Energy Intelligence

Energy Intelligence Premium Weekly

Thursday, November 3, 2022

Strategy: Upstream M&A Needs Price Stability

Global upstream M&A activity has been mostly sluggish this year due to geopolitical uncertainty, market volatility and ongoing capital constraint, even as balance sheets improve. We expect stronger deal flow in 2023 as select companies pursue advantaged deals and others rationalize for energy transition objectives. Price volatility will remain a challenge for deal execution.

- **Price volatility has been a key impediment to deal flow.** A combination of capital discipline, the Ukraine conflict and recession fears has stunted 2022 upstream M&A activity, which totaled only $73 billion through the third quarter (versus $137 billion in 2021). Despite stronger balance sheets and energy security concerns, there has not been a wave of large transformative upstream deals. M&A activity has instead involved a steady stream of asset-level divestments among larger players and continued North American shale consolidations, according to our latest quarterly analysis of deals. We expect continued strong oil prices in 2023 (our forecast is above consensus at $103/bbl), which should be generally supportive of M&A, although ongoing oil and gas market volatility will still make deals harder to execute. The financial sector is backing only the smartest deals (low risk, low debt and high accretive value), often requiring transactions to be structured creatively to account for volatility of asset valuations (e.g. up-front cash with deferred consideration, earn-outs and recalculation of payments).

- **Quality US shale deals will face increased competition.** North American transactions have accounted for two-thirds of total deal value this year, at $50 billion, with 17 deals above the $1 billion mark — following some $140 billion in deals since the 2020 industry downturn. The Permian Basin continues to drive the biggest ticket consolidations, with 2022 tie-ups including Centennial Resource Development-Colgate, Diamondback-FireBird and Desert Peak-Falcon. Other plays driving this year's deal flow include shale gas (EQT's acquisition of Tug Hill), conventionals (Exxon Mobil/Shell sale of California's Aera Energy) and deepwater Gulf of Mexico (Talos-EnVen). Private equity-backed deals have featured prominently as the sector examines strategic options in the positive price environment. We see increased competition for remaining quality deals, requiring strong acreage and drilling inventory. Selective capital markets may also continue to weigh on 2023 activity.

- **Majors are focused on portfolio rationalization to support low-carbon strategies.** The supermajor peer group has executed nearly $9 billion in announced upstream deals this year, chipping away at previously stated divestment targets. The divestments (1) rationalize upstream portfolios so only the most advantaged (low-cost, low-carbon) assets advance medium term, and (2) free up cash to allocate to lower-carbon businesses. The majors signaled openness to low-carbon M&A on recent earnings calls. BP sold Canadian oil sands, Algerian, UK and Australian assets before announcing the acquisition of US renewable gas producer Archaea Energy for $4.1 billion, including debt, helping the UK major grow its biogas supply. Spain's Repsol advanced a major component of its net-zero plan by selling a 25% stake in its upstream business to US private equity firm EIG for $4.8 billion. The entire oil and gas portfolio will later be spun off into a new company, Repsol Upstream, which will prioritize short-cycle, less capital-intensive projects.

- **Independent E&Ps are targeting niche opportunities.** The largest independent E&Ps have been fairly inactive this year, preferring to focus on shareholder demands for returns and debt service. APA, ConocoPhillips, Hess and Occidental divested various noncore US assets, while global E&Ps Woodside, Wintershall Dea and Inpex sold some noncore international stakes. But a growing pool of smaller independents has continued to take advantage of asset churn in Latin America and the North Sea. We note PetroRio in Brazil and Ithaca Energy and Sval Energi in the UK and Norway, respectively, as emerging players.

- **National oil companies are also focused on rationalization.** The cash-rich NOC peer group, initially expected to be a major beneficiary of higher asset liquidity, has been entirely absent in the M&A market. Chinese NOCs have acquired no major assets, instead prioritizing select portfolio sell-offs due to geopolitical pressures. CNOOC is seeking to sell US, Canadian and UK assets because of sanctions and policy uncertainty. PTT and Petronas have executed noncore asset sales in Brazil and West Africa, as they, too, bolster portfolio resilience to fund priority international and domestic projects.

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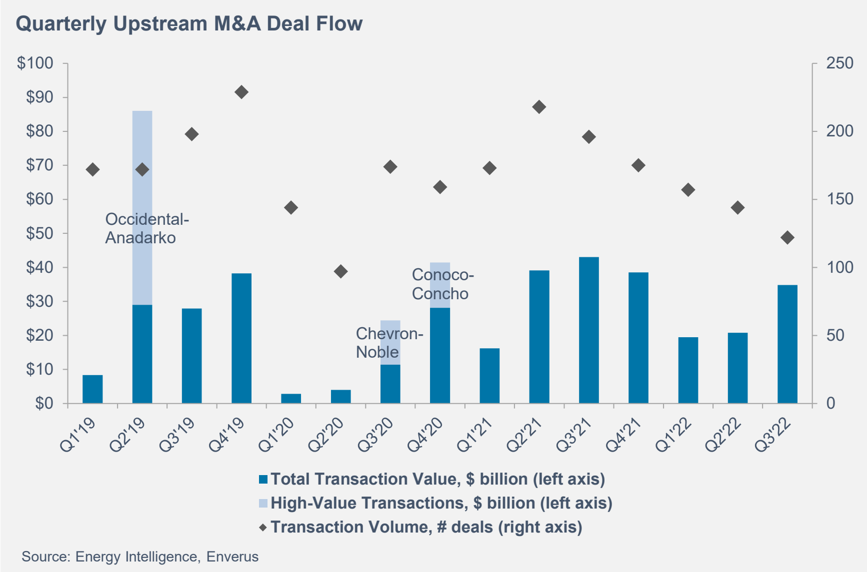

Top Upstream M&A Deals in 2022 (YTD)

Deal Details	Location	Announced Value ($ billion)
PKN Orlen acquires PGNIG in deal worth $7.6 billion	Poland	7.6
EQT acquires Tug Hill and XcL Midstream assets in the core of Southwest Appalachia for $5.2 billion	US	5.2
EIG acquires 25% stake in Repsol's Upstream business in deal worth $4.8 billion	Spain	4.8
Centennial Resource Development and Colgate Energy combine in a merger of equals worth $3.9 billion	US	3.9
Bakken pure-plays Oasis Petroleum and Whiting Petroleum combine in merger of equals worth $3.9 billion	US	3.9
Shell and Exxon Mobil divest Aera Energy to IKAV for $3.9 billion	US	3.9
Chesapeake Energy acquires Marcellus pure-play Chief Oil & Gas and interests held by Tug Hill in deal worth $2.6 billion	US	2.6
Sitio Royalties and Brigham Minerals combine in an all-stock merger deal worth $1.9 billion	US	1.9
Devon Energy bolts on additional Eagle Ford assets with Validus Energy acquisition for $1.8 billion	US	1.8
Riverbend Energy divests Riverbend Oil & Gas VI, Riverbend Oil & Gas VI-B and Riverbend Oil & Gas VIII to undisclosed buyer for $1.8 billion	US	1.8

Source: Energy Intelligence, Enverus

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