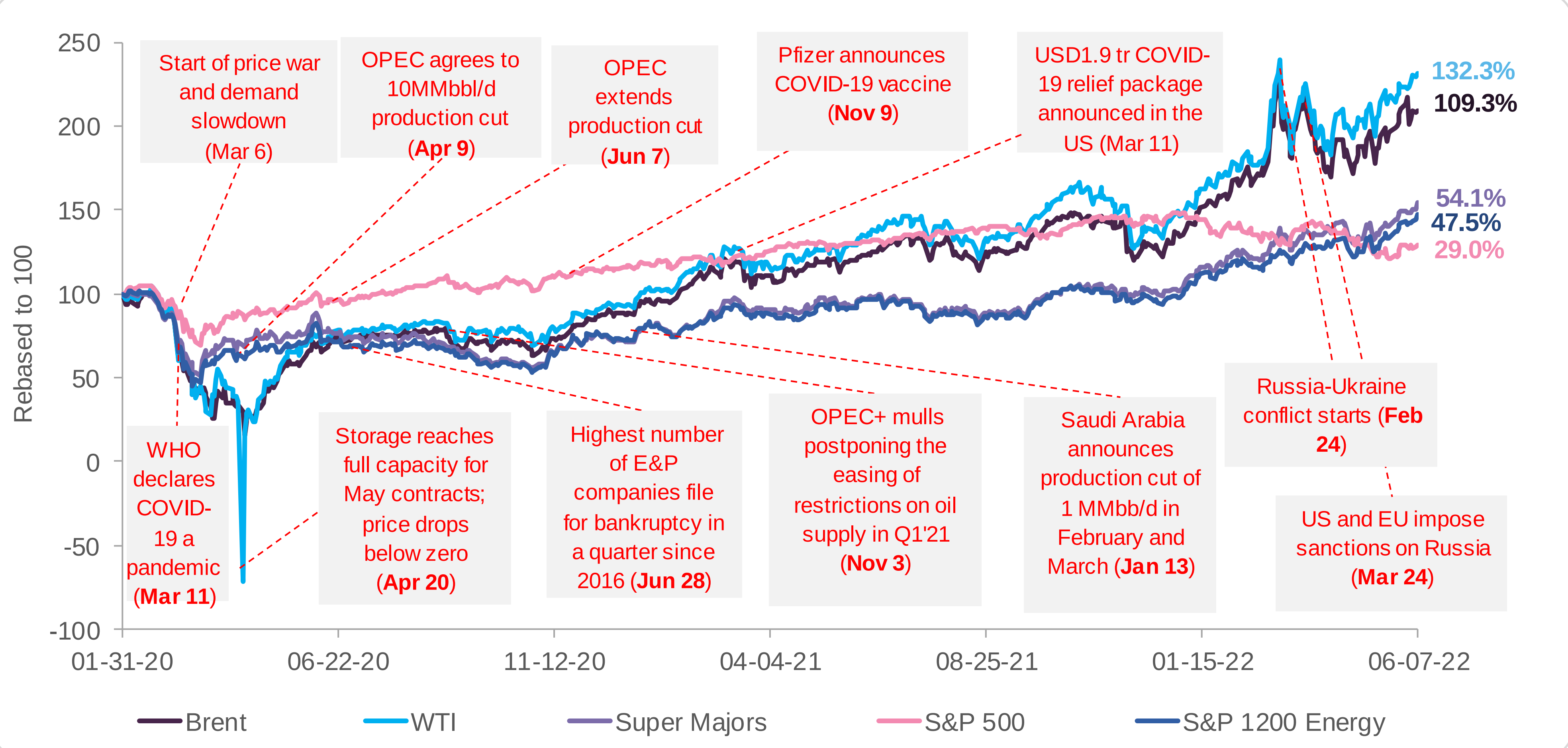
- **Geopolitical tensions**: The ongoing conflict between Ukraine and Russia conflict is creating uncertainties across global economies. Many major economies have banned oil and gas imports from Russia. On the other hand, with the gradual reopening of countries across the globe, the demand for oil and gas has been increasing steadily. Both the events have led to a supply crunch amid growing demand, which in turn has led to a surge in oil price to above USD100/bbl.
- **COVID-19**: According to Deutsche Welle (DW), 78 countries reported an increase in new COVID-19 cases in May 2022. The emergence of new variants reflects that the pandemic is not over yet and dampens the hope of a rapid economic recovery across the globe.
- **Vaccination impact**: According to data collected by Bloomberg, more than 12 bn vaccination doses had been administered across 184 countries until May end. However, as per the World Economic Outlook, a large proportion of the population in emerging economies will not be vaccinated before 2022. Furthermore, the emergence of new COVID-19 variants is questioning the effectiveness of the vaccines and could drive uncertainties in the market.
- **Other geopolitical events** that could dictate the course of global economic recovery include the Libyan Crisis and the ceasefire in Yemen.

Outlook for global economy uncertain despite positive O&G output

- **Global economic outlook**: According to the World Bank, the global economy is expected to slump from 5.7% in 2021 to 2.9% in 2022, which is significantly lower than the estimated 4.1% in January. Also, the forecast for 2023 is about the same as for 2022. The IMF's 2022 and 2023 outlook for the global economy indicates stagflation, which means low growth and high inflation.
- **Demand and supply**: According to the Energy Information Administration (EIA), in May 2022, the gap between global oil consumption and production was 0.5 MMbbl/d. This means that any increase in demand without a similar increase in production can raise the already high oil prices. To mitigate this threat and offset Russian output losses, recently, OPEC+ (including Russia) members agreed to increase their production by 648,000b/d in July and August.
- **Sector outlook**: A strong rebound in oil prices has given enough appetite to oil and gas companies to invest organically and inorganically to provide strong returns to shareholders, as well as build sustainable operations for future growth. We believe that the sector showed robust signs of recovery in 2021 and will remain on a steady path in 2022.
- **Top growth drivers in 2022 and 2023**: The adaptation to the pandemic; the growing influence of environmental, social, and corporate governance (ESG) on capex; and the acceptance of energy transition are likely to be the major themes driving growth in the sector.

S&P 500 companies have performed better than oil and gas companies

Supermajors versus S&P oil and gas versus S&P 500



Till end of May’22, oil prices performance have outpaced share prices performance of Super Majors and S&P indices because of fear of disruptions in demand supply dynamics due to ongoing geopolitical tensions

Source: FactSet.

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

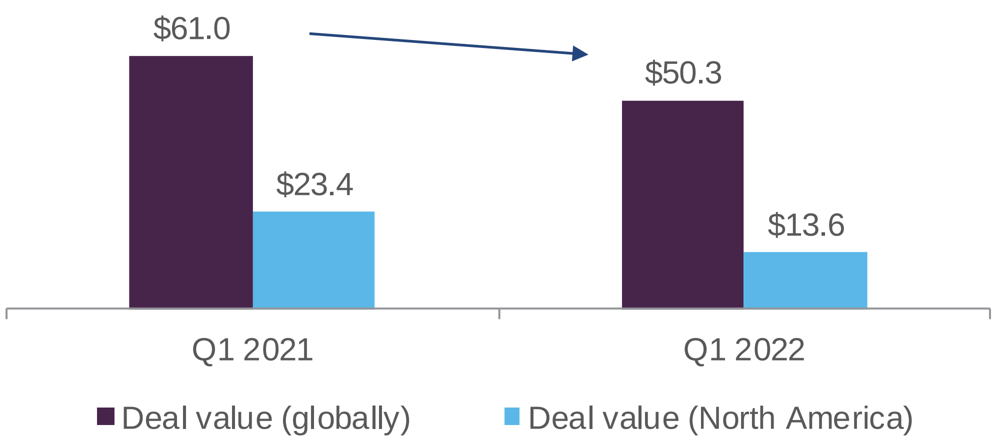
M&A scenario in Q1’22 (1 / 2)

M&A deal activity across the globe and in North America has decreased in Q1’22

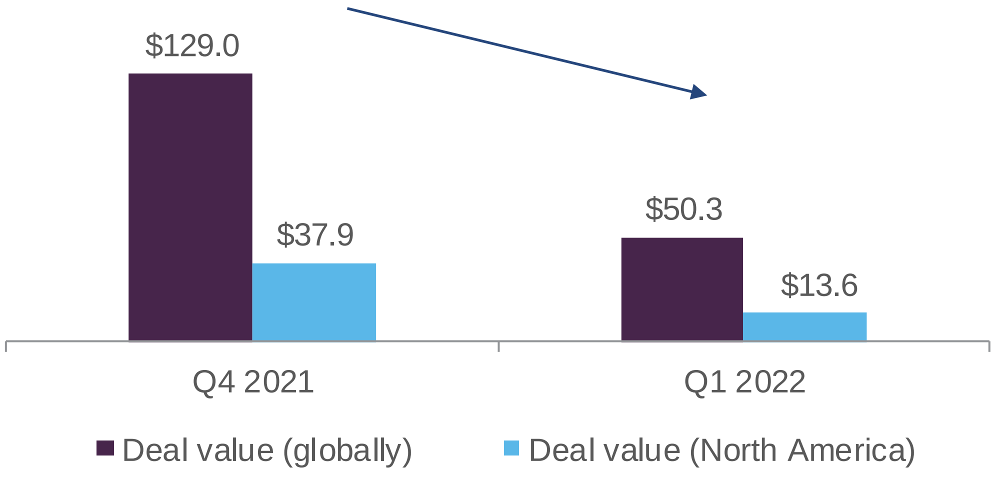
Key deals in Q1’22

- Enterprise Products Partners acquired Navitas Midstream Partners for USD3.25bn.
- Chesapeake Energy acquired Chief E&D Holdings and Tug Hill for USD2.65bn.
- PDC Energy acquired Great Western Petroleum for USD1.3bn.
- Enerflex acquired Exterran for USD735mn.
- Clearfork Midstream secured USD400mn in a private equity deal from EnCap Flatrock Midstream.
- Vermilion Energy acquired Leucrotta Exploration for USD382.21mn.
- Targa Resources acquired Southcross Energy for USD200mn.

Y-o-Y change: Global (17.5%) and North America (41.0%)



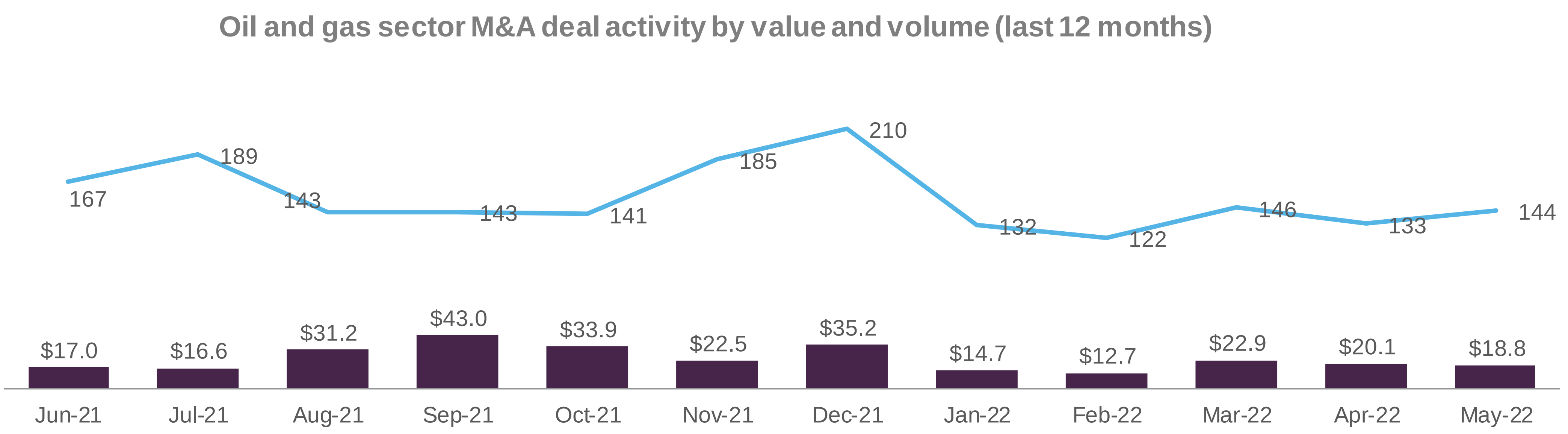
Q-o-Q change: Global (61.2%) and North America (64.1%)



Source: GlobalData

M&A scenario in Q1’22 (2 / 2)

- Deal activity (by volume and value) in Q1’22 was slightly below that in Q4’21.
- In the last 12 months, the majority of the M&A deals have happened in the US.



Source: GlobalData

Factors affecting M&A activity – Non-traditional factors are shaping oil and gas sector

Geopolitical tensions and threat from pandemic

At the end of 2021, M&A activity in the oil and gas sector was improving as economies were gradually opening up. However, speculations about another wave of COVID-19 cases may weigh on the demand and price of oil. On the other hand, the Ukraine-Russia conflict has cut off supplies and led to an increase in oil prices. The volatility is driving high uncertainty and making it difficult for companies to forecast and make investment plans.

Rising interest rates

High inflation has emerged as a common problem across regions as economies re-open and consumers exhibit high spending behavior. There is a demand-supply gap, which is increasing the prices of oil and gas products. Governments across the globe are raising their interest rates to curb this inflation. The UK and the US have decided to raise interest rates to 1%, while India and Mexico have already raised interest rates to 4.4% and 6.5%, respectively. The increasing need for capital to meet the growing demand, amid the increasing interest rates, is compelling companies / investors to focus only on low-risk investments that will be accretive to their future earnings. As a result, M&A activity could slow down as no one would want to take additional risks after experiencing difficult times in the last two years.

Increasing pressure for ESG compliance

ESG is gaining prominence in the O&G sector as the sector is often associated with multiple types of environmental pollution. Most major economies are implementing more stringent ESG regulations to tackle issues related to environmental pollution and climate change. For instance, in Nov 2021, the EPA proposed a rule that requires O&G companies to reduce methane emissions. This rule can reduce methane emissions by 41 million tons by 2035. Furthermore, companies need to show their social commitment by adding value to local communities, exhibit no gender biases in their workforce, and adopt fair governance processes. Many shareholders expect O&G companies to disclose their ESG strategies and metrics. ESG risks have become an integral part of M&A due diligence and private / institutional investors are looking at ESG scorecards before investing. In addition, larger players are hesitating to participate in deals that do not align their actions with shareholder value, ESG, and energy transition priorities due to shareholder and market backlash.

Development of green portfolios through energy transition deals

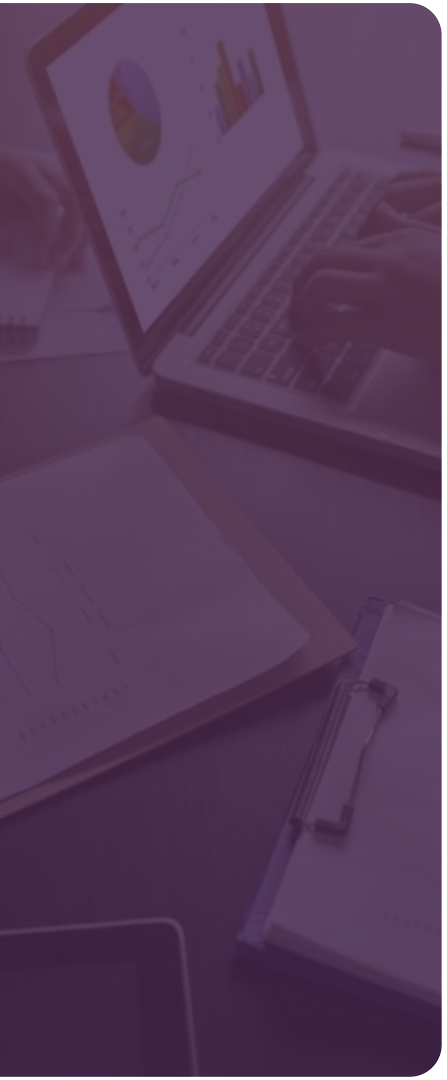
Development of green portfolios through energy transition deals: Over the last couple of years, investors in oil and gas companies have been demanding more investments in sustainable and resilient assets. Thus, many oil and gas companies are aligning their long-term strategies with a zero-carbon emissions goal. As a result, the traditional oil and gas market will likely witness an increase in M&A activity, as companies will try to reduce their carbon footprint through relevant partnerships and acquisitions. According to Bain, Shell has sold acreage in the Permian Basin to ConocoPhillips for USD9.5bn as part of its energy transition strategy. LyondellBasell's JV with Suez (now Veolia) has acquired plastics recycling company Quality Circular Polymers to mechanically convert consumer waste into 25,000 ton of polypropylene and high-density polyethylene annually.

M&A outlook for FY'22 (1 / 2) – Focus is shifting towards green and sustainable portfolio

Oil prices have surged since the beginning of FY'22, resulting in a high inflow of cash in the sector, which was bleeding over the last two years. However, despite this positive development, factors such as geopolitical tension, the increasing influence of ESG, high inflation, and focus on energy transition are decelerating the M&A activity in the sector.

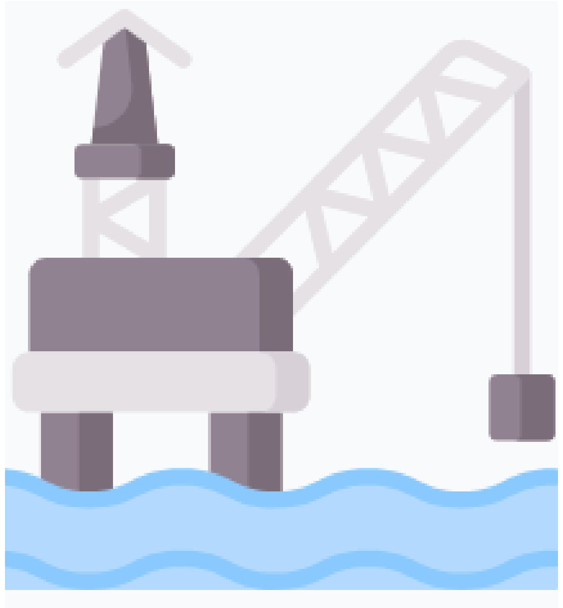
M&A trends	Key transactions
Consolidation to continue but at a slower pace: The sector has witnessed substantial consolidation over the last two years. However, the pace of consolidation is slowing down due to higher oil prices. As of now, companies do not need to undertake M&A for survival and scalability and are thus focusing on fine-tuning their portfolios. However, in late-2022, if the geopolitical tensions subside and oil prices become stable, small to midsized oil and gas players could play a critical role in consolidation. Furthermore, large players that want to exit their non-core businesses will look for buyers to divest those segments.	• Enterprise Products Partners acquired Navitas Midstream Partners for USD3.25bn. • Chesapeake Energy acquired Chief E&D Holdings and Tug Hill for USD2.65bn. • PDC Energy acquired Great Western Petroleum for USD1.3bn.
Greener operations and stronger ESG assets: Companies are focusing on deals that can reduce their carbon emissions and help them meet their net-zero targets. According to a Deloitte report, ESG-related investments (USD1.7 trillion) account for about 10% of fund assets across industries globally. However, only 10% of the oil and gas deals in 2021 cited ESG as their key deal rationale or openly communicated their ESG consideration in deals to stakeholders. This is not a big number but given that ESG compliance is not easy to follow in this sector, it is a great start. In the future, companies will likely follow this trend and mold their investment strategies accordingly.	• In 2019, Occidental Petroleum, a major oil and gas producer in the Permian Basin, acquired solar-power-generation assets to power its drilling and completions operations. • In November 2021, Bonanza Creek and Extraction Oil & Gas merged to form Civitas Resources, Colorado's first net-zero oil and gas producer.
Focus on energy transition or green acquisitions: To decrease the number of carbon-emitting assets in their portfolios, large oil and gas companies are planning to acquire or develop renewable energy sources. For instance, BP aims to develop 50 GW by 2030, Eni plans to have 25 GW by 2035, Equinor wants to establish a range of 12 GW to 16 GW by 2035, and Repsol is aiming for 15 GW by 2030.	• In December 2021, Aker BP proposed the acquisition of the E&P business of Lundin Energy for USD14.0bn. The transaction is characterized by Aker as creating an E&P company that will have high free cash flow, low cost, low CO2 emissions, and attractive growth pipeline. • In 2020, Total acquired nine renewable energy and power sector companies. Similarly, other majors have acquired renewable energy assets over the last year.

M&A outlook for FY'22 (2 / 2) – Focus is shifting towards green and sustainable portfolio



M&A activity in the sector is slower in Q1'22 than in 2021; we expect it to pick up in H2'22. Shifting towards energy transition, building ESG strategies, and portfolio optimization will drive M&A activities in 2022.

> *Digital initiatives for better integration of different segments, increased automation for workforce safety and flexibility, and new hedging techniques across the energy value chain (upstream, midstream, downstream, and OFS) can help oil and gas companies boost efficiency.*



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

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