M&A 2019: How Will Oil and Gas Prices Determine the Outlook

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At the beginning of 2018, the energy mergers and acquisitions market was poised to be strong and potentially record-breaking based on strengthening commodity prices after the low price environment of the previous several years. As it turned out, while 2018 may not have been as strong as many had initially hoped, it has been solid, and many basins with little M&A activity over the previous several years were much more active in 2018.

The year can be summarized as a combination of an active market in several basins (not just the Permian basin as in years past), the rise of the mega-deal, failed auction processes, constrained capital markets, and significant fluctuations in commodity prices late in the year.

2019 is sure to be an interesting year. In an industry that is constantly dependent on capital to fund exploration, development, growth and infrastructure needs, M&A will always be an important tool in the toolbox for energy companies. The Permian basin continues to be an area where further consolidation looks likely, and where infrastructure needs will continue to drive M&A activity. As development in other basins becomes more economic with strengthening commodity pricing (especially gas-heavy basins), companies with assets in those basins may look for opportunities to divest in hopes of capitalizing on the higher prices. However, the drop in crude oil prices (especially if prices remain lower for an extended period) may put a damper on M&A activity in oil-heavy plays. Other investors will look for opportunities to capitalize on lower prices. So, as usual, commodity prices will likely be a significant driver of M&A activity in the energy industry in 2019.

As an overview, the volume and value of M&A deals in the first three quarters of 2018 provided a positive and active outlook for 2019, but that was subsequently dampened by fluctuations in commodity prices. This upward trend in M&A deals in the first three quarters appeared to be largely attributed to the view that commodity prices would remain steady or move higher. However, with the drop in crude oil prices in late October/early November 2018 after a nearly four-year high earlier, coupled with a significant increase in natural gas prices during the same period, it remains to be seen what effect this volatility will have on M&A deal trends in 2019. Based on the Dec. 7, 2018, production cut agreed to by OPEC and Russia, crude oil pricing may strengthen or remain steady.
M&A deals for the third quarter of 2018 indicated a strong upward trend, as the number of deals increased more than a third from the prior quarter and the value of the deals increased by almost three-fourths. More significantly, the value of deals increased over 400 percent from the third quarter of 2017 to the third quarter of 2018, and the volume of deals decreased during that same time period. A vast majority of deal value in the third quarter of 2018 was in the midstream sector, while upstream deals made up a majority of deal volume according to daily legal and business newspaper, the Journal Record.

Total deal value for 2018 indicates a strong and healthy environment for energy deals in 2019. Looking back on 2018 it is likely that the total value of deals will exceed the total value of deals in 2017. In fact, the over $230 billion total deal value for the first nine months of 2018 is the highest value reported over that same time period in the last decade. Total deal volume did not have the same upward trajectory as deal value. There were close to 150 deals reported in the first three quarters of 2018. With over 200 deals reported in all of 2017, it is unlikely the energy sector will match or surpass that amount by the end of 2018.

The higher value of deals in 2018 compared with 2017 can largely be explained by the rise of megadeals valued at $5 billion and over. This megadeal trend was particularly evident in the third quarter of 2018. Particularly, there were four megadeals with value over $5 billion in the third quarter, according to PwC. Combined, the total value of megadeals announced in the third quarter was just over $100 billion. A major facet of the megadeal trend continues to be the MLP to C-corporation restructurings and MLP simplification in the midstream sub-sector, with about $100 billion in value so far in 2018.

In addition to two restructuring/simplification megadeals with values of approximately $64 billion and $17 billion, respectively, notable 2018 third-quarter megadeals include a major acquisition of assets in the Permian, Eagle Ford and Haynesville basins for $10.5 billion and an all-stock acquisition in the Permian valued just over $9 billion. In terms of deal value in the Permian basin, the previously mentioned third-quarter just over $9 billion deal is a close second to the $9.5 billion deal in the first quarter of 2018, also in an all-stock transaction. These acquisitions highlight a consolidation trend in the Permian basin that may continue into 2019 and beyond. Additionally, we would expect this megadeal trend to continue with additional MLP restructurings and simplifications, as capital markets remain closed and the regulatory backdrop does not appear to be changing in favor of MLPs.

Private equity backed deals made a strong showing in the third quarter of 2018 after a largely downward trend for the first half of the year. Notably, according to PwC, there was a nearly 15 percent increase in total deal volume from the second quarter to the third quarter of 2018, largely in the midstream sub-sector.

In terms of the outlook for 2019 M&A deals, crude oil prices and natural gas prices will have a huge impact. The effect of the current drop in oil prices that occurred in November 2018 will not be fully understood until fourth quarter results are reported in early 2019.

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