

U.S. Oil and Gas Industry M&A Trends 2021/22

A Practical Guidance® Article by I. Bobby Majumder, Frost Brown Todd LLC



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This article discusses trends in oil and gas industry M&A transactions in 2021 and the forecast for 2022, including market activity; specific sector activity in the upstream, oil field services, midstream, and downstream sectors; and transactional considerations.

Market Activity

2021 was eventful for the domestic oil and gas industry. Oil prices recovered in 2021 after turning negative in April 2020 at the onset of the pandemic. With prices back in the 80s and now hovering around 100/bbl. as a result of the Russian invasion of Ukraine, oil and gas producers are enjoying reinvigorated cash flows. In 2021, the total count and value of U.S. upstream deals during the first eight months of 2021 were 30% and 46%, respectively, down from the same period in 2019 according to a study by Deloitte. Oil and gas producers have been required by investors to become more disciplined in the management of their cash flows. Accordingly, an emphasis on returning surplus cash flow to investors through dividends and share buybacks as well as slowing additional drilling was prevalent in 2021. Instead of engaging in increased E&P activity, consolidation appears to be the *raison d'être* for 2021 deal activity and is likely to continue into 2022.

Oil price volatility is a pervasive factor in the industry's deal statistics, inevitably affecting deal value each quarter. When

prices are stable, it allows both buyer and seller increased confidence that a deal is not heavily favorable to the counterparty and further suggests a maturation of the cost-cutting measures taken by domestic shale producers. More stable economics allow typical sellers—generally distressed sellers that are considering selling assets to de-lever their balance sheets—and typical buyers—generally strategic buyers and financial sponsors making bets that the market has reached a level of stability with respect to oil and gas prices—to have comfort that their decisions are not going to be second guessed because of massive fluctuations in price.

From 2009 to 2014, deal-making relied on stable oil prices between \$70 and \$80 per barrel. In 2015, oil prices fluctuated wildly, leading to uncertainty in deal making. Oil prices then stabilized, ranging between \$42 and \$52 per barrel beginning in June 2016, and that stability led to a moderate increase in oil and gas acquisitions and dispositions. 2017 brought similar stability at a range between \$50 and \$60 per barrel but deal value and deal count took a small dive, with experts citing lasting effects of caution arising out of the “lower for longer” business environment of the past several years. Oil prices reached a four-year high by October 2018 before plunging and leading to such a dismal level of activity in 2019. With the onset of the pandemic in 2020, demand plummeted and prices fell accordingly. As mentioned earlier, for a brief moment in time in April 2020, crude oil prices were negative, meaning producers were paying customers to purchase and store their produced oil. Natural gas producers also suffered in tandem with oil producers but the depression in the A&D market for U.S. gas companies has been longer-lived as the U.S. continues to enjoy a surplus of natural gas production volumes.

Further, increased government scrutiny from the Biden administration has slowed the construction of much-needed pipelines to get produced natural gas from the wellhead to key domestic consumption markets and export terminals. As the country got vaccinated in 2021 and learned to live with COVID-19, demand for oil and gas began to rise again as did domestic oil production. OPEC though remains disciplined in restraining production and this increased demand along with constrained supply leads us into 2022 with an interesting set of macroeconomic conditions.

The oil and gas industry is capital-centric, so without adequate access to capital, oil and gas companies cannot survive. Low or volatile oil prices force oil and gas companies to be creative in their efforts to raise capital. The threat of a decreased borrowing base often motivates producers to consider strategic dispositions or alternative capital providers. These alternative providers include private equity funds and mezzanine funds, though these funding sources often come with heavy strings attached, and many private equity funds with substantial available cash are instead content to withhold capital and poach prized assets out of bankruptcy.

Recent Trends

The oil and gas industry comprises four main sectors:

- Upstream: Companies that explore for and produce the oil and gas
- Oil field services: Companies that provide services to the exploration and production industry
- Midstream: Companies that transport and store oil and gas
- Downstream: Companies that refine, process, and distribute oil and gas

Because of the different role each sector plays in the production and distribution of oil and gas, each sector experiences different effects from fluctuations in oil and gas prices. Accordingly, trends in M&A activity are best examined at the sector level.

Upstream Trends

In 2021, A&D activity rebounded with 152 deals announced at a total transaction value of \$133 billion. The number of transactions increased significantly in the second half of 2021 as the economy opened up, rising 34%, while the total values of those transactions went up by 30% over the first half of 2021 according to Pricewaterhouse Coopers. Upstream deals comprised the majority of this

growth, with 42 deals being announced with an aggregate transaction value of \$47 billion. Notable deals were the \$9.5 billion Permian Basin asset deal for ConocoPhillips/Shell and formation of Coterra Energy by Cimarex and Cabot. Corporate strategic and asset deals accounted for nearly 75% of deal volume and value throughout the year as private equity and financial investor activity remained mostly on the sidelines according to Pricewaterhouse Coopers.

Oil Field Services Trends

Oil field services (OFS) companies have been hamstrung by the slowdown in new drilling activity in response to capital markets insisting on more cashflow discipline from producers. As the demand for rigs per drilling unit has decreased and midstream bottlenecking has held back demand growth for OFS companies have resorted to selling assets that were not producing sufficient revenues.

A common strategy in OFS deals is to supplement existing services as opposed to creating new segments. Nearly all the OFS deals prior to the pandemic were between a buyer and seller with significantly overlapping business models, which suggests that companies remained conservative at that time, focusing on what they already do well in the industry. In 2021, we saw the rise of Environmental, Social, and Governance (ESG) as a consideration in company business models, and OFS companies began to look for ways to diversify away from being pure-play oil field services businesses. In fact, 20% of OFS deals in 2021 involved a target company with operations in renewable energy, as compared with 5% between 2017 and 2020 according to Rystad Energy.

This is a trend that should continue in 2022 with about 30% of surveyed executives believing that building capabilities in ancillary service verticals such as hydrogen and carbon capture, utilization, and storage (CCUS) will be important for the sustainability of OFS companies according to Deloitte. It is unlikely that we will see many large-scale M&A transactions in 2022 as the OFS sector has already consolidated significantly in the past few years. Instead it is more likely that smaller OFS companies will purchase business units from larger OFS companies as those larger companies leave regions where new drilling activity has slowed or come to a halt.

Midstream Trends

With the raging pandemic causing decreased oil and gas deal activity in 2020, the midstream sector saw a modest increase in aggregate deal value in 2021.

A general bottlenecking of infrastructure, along with increased regulatory scrutiny of new pipeline construction, has resulted in a general increased interest in existing, completed pipeline assets over the past couple years.

Long-term, fixed-price contracts are common in the midstream sector, as these agreements protect midstream revenue. Industry analysts believed the fixed-price contract structure would protect the midstream sector for a significant amount of time. However, deal activity in the midstream sector is susceptible to a prolonged downturn in oil prices. Since its spike in both deal count and deal value in late 2016, the sector has not quite picked up again since. Most of the deals that were completed in 2021 were done by utilities who were shedding natural gas transportation assets and instead signing long-term supply contracts with midstream companies. ESG concerns in 2022 are likely to encourage additional asset purchases by midstream companies rather than committing to fresh capex expenditures in light of federal government hostility to new pipeline construction. Instead, LNG infrastructure should see additional interest especially in light of hostilities in Europe and the resulting cut-off from Russian gas supplies. A notable deal in 2021 for LNG assets was the \$1.5 billion acquisition of Teekay LNG Partners by Stonepeak.

Master limited partnership (MLP)-backed deals continue to slow down in the midstream sector after the Federal Energy Regulatory Commission enacted an unfavorable tax policy toward this type of structure in early 2018. Private equity continues to show interest in the midstream sector, demonstrating the many creative ways an oil and gas deal may be structured. Special purpose acquisitions companies (SPACs) have also proven to be a viable deal-making strategy in the sector, a notable example being the SPAC Kayne Anderson Acquisition Corporation's \$3.5 billion deal that created the first debt-free, cash-rich, publicly-traded, pure-play midstream corporation in the Permian Basin.

Downstream Trends

In 2021, the name of the game was addition by subtraction. Integrated oil companies were shedding assets to independent refiners as they sought to be rid of environmentally challenging assets as concerns about ESG issues reached higher levels. 2021 also saw a fair number of deals for retail gas stations and convenience stores being closed. This area should slow down in activity in 2022 due to the number of large deals being closed in 2021. A significant deal in the sector saw Texas-based 7-Eleven Inc. buying the approximately 3,800-store Speedway chain from

Ohio-based Marathon Petroleum Corp. for \$21 billion in May 2021.

Industry-Specific Transactional Considerations

Deal Structure

Deal structuring issues tend to turn upon two factors: first, the involvement, if any, the sellers will have in the ongoing assets or enterprise; and second, the tax ramifications of the deal in question. In terms of post-transaction involvement, management of the selling entity will seek to retain some form of upside. A royalty spin-off and earn-outs are two attractive methods sellers use to protect upside.

Due Diligence

The cost of production is the first and foremost due diligence issue in oil and gas M&A. A low oil price environment demands an accurate cost of production picture. Due diligence must therefore be precise and complete. Even with higher oil prices in 2021 and 2022, the capital markets are insisting that producers remain disciplined in their A&D activity and be cognizant of ESG issues. Engaging reputable industry consultants who are independent and not incentivized to close helps dealmakers gain a more accurate rendering of the cost of production. Additionally, due diligence concerning title issues, environmental liabilities, third-party processing and transportation agreements, and storage facilities continue to be necessary when conducting oil and gas due diligence.

Regulatory Requirements

Most commonly, oil and gas transactions are regulated by organizations such as the Environmental Protection Agency and the relevant state-level administrative agencies (for example, the Texas Railroad Commission). However, many practitioners would be unaware of the need to get approval from the Bureau of Land Management (BLM) (a part of the U.S. Department of the Interior) for transactions involving production or leases on Native American reservations. The BLM is an inherently convoluted and cumbersome area of regulation; therefore, the help of a BLM specialist is important when constructing deals that require BLM approval. For instance, the Dakota Access Pipeline—currently in the news due to Native American protests—had to receive permission from the BLM in order to develop the pipeline.

Recent Transactions

Below are recent examples of oil and gas industry acquisition transactions in Market Standards, the searchable database of publicly filed M&A deals from Practical Guidance that enables users to search, compare, and analyze its comprehensive database of transactions using over 150 detailed deal points to filter search results. You can customize this search to your needs by adding filters or modifying the search criteria. For more information on Market Standards, click [here](#).

Seller / Buyer	Transaction Value	Date of Agreement	Agreement / Transaction
Teekay LNG Partners / Stonepeak	\$1.5 billion	October 4, 2021	Agreement and Plan of Merger
Shell Enterprises LLC / ConocoPhillips Company	\$9.5 billion	September 20, 2021	Purchase and Sale Agreement
Cimarex Energy Co / Cabot Oil & Gas Corporation	\$17 billion	May 23, 2021 (initial agreement)	Agreement and Plan of Merger Amendment No. 1 to Agreement and Plan of Merger
Marathon Petroleum / 7-Eleven	\$21 billion	August 2, 2020 (initial agreement)	Purchase and Sale Agreement Amendment No. 2 to the Purchase Agreement, May 14, 2021

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Bobby is a member in the Dallas office and focuses his practice on corporate and securities transactions primarily in the energy (oil & gas, coal, and renewables), mining, health care, and information technology industry verticals. He represents underwriters, placement agents, and issuers in both public and private offerings of securities; public and privately-held companies in both cross-border and domestic mergers and acquisitions (M&A); private equity funds, hedge funds, and venture capital funds in connection with their formation as well as their investments; and companies receiving private equity and venture capital financing.

Bobby advises established companies, as well as new and emerging issuers, in connection with raising capital from both the public and private capital markets in the United States and Europe (including Rule 144A / Regulation S offerings) such as the \$706M Initial Public Offering of the CPSE ETF, an Indian exchange traded fund. He also advises US and foreign private issuers in connection with their SEC reporting and compliance obligations.

Bobby has extensive M&A experience advising companies in the IT, telecoms, mining, energy, and health care industry sectors such as the \$603M sale of Regency Energy Partners LP to GE Energy Financial Services.

Finally, Bobby also has extensive experience representing private equity sponsors, hedge funds, and venture capital funds in their investments in both public companies and privately-held companies such as Amazon.com's \$60M investment in BankBazaar.

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