Deals

Recent Trends in Energy Valuation

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pwc

Recent trends in Energy valuation

- Commercial development of unconventional resources over the last decade provided tremendous growth opportunities for companies in all O&G sectors
- Until 2015 the *focus was on Growth* as a vehicle for creating “Value” (i.e. volumes, acreage positions, Revenue, NAV)
- Post-2015 focus has shifted to away from growth at all cost and “Value” is examined by investors through a prism of cash flows and excess return on capital
- Earnings call increasingly discuss acquisitions in terms such as “accretion”, “cash flow” and “total shareholder returns”
- As a result deal diligence times have increased and scrutiny on value is high, with a clear objective of a robust support for price
- ***Conclusion:*** Managing deal value throughout all stage of a transaction – *pre-deal and post-close* – is detrimental to ensuring value is created and appropriate TSR and Cash flows are delivered to investors

Relationship between Price and Value in a Deal context

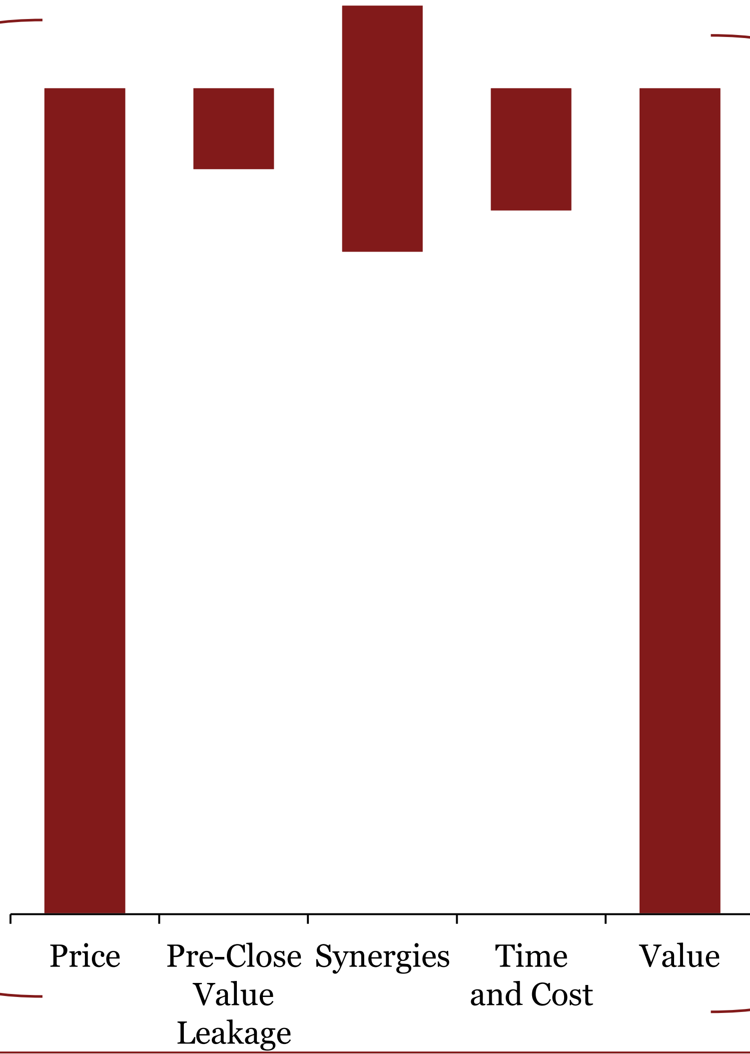
Price

Objective factors

- Price is an objective observation, it is a "given"
- Market participants would agree on price
- Elements of price are well understood

Subjective factors

- Price is set under deal specific circumstances (negotiating power, structuring)
- Price is not always based on intrinsic value of the business / assets acquired



Value

Objective factors

- Value will change (time, "value events", extraneous influence)
- Most of the Value is based on objective characteristics of the underlying business / asset

Subjective factors

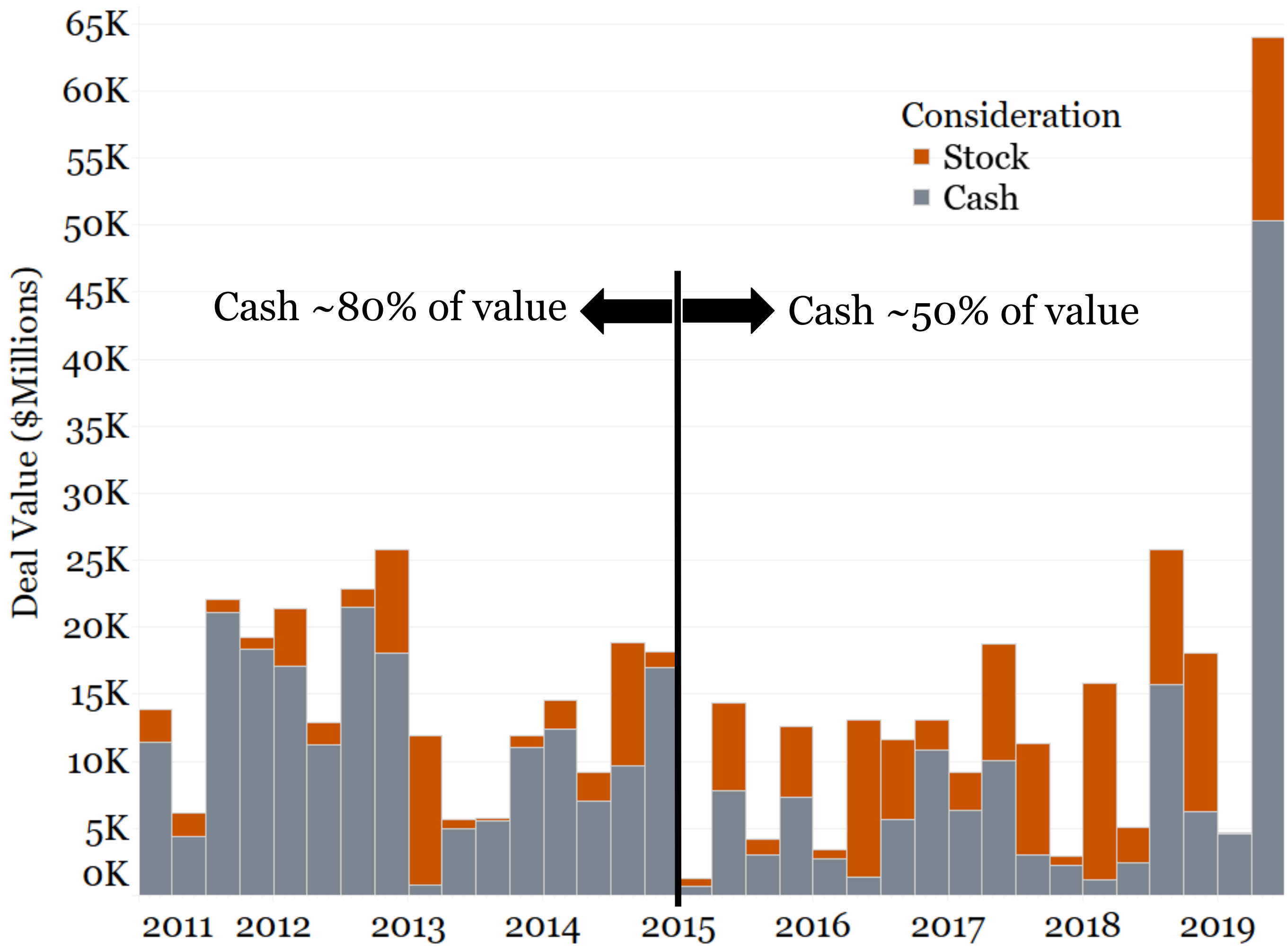
- Market participants rarely agree on a point estimate of value
- Elements of value are not always well understood (pre or post-deal
- Buyers are "optimistic" about value and underlying expectations once acquisition is complete

Structure of considerations paid signals cyclical sensitivity of investors to capturing deal value

Price

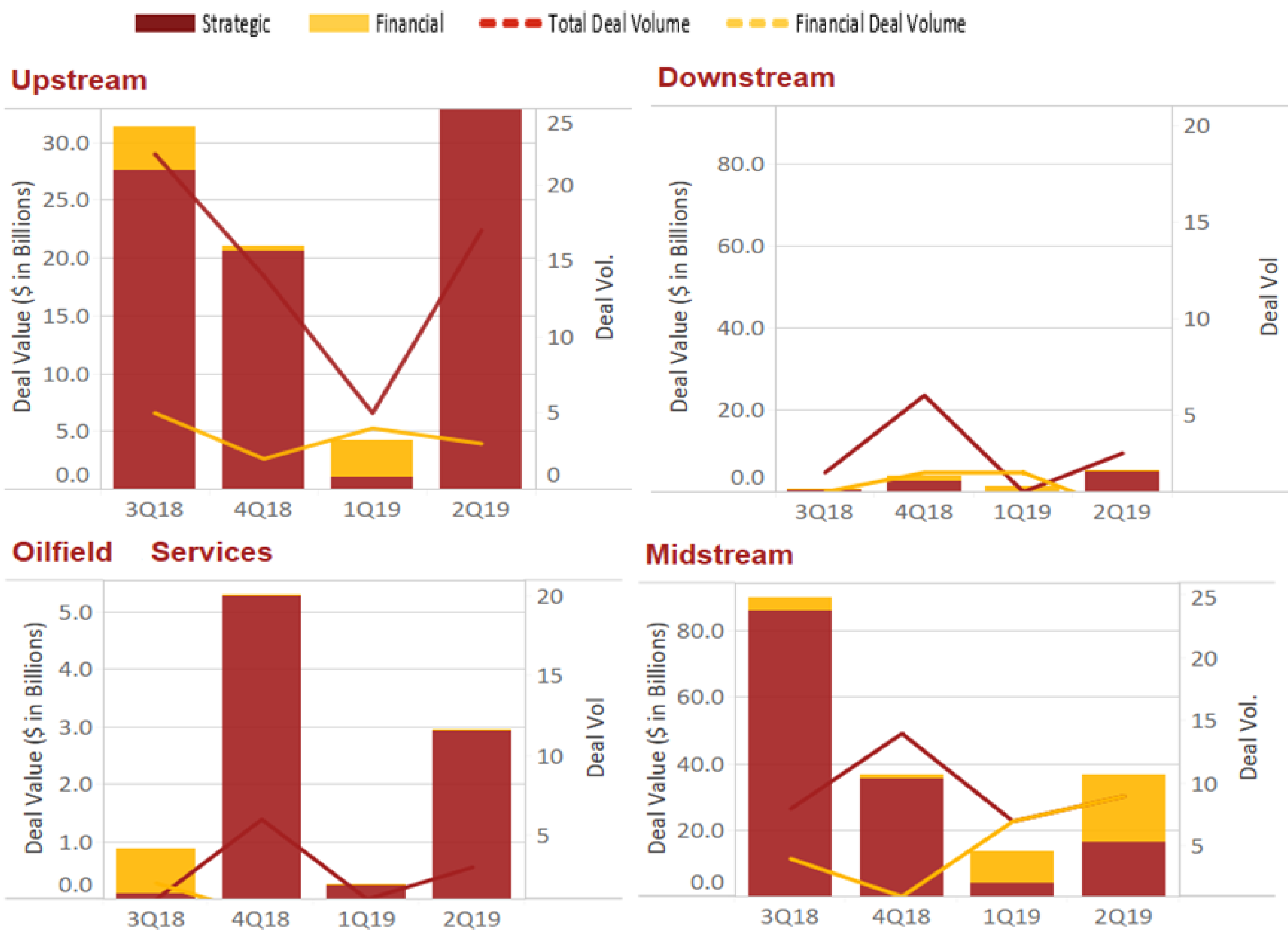
- Consideration can be structured in a way as to minimize exposure to value volatility post-deal
- Cash is a “fixed” elements of consideration and thus is a poor tool for managing value realization
- Market participants can leverage more flexible components of considerations such as stock offerings and “contingencies”
- Contingencies such as earn-out, allow a buyer to “lock in” the seller to be invested in realizing value
- Troughs and peaks in sector cycles typically exhibit favoritism towards cash vs. contingencies

Deal value since 2011 by consideration



Source: Capital IQ, IHS Markit

Financial buyers are opportunistic in selection of the underlying O&G sub-sectors



Price and Value

- Financial buyers have a track record of focusing on both sides of the equation relative to Corporates
- By focusing on Price with use of performance based considerations
- By focusing on Value side by understanding value elements, cost takeout and lean management
- Corporate buyers are able to execute larger transactions and are focused on long term value accretion

Source: IHS Markit, Global Data and PwC Analysis

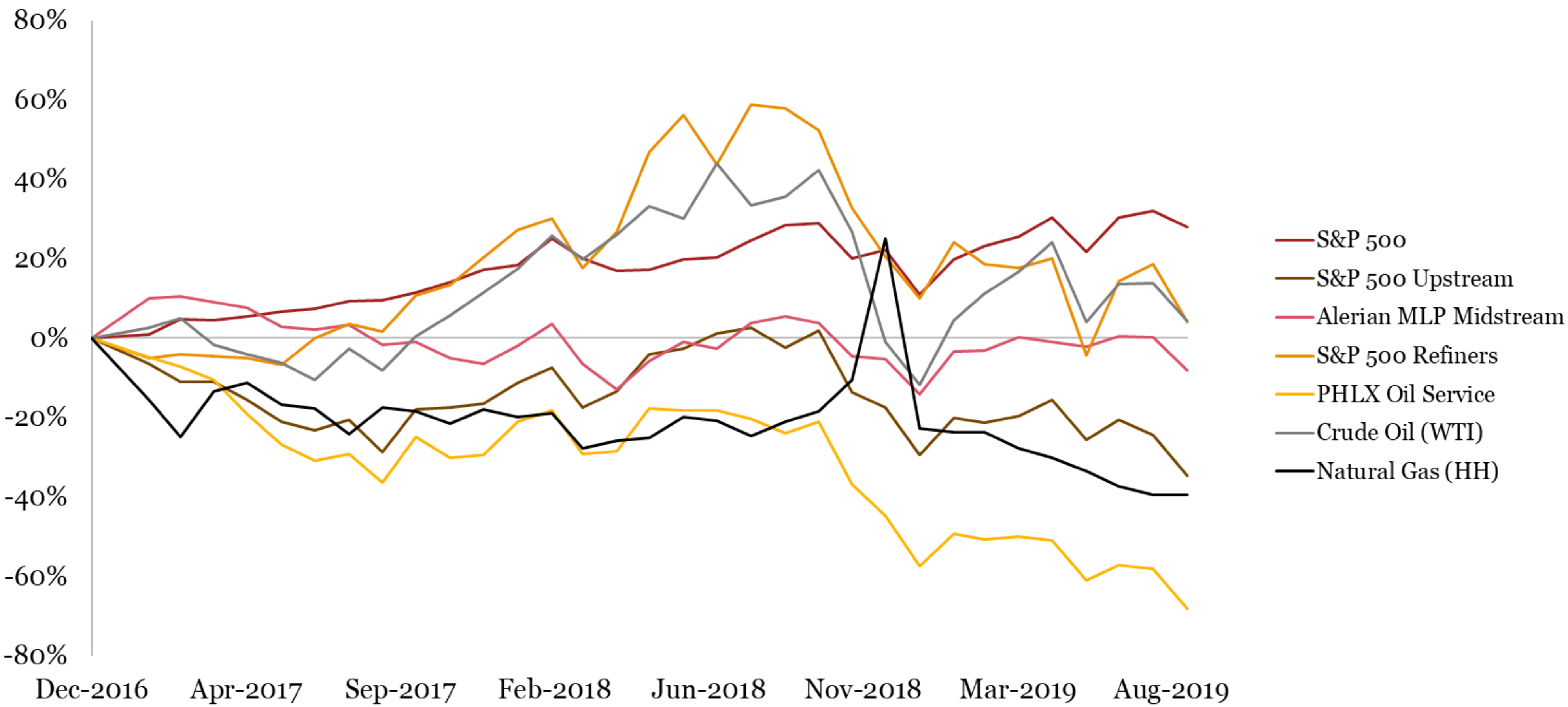
Pre-deal considerations

- As Deal structuring and negotiations are ongoing (or pre-negotiations) a buyer should perform value diligence, including:
  - Price to Value bridge
  - Explanation of "gaps" based on activity based drivers
  - Perform "value at risk" analysis using sensitivities around key value drivers
  - Assess risk / return and benchmark to internal or external cost of capital considerations
- If "value diligence" is done correctly it enables:
  - Validates acquisition strategy and portfolio management at inception
  - Informed management of the negotiation and Price determination process
  - Full understanding of expected synergies and KPI to be tracked post-close
  - Transparent communication to investors and stakeholders
  - Purchase price allocation process is a "breeze" for tax and / or financial reporting purposes

Post-deal considerations

- Executing on post-close activities Management teams should be able to have all of the tools to optimize value capture by:
  - Monitoring key value drivers real time and track realization of expected synergies
  - Measuring the timeline and cost of implementing synergies
  - Enabling transparent analysis in the accretion or destruction of Value vs Price paid
  - Communicating internally and externally on critical action items to shift focus as needed
  - Support for allocations performed for tax and accounting purposes
- Key post-deal action item is to refer back to deal strategy at the inception and verify the value premise that underpinned the deal

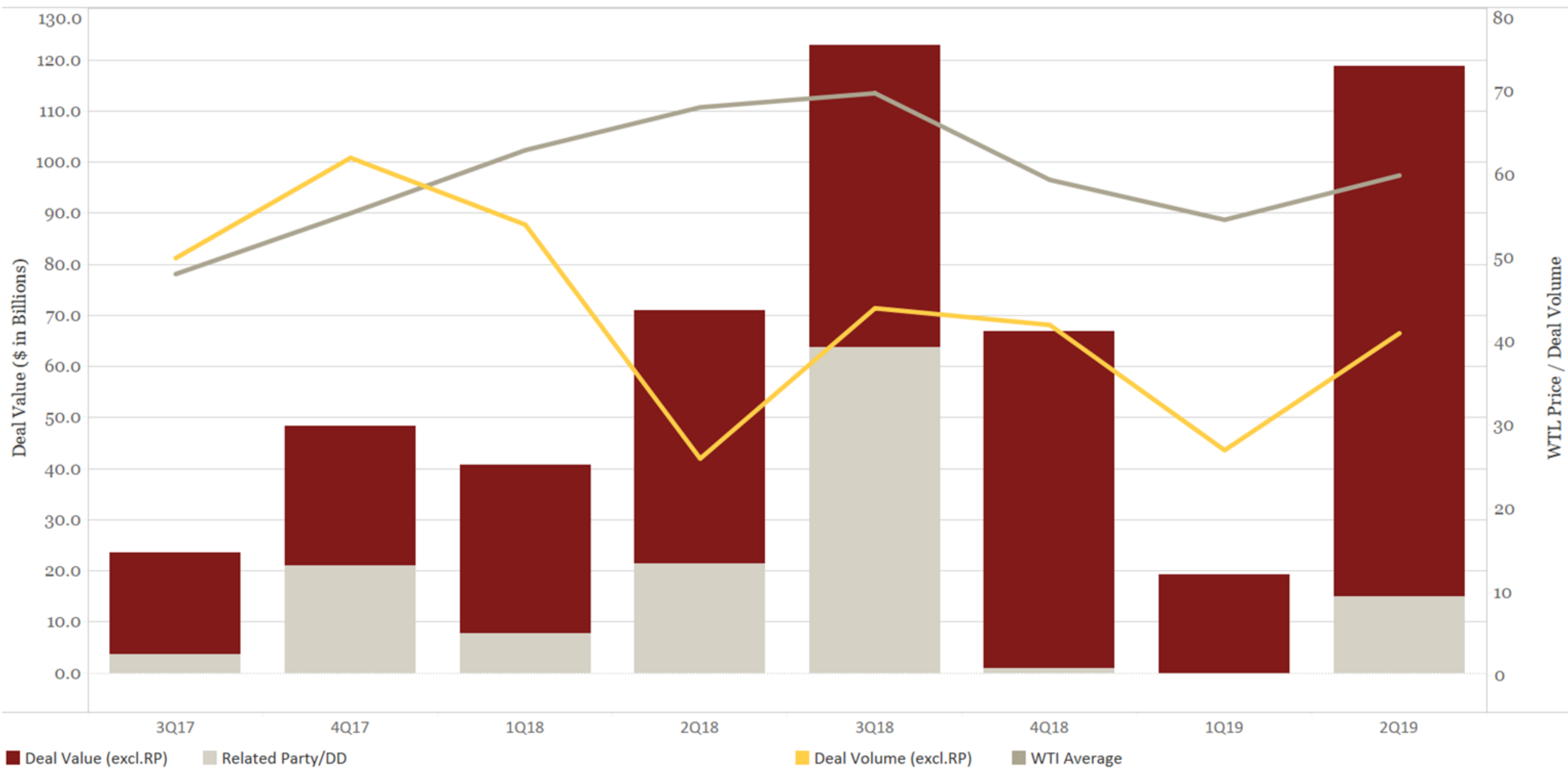
Energy indices struggles to deliver positive returns, apart from Downstream



Source: S&P Capital IQ

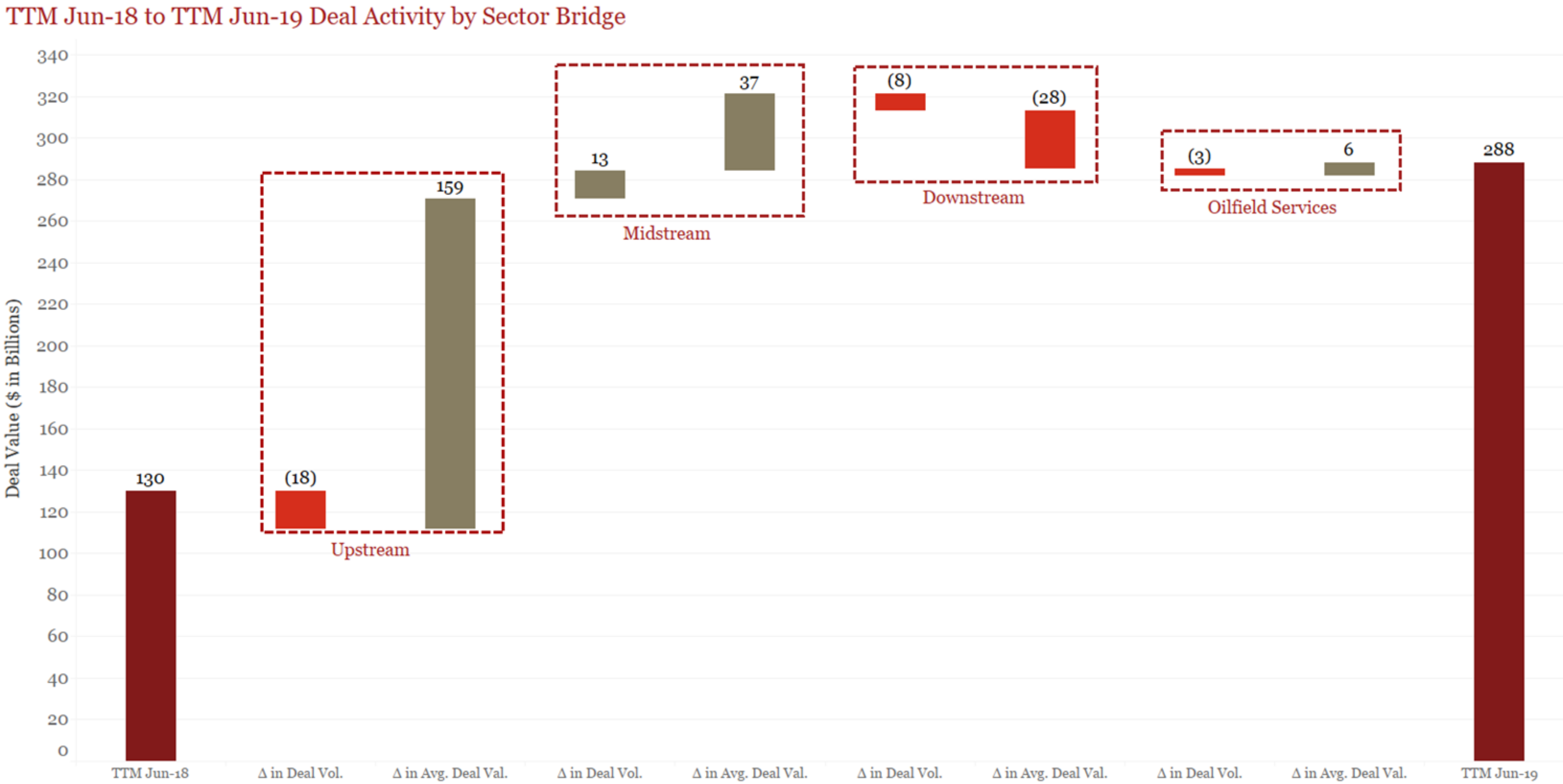
2Q19 deal volume up 63% versus 1Q19 and back to average quarterly volumes in 2018

Quarterly Deal Activity



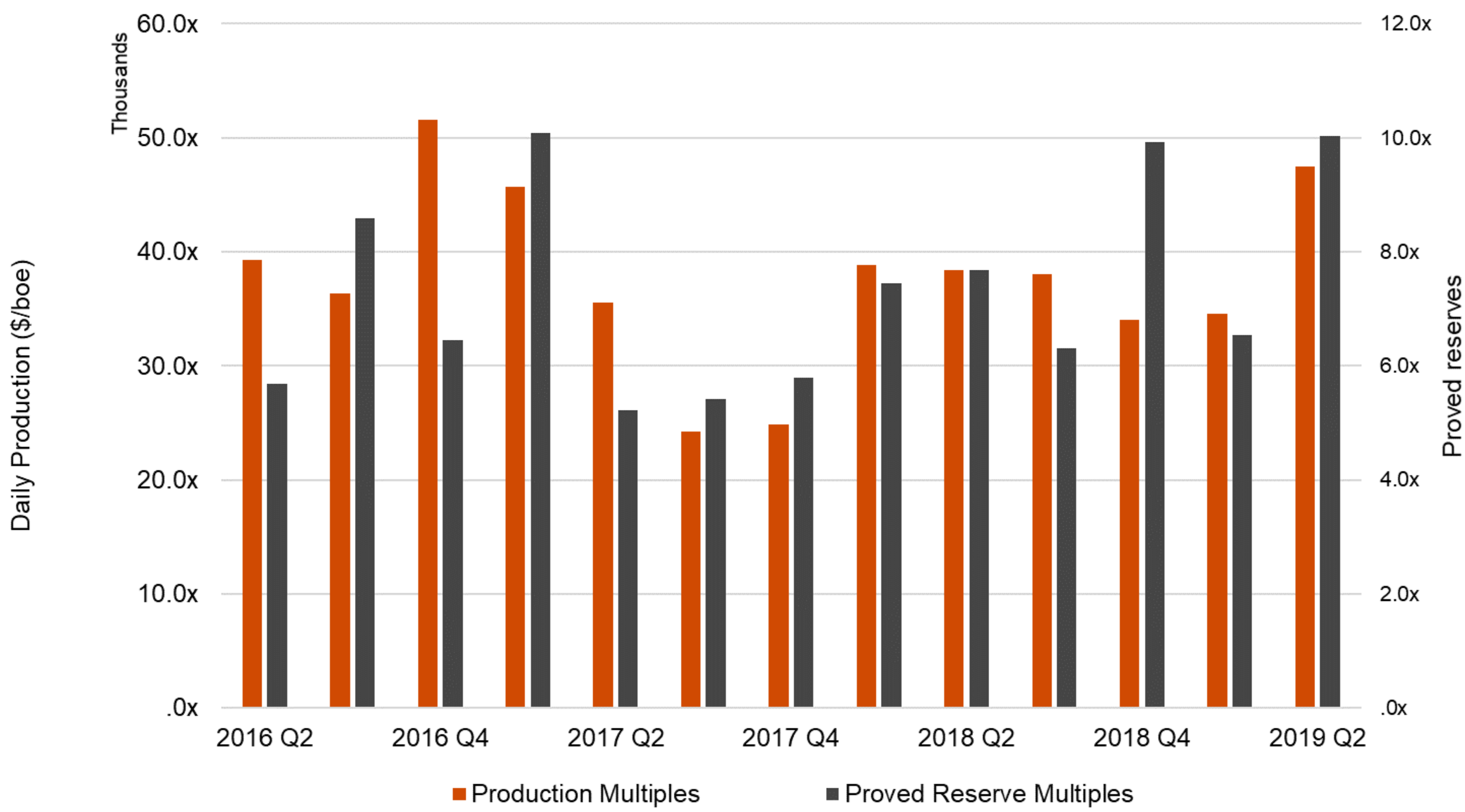
Source: IHS Markit, Global Data and PwC Analysis

Year-over-year increase in upstream and midstream deal size drove the increase in deal value in TTM Jun-19



Note: This analysis excludes the impact of drop downs and other related party transactions.
Source: IHS Markit, Global Data and PwC Analysis

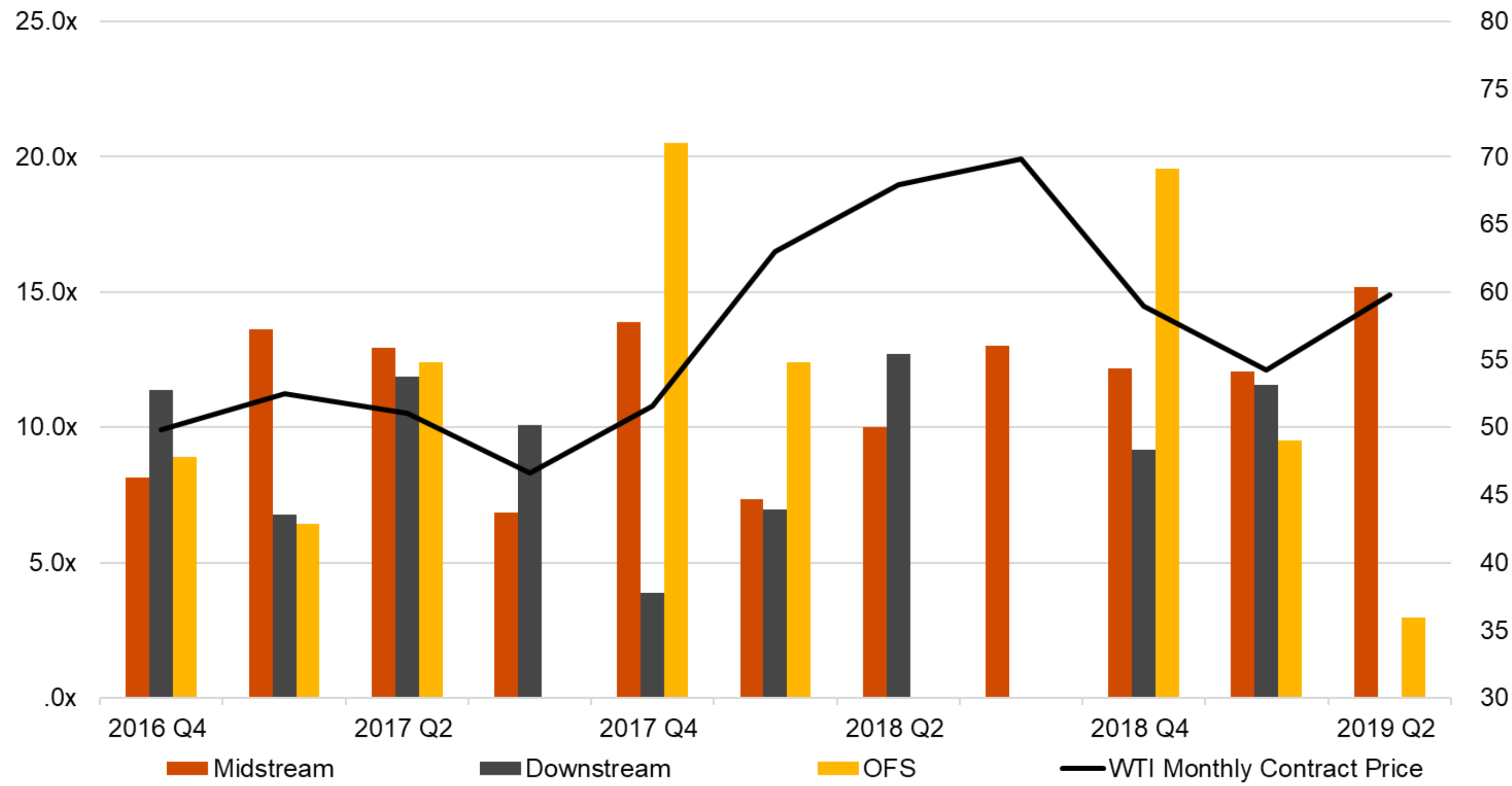
Q2 2019 multiples near 3-year high



Source: IHS Markit

Median midstream multiples rise, OFS fall from previous quarter

EV-to-EBITDA Transaction Multiples by Vertical



Source: Capital IQ, IHS Markit

Trends to Watch

- Upstream sector is attempting to control key elements of value creation: focus on cash flow neutrality, balance sheet management, capital allocation and returns on capital
- Midstream sector is well positioned for continued growth opportunities but value creation will only occur if capital deployment is rationalize through long term value lens (i.e. overcapacity), partnership with upstream is key
- Downstream sector continues to adapt and reliably deliver cash flow and capital returns, while significant value can be still be delivered in a right partnership with midstream (e.g. exports, IMO2020, petrochemical demand)
- OFS sector is struggling with value creation outside of niche offerings due to structural issues in the sector (e.g. low barriers to entry, fragmentation, buyer power), consolidation is overdue
- Recent investor ***focus on TSR, excess returns on capital and cash flows*** should be viewed as ***an opportunity for a fundamental shift in how Value*** is created in Mergers, Acquisitions and Divestitures

Questions and Answers

Max Raev, Deals Director

Max Raev is a Director in PwC's Deals practice and has over 12 years of experience in delivering value and deal engagements to clients in domestic and international settings. Specifically, he focuses on value assessment and impact as well as business modeling for strategic planning, investment and capital deployment purposes.

Max brings significant industry experience, having executed valuation projects and deals in the energy industry including upstream, midstream, downstream and oilfield services. Prior to joining PwC, he was at another Big four firms and most recently at a global integrated energy company in Business Development role.

Mr. Raev holds an MBA and a Bachelor's degree in Finance from the American University, Washington, DC and is a member of the Association of Chartered Certified Accountants.

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