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Energy Deals: An update on M&A and Capital Markets Trends in the Industry

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Learning objectives

1. Cite current M&A data specific to the energy industry
2. Analyze the implications of capital markets trends for your business
3. Describe specific investment trends within the energy space

Agenda

1. Introduction and background
2. Upstream sector
3. Midstream sector
4. Downstream sector
5. Oilfield services sector
6. Q&A
7. Closing remarks

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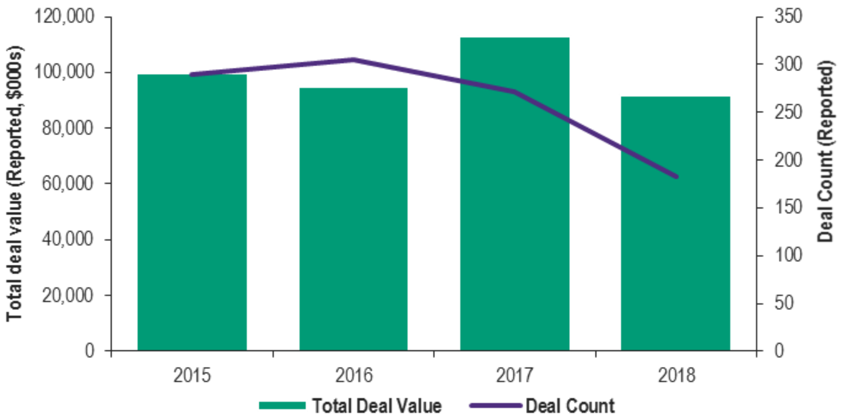
Introduction and background

- Current trends in energy deals and capital markets
- Global impact
- Response in the energy industry

Private equity waiting for the right opportunity

- Private equity energy deals with a reported purchase price declined from 2017 to 2018 in both count and value by 33% and 19%, respectively, as PE firms struggled to identify attractive assets.
  - PE deal count (all industries) also declined as a percentage of total deals from 26% in 2017 to 22% in 2018
  - Key drivers of / challenges to deal activity include:
    - Ability to secure financing, particularly for larger midstream deals
    - Upward pressure on multiples by stock-driven transactions for few-and-far-between attractive assets
    - Convergence between buyer and seller expectations

PE energy reported deal volume and value



- **2019 PE forecast** – Upstream IPO recovery could stir renewed PE demand for the sector as the additional departure route helps ease exit concerns. Continued difficulty to obtain financing will hamper infrastructure-heavy midstream deals, particularly as the sector faces increased environmental and eminent domain challenges.

Sources: IHS Markit, Pitchbook

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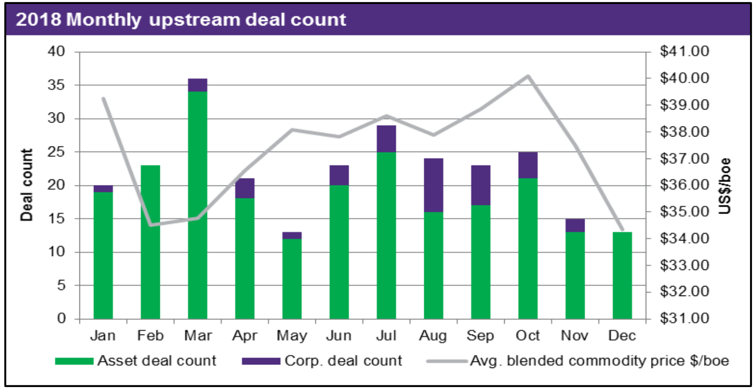
Upstream tumbles in Q4 as oil price falls

- **Upstream sector** M&A activity initially surged in Q3'18 but dropped in Q4'18 after oil declined 40% from a 4-year high, contributing to a YoY 14% decrease in global upstream deal count.
  - 2018 global upstream M&A totaled 265 deals valued at $127.3B.
  - 2018 median announced LTM price per acre and proved reserve value per boe both declined from their 2017 values, as seen below.

Global Measures	2017	2018
Acreage (US$/Acre)	3,532	2,517
Proved Reserve (US$/Boe)	6.84	6.53



  - Private equity players decreased acquisitions by 40% in 2018 but remained net upstream buyers
  - Acquisitions of unconventional fields declined 13% from a record high of $86B in 2017 to $75B in 2018 but still accounted for more than 50% of global Upstream and 80% of North American Upstream M&A activity, respectively.
- **2019 Upstream forecast** – OPEC nations continue to restrain production, despite Middle East investment, in order to prevent further supply surplus. Supermajors and large independents expected to deepen investments in Permian Basin (e.g. BP's acquisition of BHP Billiton's onshore assets in Q2'18) to ensure long-term success while disposing of other non-core assets.

Sources: IHS Markit

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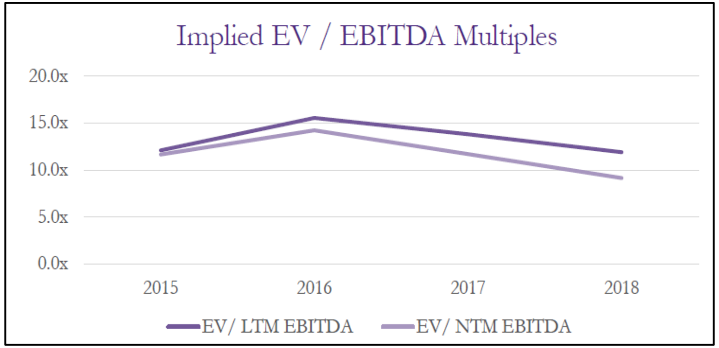
Midstream focused on structural simplifications

- **2018 Midstream sector** M&A total deal value increased by 239% over 2017 as U.S. tax policy change reduced the attractiveness of MLPs (Master Limited Partnership), leading to many affiliate transactions or "internal mergers".
  - Affiliate transactions aimed to improve investor confidence and ability to raise capital through increased transparency. These deals dominated 75% of 2018 Midstream M&A, including:
    - Energy Transfer ($67.9B Q3)
    - Western ($12.9B Q4)
    - Williams ($63.6B Q2)
    - Enbridge ($17.4B Q2)
  - Total deal count and average deal value increased by 48% and 128%, respectively, over 2017



  - Midstream LTM multiples declined from 13.8x in 2017 to 11.9x in 2018, with highest observed in the Bakken Shale (14.9x) and lowest in the Fayetteville Shale (9.4x).
- **2019 midstream forecast** – As infrastructure projects are completed, particularly in west Texas and western Canada, bottleneck relief is expected to decrease price differentials. In addition, stagnant or declining oil prices may put downward pressure on production and deal flow.

Sources: IHS Markit

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Downstream Deals – Less is More

- **2018 Downstream sector** M&A activity declined 29% in deal count but increased 49% in deal value, primarily driven by Marathon's $33.8B acquisition of Andeavor in Q2'18.
  - Exclusive of the Andeavor acquisition, average deal value increased 33% from $578M in 2017 to $768M in 2018.
  - 3Q'18 and 4Q'18 were smallest quarters of last two years in terms of both deal count (15 and 18) and total deal value ($4.0B and $14.5B).
  - 2018 observed median LTM EBITDA multiple of 8.4x declined from the 2017 median multiple of 10.1x.

	2018		2017	
Sector	**Deal Count**	**Value ($ millions)**	**Deal Count**	**Value ($ millions)**
Distribution	19	22,983	26	10,630
Diversified	5	41,244	11	14,134
Marketing	7	2,341	10	2,451
Petrochemicals	7	3,876	8	8,801
Refining	5	7,536	4	8,766
Retail	7	4,136	11	4,558
Storage	3	342	5	771
Terminals	20	7,112	28	10,210
Other	1	319	1	155
Downstream	**74**	**89,889**	**104**	**60,476**

  - Diversified Downstream transactions involving more than one type of Downstream asset (e.g. terminals and refining) remained the largest segment by deal value.

- **2019 Downstream forecast** – Downward revision of retail gasoline prices to $2.47/gallon. Sector faces potential uphill battle as benefits from strong domestic diesel fuel demand erode due to:
  - Reduced output from Canada and OPEC nations
  - Possible sanctions on Venezuelan oil
  - Pipeline constraints in Western Canada
  - Continued shale boom in continental U.S.

Source: IHS Markit

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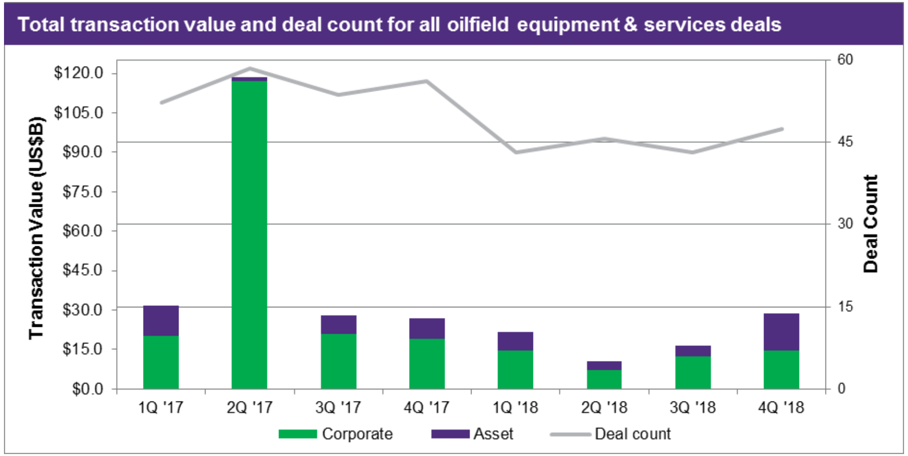
OFS low margins and over capacity

- 4Q'18 OFS M&A posted the highest total deal value since 2Q'17 but was not enough to make up for minimal activity during the first 3 quarters, resulting in 5-year low total deal value of $20.6B.
  - Corporate deal values typically outpaced asset deals throughout 2018 until 4Q'18, due to WorleyParsons' $3.3B asset acquisition of Jacobs Engineering Group's Energy, Chemicals and Resources segment.
  - The U.S. portion of global transaction value increased from 6% in 2017 to 23% in 2018.
  - 2018 median observed LTM EBITDA multiple of 8.6x trailed the 2017 median multiple of 9.4x.
  - Midstream's continued capacity constraints combined with low pricing and margins for OFS players contributed to the sector's poor performance. However, mid-cap businesses leveraged this opportunity to purchase under-utilized assets from small-size businesses.



- **2019 OFS forecast** – Sector performance is expected to continue its slide, especially in the Permian Basin as companies face a combination of staffing difficulties and idle service equipment.

Source: IHS Markit

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Key diligence issues in recent energy deals

Valuing Working Capital	• Buyers and sellers frequently disagree on appropriate calculation method • Important for all players to understand importance of aligning EBITDA valuation period with working capital peg period (i.e. TTM EBITDA with TTM average working capital)
POC Accounting	• Percentage of Completion (POC) revenue recognition is often applied incorrectly and inconsistently, even within the same company • Consider advantages of normalizing methodologies, such as improved earnings forecasts
Separating Intercompany	• Companies with intercompany activity struggle to identify intercompany profit in inventory, irrespective of company size or ERP sophistication • Consider potential impact to EBITDA and to transaction value
Housing Human Capital	• Housing shortages in west Texas have created need for "man camps" to house employees • The widespread usage in Upstream and OFS has not yet been considered as an employee benefit, which would add costs to already margin-squeezed sectors

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