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Oil & Gas Mergers and Acquisitions Report—Yearend 2018

Unrealized potential

Contents

Note: M&A activity explored in this report is based on data from 1Derrick's M&A Database as of January 4, 2019. The data represents acquisitions, mergers, and swaps with deal values greater than $10 million, including transactions with no disclosure on reserves and/or production. Our analysis has excluded transactions with no announced value as well as transactions between affiliated companies to provide a more accurate picture of M&A activity in the industry.

Executive summary

Two multiyear buildups in the oil and gas industry reached critical points in 2018. First, in a context of Russian and Saudi Arabian production restraint, the United States completed a historical shift to become the world's largest oil and gas producer.[1] Second, oil prices had been steadily increasing to reach a four-year high at the beginning of October, strengthening confidence. However, just as it appeared that a flush industry might be on the cusp of a revival in M&A activity, a return to price volatility and falling oil stock prices at the end of the year reinforced the caution that has characterized the industry since its 2014 downturn. Equity markets had remained closed to oil and gas IPOs and new equity issuance, even as commodity price conditions improved in the first three quarters of the year, with shareholders demanding financial prudence and discipline in capital spending with a focus on developing existing assets.

The year ended with higher global and US rig counts compared to 2017,[2] and a market potentially headed toward oversupply amid a worsening global macroeconomic outlook and high current and projected production levels. Projected supply-and-demand imbalances spurred members of the Organization of the Petroleum Exporting Countries (OPEC) and the non-OPEC Vienna agreement countries—led by Russia—to curtail production in order to mitigate downside price risk.[3] Global oil and gas merger and acquisition (M&A) activity reflected the renewed caution, with a flat deal value and the lowest count since 2015.[4] Consolidation and optimization continued to be a major driver of deal flow in 2018, reflecting an organic, low-risk growth strategy. Aside from a buyer-seller valuation gap, the depressed activity reflected corporate buyers' focus on demonstrating their ability to return value to shareholders rather than expand through acquisitions for which equity markets were not rewarding them.[5]

Compared to 2017, deal counts fell across the segments, remaining level downstream. Upstream and oilfield services (OFS) total deal values also fell. Midstream and downstream deal values increased—the latter driven by Marathon Petroleum's $35.6 billion acquisition of independent refiner Andeavor. Upstream maintained its perpetual lead overall, albeit a weakened one.[6]

The United States accounted for more than two-thirds of the total oil and gas deal value—a record-high share. Each of the top 10 oil and gas deals in 2018 involved acquisitions of North American assets. Two deals were notable for being more than $10 billion: The Marathon Petroleum/Andeavor transaction and BP's $10.5 billion acquisition of BHP Billiton's US onshore unconventional assets.[7] In both cases, as well as all six of the upstream deals among the overall top 10, the acquirer's shares fell following the deal, indicating a predominantly seller's market for most of the year. The only midstream and OFS deals among the top 10 were, respectively, Enbridge's acquisition of Spectra Energy Partners for $4.8 billion and Ensco's acquisition of Rowan Companies for $3.7 billion.[8]

Overall, an industry that was strong in 2018 did not realize its potential for increased M&A activity largely because it remained financially constrained in a context of continued caution. Hopes for a return of confidence were set further back at the end of the year when the oil price dropped, raising fears of a return to volatility. With deteriorating market conditions on the horizon, caution and closed equity markets will likely continue to shape M&A activity in 2019 with the advantage remaining with well-capitalized buyers.

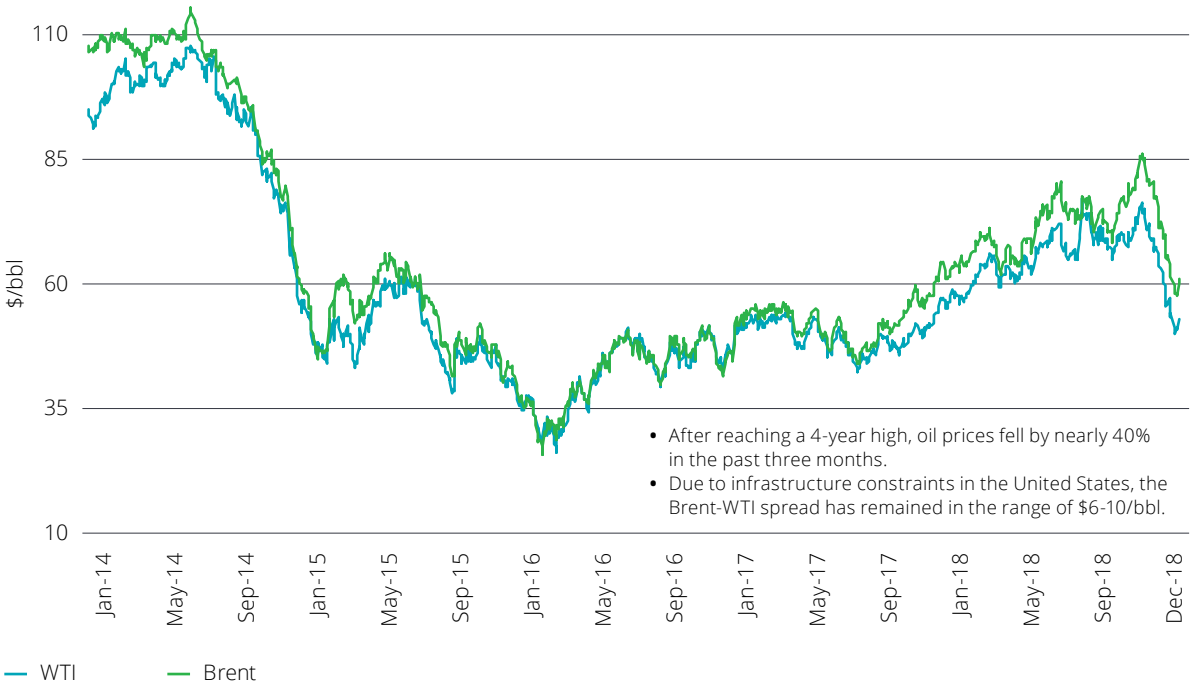
High expectations in 2018; as yet unfulfilled

A tale of two buildups

The United States delivered on the unexpected promise it had been showing over the past few years to become the world's leading oil and gas producer as its crude oil production rose to 11.7 million barrels per day.[9] Weekly data released in December also showed record exports that propelled the United States into the novel role of being a net oil and oil-derived liquids exporter for the first time in three quarters of a century.[10]

However, a second multiyear buildup—in oil prices and confidence—auguring a boom in M&A activity, faltered in 2018. After steadily increasing since 2016 to reach a four-year high at the beginning of October, oil prices fell by 40 percent in the last quarter of the year (figure 1). In addition to the price decline, volatility increased, with a series of "rare and large price declines"[11] in November and December. In another flip, the West Texas Intermediate (WTI) market, which had been in backwardation for most of the year, entered contango at the end of 2018, suggesting fears of coming oversupply. The Brent market contango also widened. Due to infrastructure constraints in the United States, the Brent-WTI spread remained in the range of $6–10/bbl.

Figure 1. Crude oil prices precipitously fell and volatilized at the end of 2018

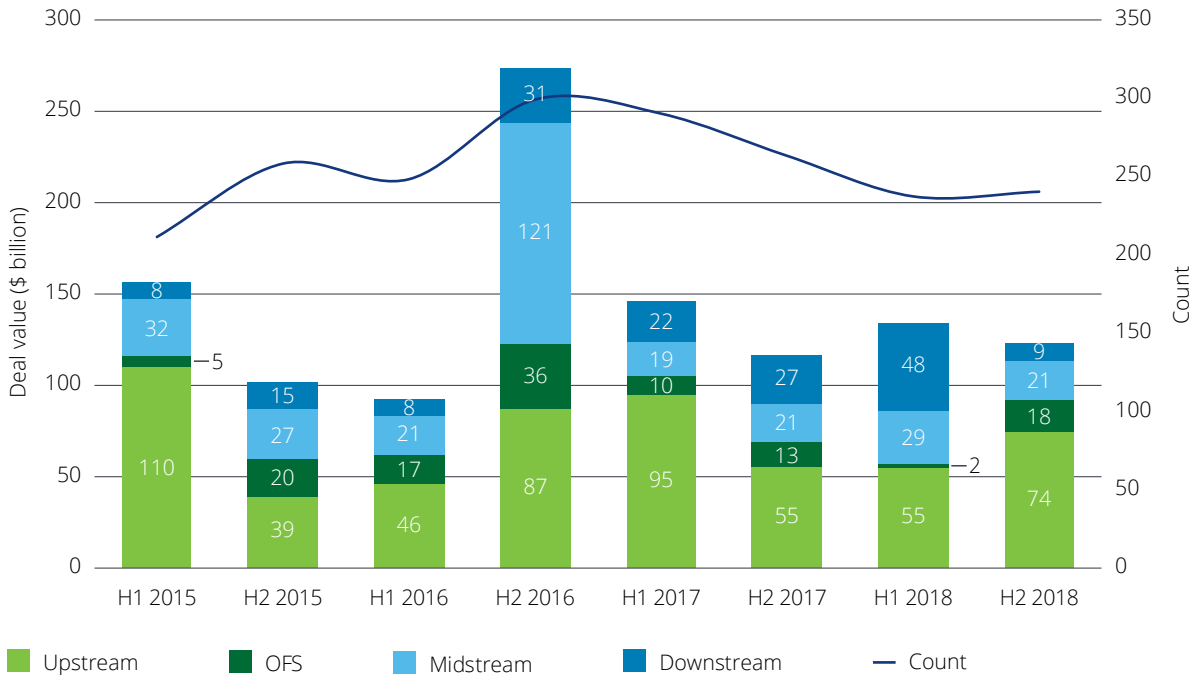


Sources: EIA, Petroleum & Other Liquids spot prices database

A cautious business environment dampened the industry's potential in 2018

The abrupt eleventh-hour change in market conditions aside, the oil price rally throughout most of 2018 did not translate into a boom in M&A activity, and equity markets remained closed. While oil majors' profitability rose to meet and even exceed pre-2014 downturn levels, most companies chose to repair balance sheets and reward investors before investing for growth. Tens of billions of dollars in dividends were returned to shareholders,[12] and debt-to-equity ratios fell to 2014 levels.[13] The corporate value of global deal activity increased, but the asset value decreased, yielding a relatively flat total deal value and a count that was lower than the previous two years (figure 2). In terms of value, the overall pattern was almost identical to 2017 with a stronger first half of the year than the second. However, there were significant sectoral differences. The downstream deal value was a record high, while OFS recorded the lowest value since 2013, and upstream, the lowest value since 2008.

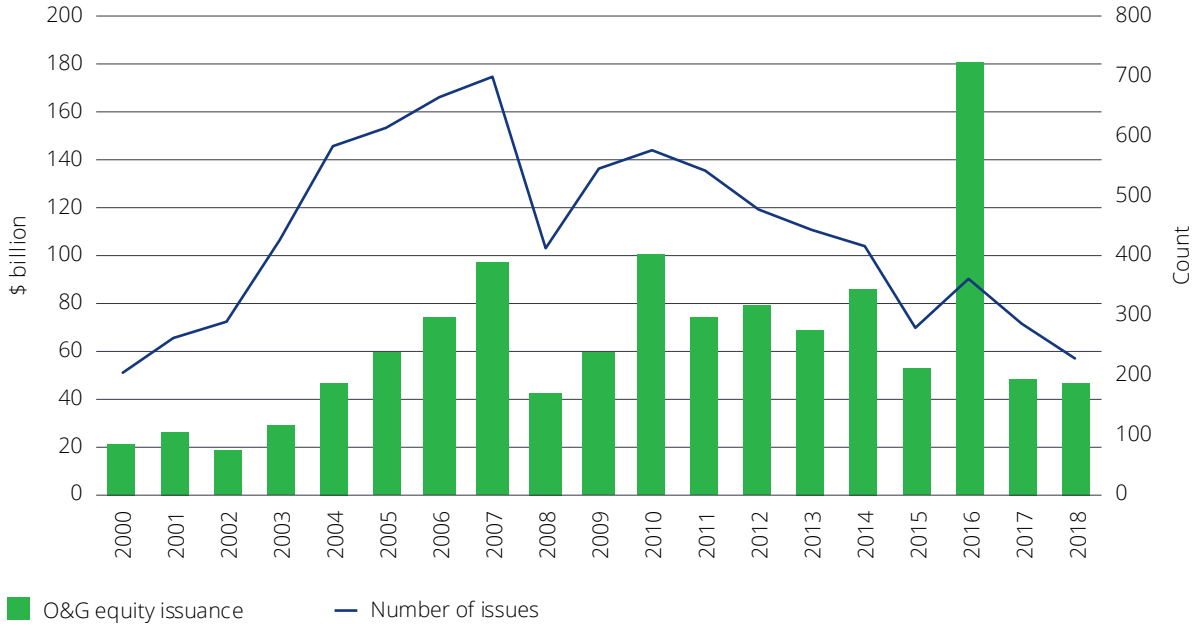
Figure 2. Global oil and gas M&A deal value remained flat and the count declined from 2017



Source: 1Derrick's M&A Database

Public equity markets remained closed throughout 2018, as shareholders—still wary of undisciplined spending—requested that companies be financially prudent and focus on developing existing assets while operating within their cash flows.[14] This caution was reflected in equity issuance, which fell to the lowest count since 2000 and lowest value since 2008 for the oil and gas industry (figure 3). The public upstream sector's return on capital employed continues to consistently remain below its weighted average cost of capital—a situation that would need to improve for public equity markets to reopen.[15] Investors are demanding not just a return *on* capital, but also a return *of* capital.

Figure 3. Equity issuance value fell to a 10-year low



Source: Thomson One M&A Database

In the absence of public acquirer interest, private equity's shale strategy in 2018 shifted from a flipping strategy to longer investment hold times and strategic optimization with a view to generating cash flow.[16] Many private equity firms are focusing on the consolidation of their portfolio companies and the development of organic growth, in partnership with carefully selected management teams. Private equity-to-private-equity transactions became more common. Private equity firms also started pursuing larger asset deals through consortium bids in the form of joint ventures or acquire-and-divest structures,[17] which provide a means for private equity partnerships with majors to work around closed equity markets.

Some private equity firms, as well as hedge funds, and other investors new to the oil and gas industry sought in 2018 to push for unconventional oil and gas industry consolidation, bringing their activism to bear on a sector where most producers were still spending more than they took in even as oil prices peaked. Activist investors were behind the year's second- and fourth-largest deals, respectively, BHP Billiton's sale of its US onshore shale assets to BP and Energen's sale of itself to Diamondback Energy. However, a wave of consolidation failed to materialize in the face of resistance from the management teams of the sector's mostly small and midsize companies.[18]

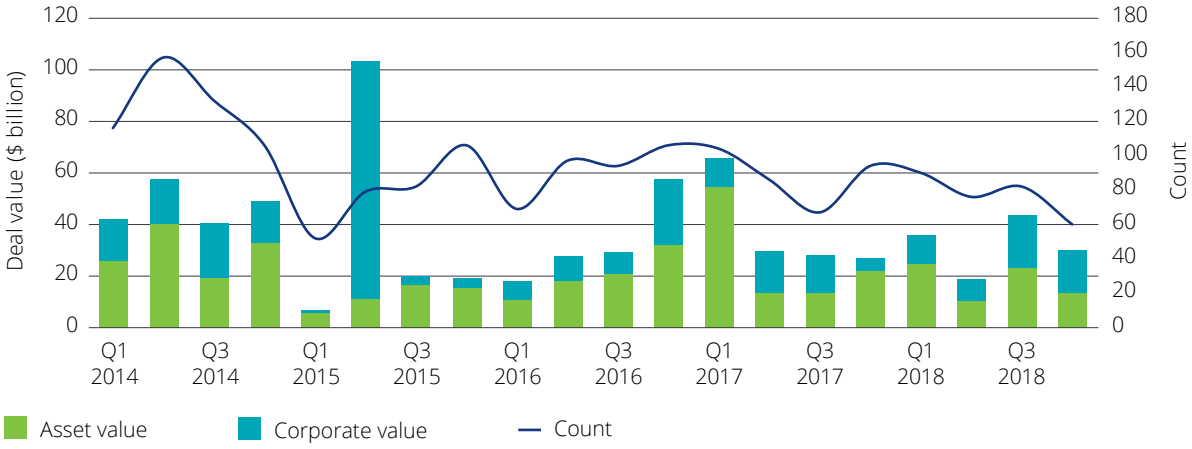
Several policy developments in 2018 contributed to the cautious business environment. Trade tensions between the United States and China indirectly affected the oil and gas industry. While China's 10 percent tariff on US LNG imports has had modest impact, US steel product tariffs hiked pipeline costs, with the Department of Commerce rejecting waiver requests.[19] More broadly, these tensions cast a pall over the global economic outlook in 2018 and raised concerns about future tariffs. While the effects of the sanctions on Iran and turmoil in Venezuela were more muted than initially expected, they also unsettled the market. Finally, proposition 112—an anti-fracking measure that was placed on the ballot in Colorado—slowed investment and deal-making in the state. The measure failed, but its strong prospects and the likelihood that it would resurface in different forms raised a red flag for the industry in 2018.

At a more macro level, environmental concerns have fostered additional caution. Major oil and gas companies are under increasing pressure to reduce the carbon intensity of their energy production and actively participate in the energy transition, both to meet corporate social responsibility goals and address concerns about their investment in what could eventually become stranded assets. With their falling costs and lower-risk profile, renewables and renewable-related investments attracted growing interest from companies building a long-term carbon mitigation story as part of their portfolio. Total's acquisition of a 74 percent stake in Direct Energie for $1.7 billion in April, aligned with its strategy "to develop low-carbon energies," adding 550 MW of renewables to Total's portfolio in France and Germany.[20] Other notable deals included Shell's acquisition of a 44 percent stake in US solar developer Silicon Ranch Corporation and Statoil's (now Equinor) acquisition of a 50 percent interest in two offshore wind projects in Poland. Oil and gas companies may have a competitive advantage in the offshore wind sector, given their offshore engineering expertise.[21]

Upstream: Permian shale continues to dominate

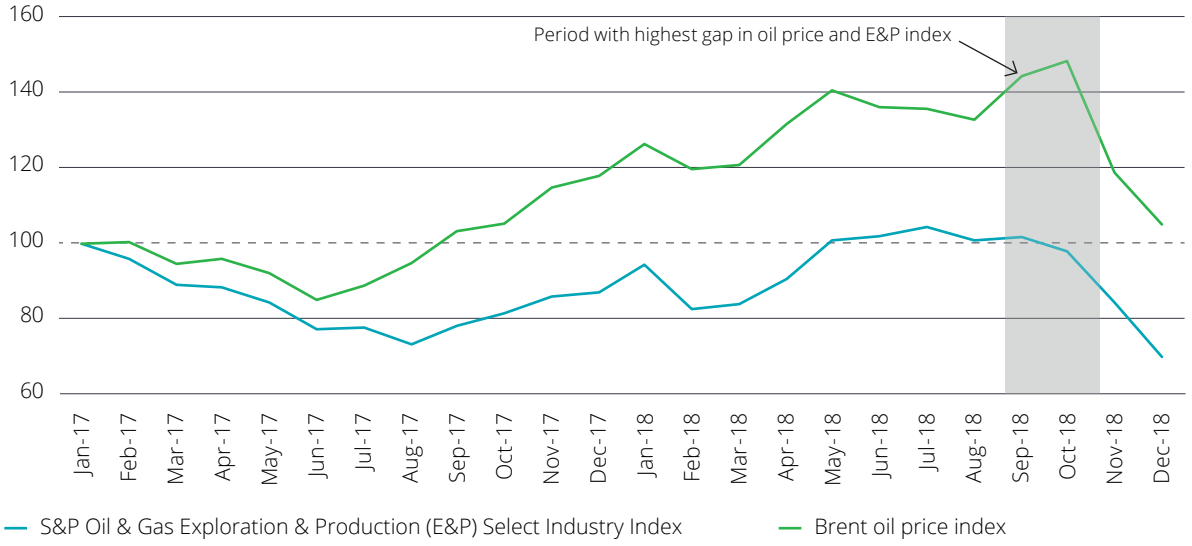
A consistent recovery for about 10 months should have boosted upstream M&A activity, but companies remained cautious about the sustainability of this trend and were proved correct when oil prices fell at year-end. In fact, upstream M&A volume for 2018 was 12 percent lower than 2017 (figure 4). The second quarter was the weakest, with a total deal value of about $18.7 billion—a level last seen in the first quarter of 2016, when oil prices dropped to about $28/bbl.[22] Price volatility, poor quarterly results, and divergent views on the existence of a new oil price floor contributed to this fall. However, attractive valuations in the third quarter (evident from the gap highlighted in figure 5) led to a quick recovery of M&A activity before the correction seen in the last quarter following the price decline.

Figure 4. Upstream M&A volume and value fell



Source: 1Derrick's M&A Database

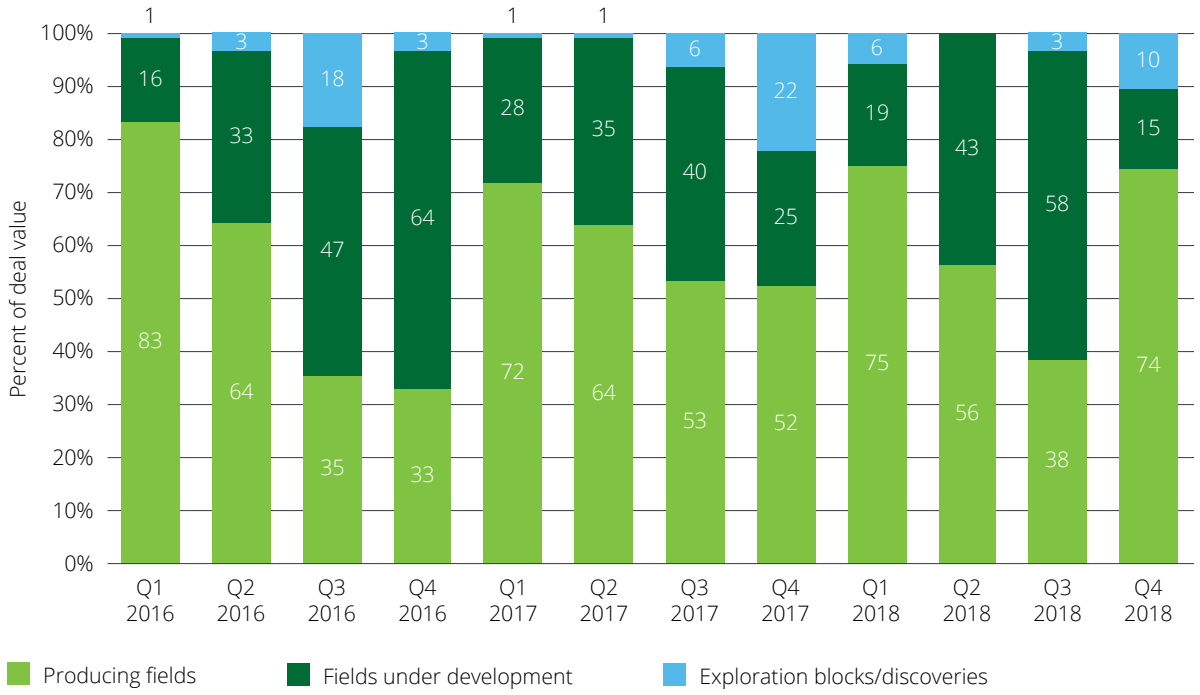
Figure 5. Attractive Q3 valuations led recovery before Q4 collapse (January 2017 = 100)



Sources: EIA, Petroleum & Other Liquids spot prices database, and S&P Capital IQ database

In terms of transactions type, corporate deal activity witnessed a 73 percent increase in deal volume and a 22 percent increase in deal value. But fewer asset exchanges took place in 2018: asset deal value totaled $72 billion in 2018, versus $103 billion in 2017.[23] Apart from the valuation mismatch, a closer look at the type of assets traded reveals that changing buyer confidence also played a role (figure 6). The year started with more cautious buying, as companies pursued low-risk acquisitions of producing fields. Companies showed increased risk appetite as the year progressed, acquiring more assets under development. In the fourth quarter, they returned to already-producing assets that generate immediate cash flow.

Figure 6. Upstream asset deal share by asset-type show a year bookended by caution



Note: Percentages are rounded to the nearest whole number.

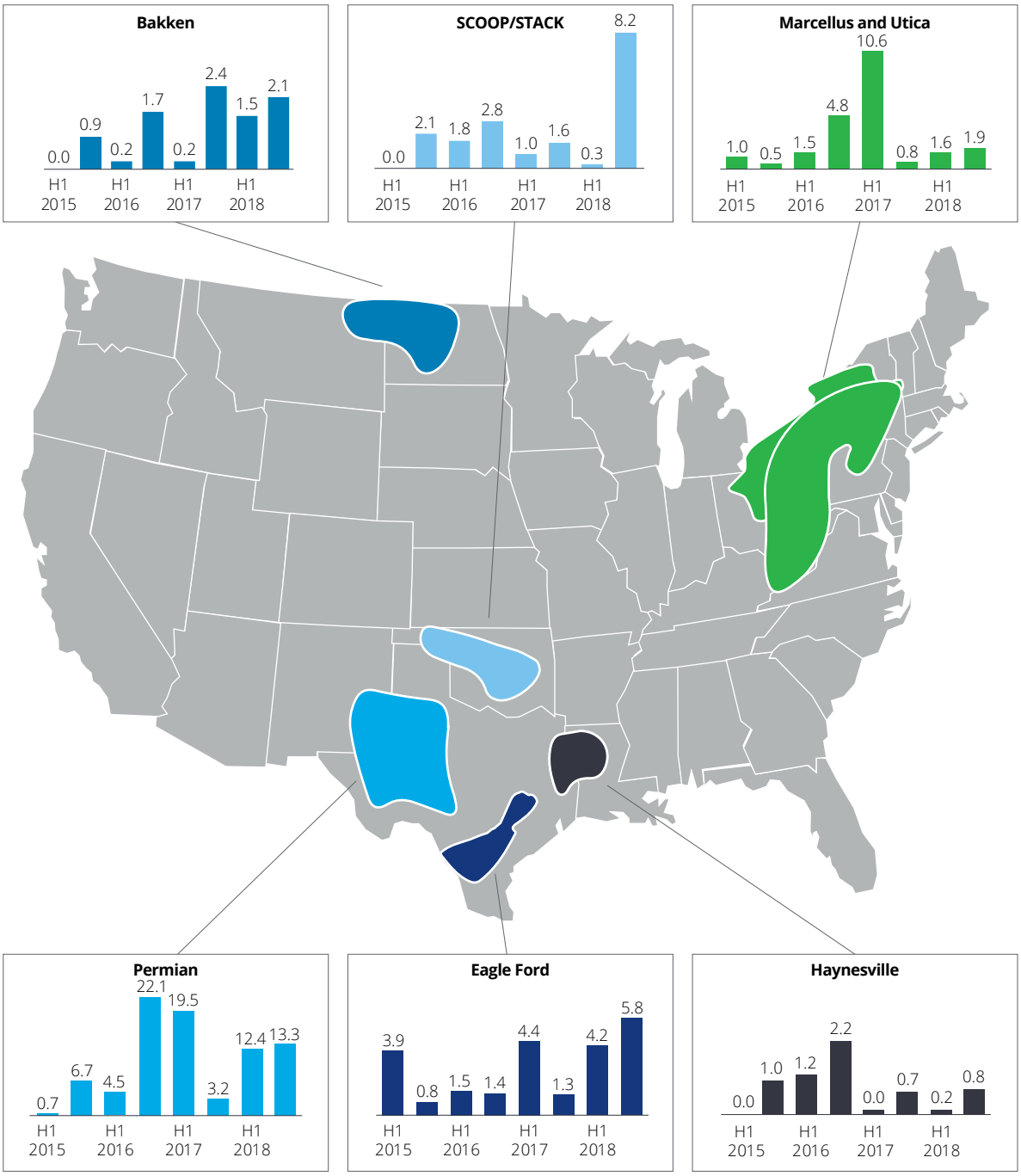
Source: 1Derrick's M&A Database

Regionally, the United States dominated upstream activity, with its $79.7 billion deal value representing a 26 percent increase year over year and accounting for almost two-thirds of the global deal value. The Middle East experienced record M&A activity, driven by the United Arab Emirates (UAE) government's sale of interests in various producing fields to several international oil companies and national oil companies (NOCs) for $8 billion. Meanwhile, Canadian M&A value halved to $15.5 billion. Although the trend of divestitures by foreign companies continued in 2018, valuation issues attributable to a heavy discount on Western Canadian Select and regional natural gas prices may have depressed the M&A activity in the region.[24]

Unsurprisingly, the attractiveness of shale led the increase in US deal activity. Ongoing consolidation, renewed seller motivation, a Wall Street push to drive free cash flow by focusing on core-of-core, and private equity dry powder looking for rapid deployment may have driven this increase.[25] The biggest deal in US shale was BP's acquisition of BHP's assets in the Permian, Eagle Ford, and Haynesville for $10.5 billion. BP thereby diversified its portfolio into short-cycle shale after missing out on the early years of the shale oil boom when it sold its legacy Permian position to Apache Corporation in 2010.[26]

In terms of basins, buyers continued to covet the Permian, which recorded deals worth $25.7 billion in 2018 (figure 7). However, M&A in the Permian lacked depth as this figure primarily reflected two megadeals over $9 billion: one between Concho Resources and RSP Permian, and another between Diamondback Energy and Energen. These deals focused on driving operational synergies through scaled-up development optimization, and capital efficiency through shared infrastructure. This consolidation should enable cash flow acceleration through portfolio high-grading and advantageous contract negotiations with OFS and midstream firms stemming from a scale advantage.[27]

Figure 7. While the Permian continued to dominate, interest in other basins grew



Note: All values are in $ billion.

Source: 1Derrick's M&A Database

Higher oil prices also increased buyers' interest in other US shales. While the Marcellus saw a lull in deal activity, primarily because it is a natural gas play, Eagle Ford and SCOOP/STACK registered total deal values in the range of $8 billion to $10 billion each—a four-year high for the former and a record high for the latter. Aside from increased profitability due to higher oil prices, this trend reversal may be attributable to easier market access to the Gulf Coast and targeted growth via diversification into less crowded plays.[28] Furthermore, the Permian has become too expensive for most smaller players. In any given quarter, the weighted average dollar per acre paid by companies for Permian assets is two to five times higher than prices for acreage in other basins. In September, a US Bureau of Land Management auction for oil and gas lease sales in New Mexico yielded a record per-acre bid for a parcel: $81,855 per acre—more than double the record set the previous year.[29]

Many companies, especially small to midsize upstream companies, also pursued royalty deals to invest in US shale (table 1). 2018 US royalty deal volume and value reached an all-time high of 29 deals worth $2.2 billion.[30] Most of these deals either focused on the Permian or on a bundle of oil-heavy shale plays. Furthermore, all the royalty deals in 2018 were for proven but undeveloped assets, implying that companies explored this tool to drive future growth and distributable cash flow per unit by minimizing the financial risk involved in operating the assets.[31]

Table 1. 2018 was a record year for US royalty deals

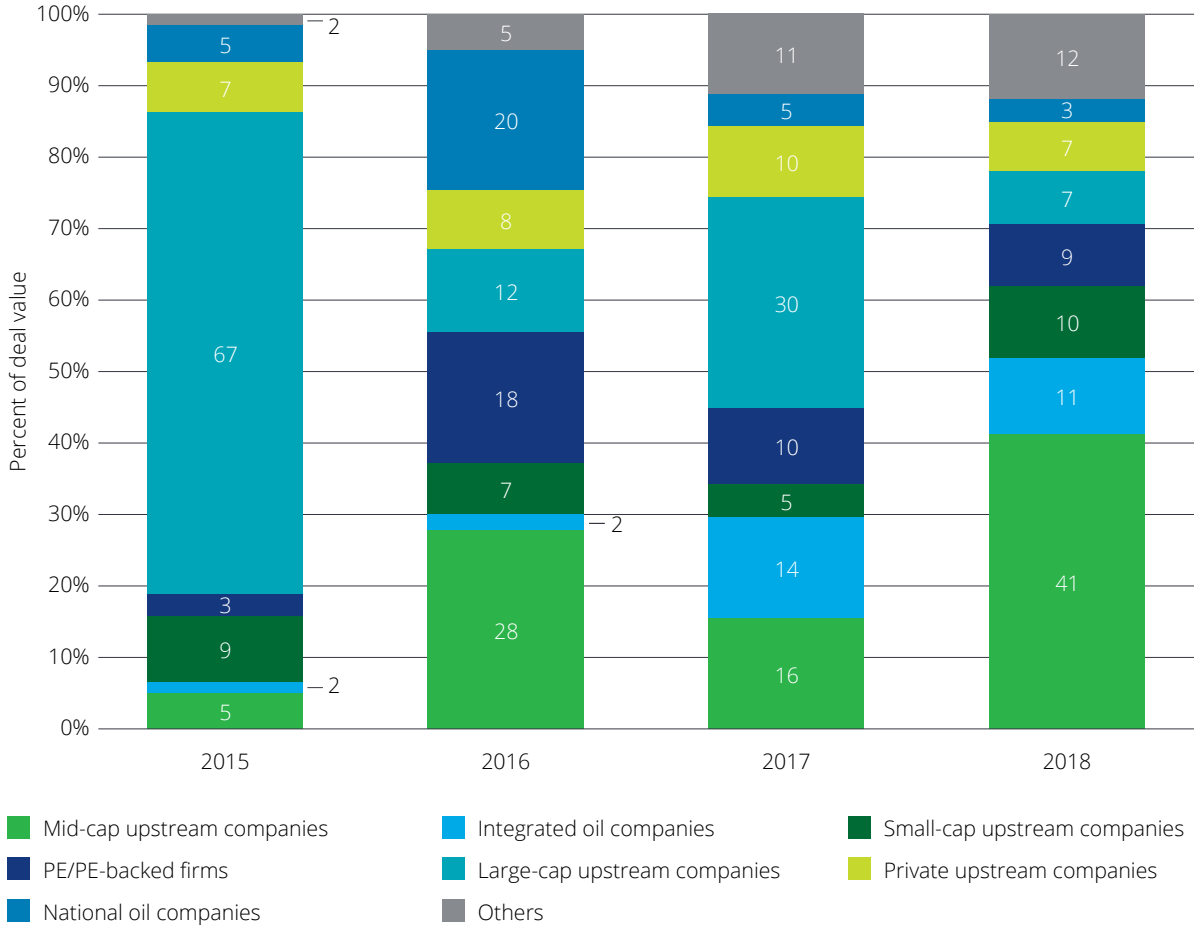
Year	Count	Value ($ billion)
2013	7	0.5
2014	12	0.3
2015	16	0.2
2016	25	1.1
2017	18	1.2
2018	29	2.2

Source: 1Derrick's M&A Database

Small and mid-cap upstream companies were the largest sellers in 2018, accounting for a combined global deal value share of 51 percent, compared to 21 percent in 2017 (figure 8). Meanwhile, large upstream companies reduced their selling by $33 billion year over year and retained their position as the largest buyers. Midsize and small upstream companies accounted for 15 percent and 13 percent of acquisitions, respectively.

The concentration of M&A activity among pure-play upstream companies shows that, in this competitive market landscape, pairings of smaller and larger players are especially attractive: small and midsize upstream companies can benefit from the financial and operational excellence of large players and in return offer high-quality assets to fuel the growth plans of large upstream companies.[32]

Figure 8. Small and mid-cap upstream companies were the largest sellers in 2018



Percentages are rounded to the nearest whole number.

Source: 1Derrick's M&A Database

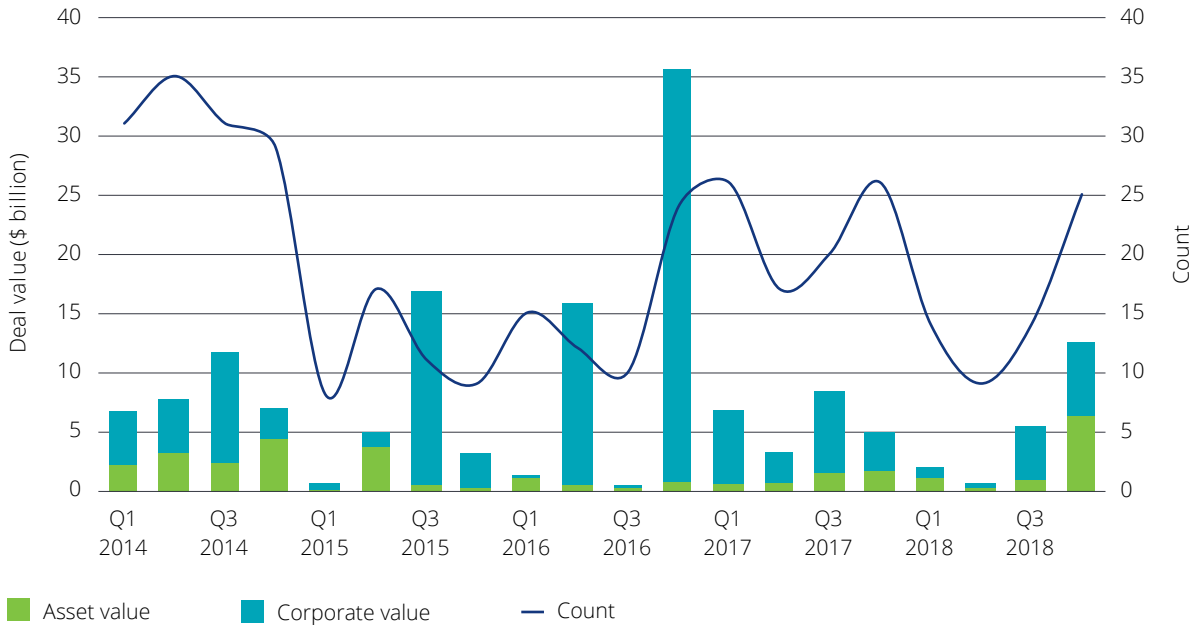
Private equity buying in the upstream sector fell by 40 percent this year, but private equity players remained net buyers of upstream assets, most likely indicating that they still saw value in select upstream assets/zones and viewed oil and gas positively relative to other sectors.

M&A activity in 2019 will likely hinge on companies' perceptions about the future landscape and their portfolio positions. Integrated oil companies that were active buyers this year could shift their focus to driving synergies and creating differentiation through technology, while others may continue to identify quality assets that fit into their growth strategy. Independents may want to maintain their focus on forming alliances and joint ventures within or outside their peer group to drive efficiencies and deliver sustainable returns to shareholders.

Oilfield services: Weak M&A activity due to large bid-ask spreads

The OFS deal value in 2018 fell to a five-year low, totaling $20.6 billion, while the deal count fell to 62 (figure 9). This drop is primarily attributable to a weak first half of the year, which recorded a deal value of only $2.5 billion. Key factors included low pricing and margins for OFS players, little clarity on the time needed for the market to return to mid- to long-term contracts, and midstream bottlenecks in the United States that derailed OFS firms' growth plans. As a result, most OFS companies' market valuations remained low. The OFS price index remained at or even below 2016 levels for most of 2018.[33]

Figure 9. OFS deal value fell to a five-year low



Source: 1Derrick's M&A Database

While the corporate deal value fell by nearly 40 percent year over year, the asset deal value doubled in 2018. In fact, with a value of more than $6 billion, the fourth quarter of 2018 marked a record for OFS asset deals.[34] As productivity has grown, the demand for rigs per unit of production has fallen significantly. Moreover, US midstream bottlenecks are holding back demand growth for completion and pressure pumping equipment. This may have pushed some companies to sell assets that were not showing profitable utilizations, while buyers saw an opportunity to scale their positions in some areas to command better margins. The activity slowdown could also threaten subsectors like sand and pressure pumping with significant overcapacity going into 2019.

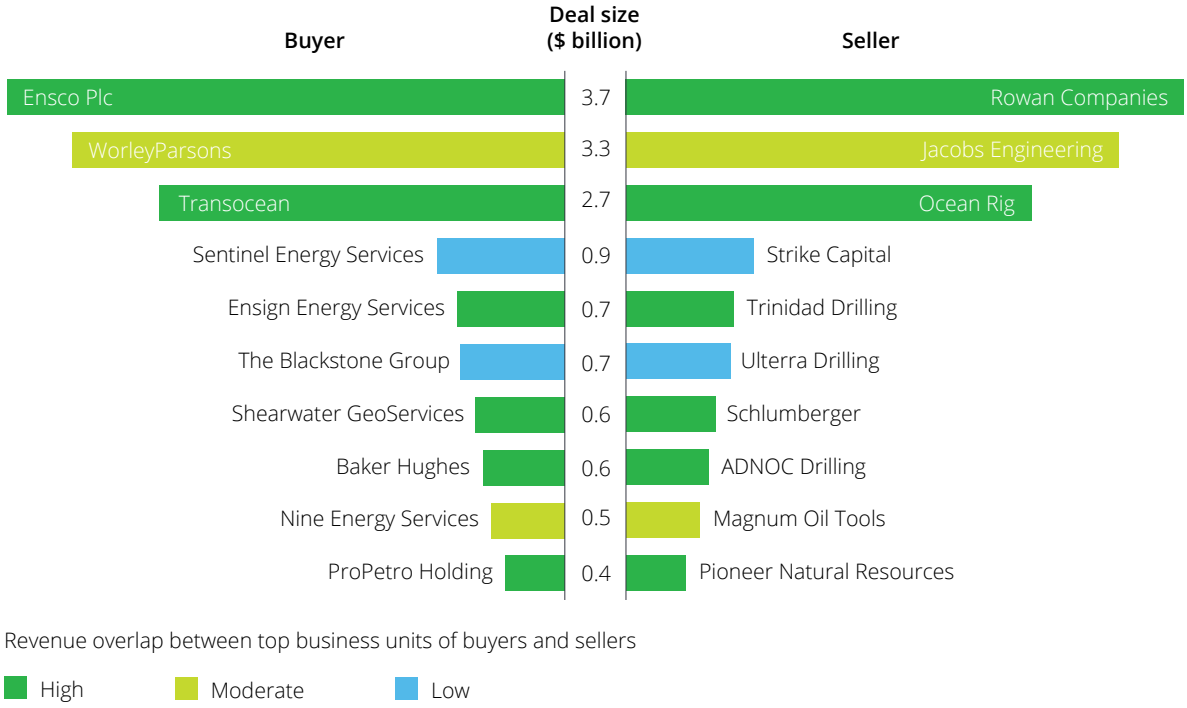
The same story is reflected in the net buying and selling by company groups. Small OFS companies and companies from other subsectors were net sellers, while midsize OFS companies were net buyers using M&A heavily to expand their position in various businesses and regions (figure 10). Muted M&A activity in the large-cap group indicates that most of these companies prioritized utilization of current assets over acquisitions. Few deals involved private equity investors, who were net buyers in the OFS market. The biggest deal involving private equity was focused on drilling tools, with Blackstone Group acquiring Ulterra Drilling from private equity counterpart American Securities for $700 million. Remaining private equity buying entirely focused on services.[35]

Figure 10. Small OFS companies were top net sellers, while midcaps were top net buyers

Source: 1Derrick's M&A Database

The deal rationales this year largely revolved around buying to achieve economies of scale in an existing segment (capacity-led consolidations) rather than making acquisitions to complement or complete service offerings (figure 11). In eight of the top 10 deals in 2018, the buyer and seller showed a high to moderate level of overlap between their top business segments. This was also the trend in 2017, when many companies were trying to consolidate their positions before the oil market recovered and demand for tools and services picked up. Another point worth noting is that the top three deals involved offshore equipment and services. This reflects an attempt to consolidate and improve offshore margins after years of overcapacity, low utilization, and bankruptcies in this segment. Regarding the year's top OFS deal—the $3.7 billion merger of Ensco and Rowan Companies—the latter's president and CEO noted that the merging of the companies' rig fleets and infrastructure would increase their scale without detracting from their attention to high-specification assets.[36] Indeed, offshore plays still offer competition for large multimillion-dollar contracts, but consolidation is increasingly an imperative as economies of scale are needed to play in this space.

Figure 11. Capacity-led consolidation drove OFS deals

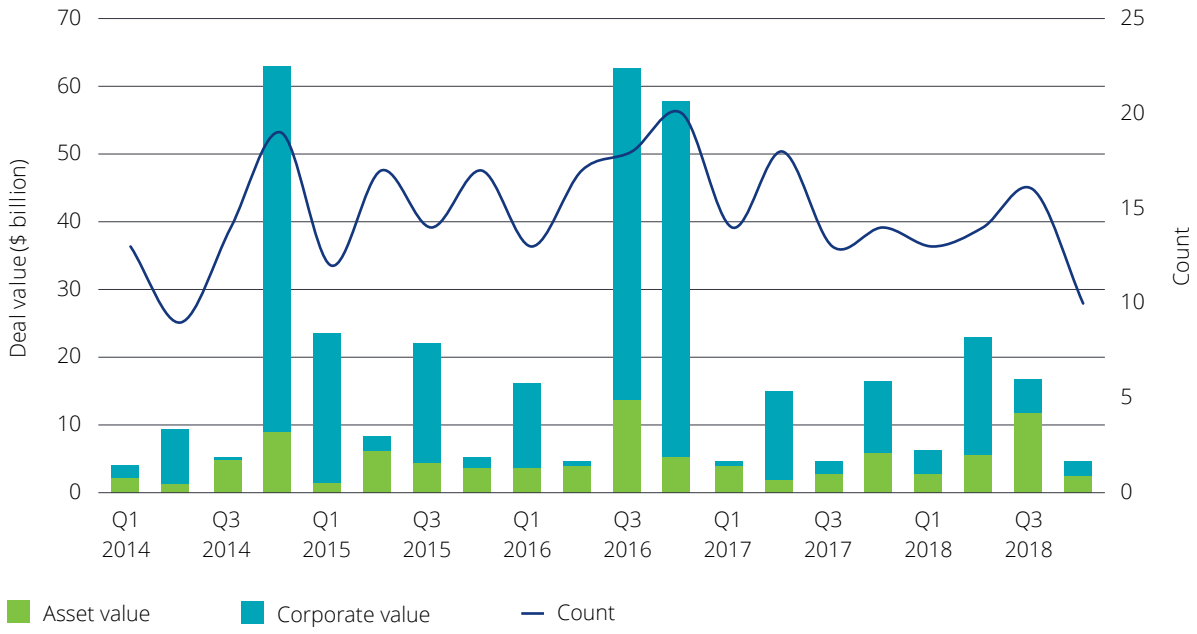


Sources: 1Derrick's M&A Database and Spears & Associates Oil Market Report

Midstream: Bottlenecks drive increased activity

Contrary to upstream and OFS, midstream recorded an uptick in deal value (figure 12), as infrastructure bottlenecks increased the attractiveness of existing pipeline assets. For example, pipeline development has not kept pace with production growth in West Texas, limiting takeaway capacity and leading to extremely high price differentials, with a Permian crude oil discount of up to $17.4/bbl to the Cushing price in the third quarter, and an implied discount of up to $25.8/bbl to the Brent crude oil price.[37] Gathering and processing deals accounted for the bulk of US midstream deal value in 2018.

Figure 12. Midstream M&A deal value increased in 2018



Source: 1Derrick's M&A Database

Just like in 2017, midstream activity was dominated by North America, and the largest deal involved a Canadian company: Canada's leading pipeline operator Enbridge acquired the US master limited partnership (MLP) Spectra Energy Partners, a holder of natural gas and oil pipelines and storage assets. Earlier in the year, in the third-largest midstream deal, Enbridge sold its noncore natural gas processing plants to private equity firm Brookfield Infrastructure Partners for $3.3 billion to reduce debt, enabling the Spectra MLP acquisition.[38] A key deal driver cited was weak MLP capital markets after the Federal Energy Regulatory Commission (FERC) announced an adverse tax policy change in March.[39] The ruling created "zombie" MLPs, and many predicted the demise of the structure at the time. Since MLPs are a big acquirer, activity was severely impacted.

Midstream activity moved toward abandoning MLP structures and creating internal "mergers" to become taxable C corporations. For example, Tallgrass Energy GP bought out the public unitholders of its MLP following the ruling, and Williams Companies bought out the rest of its MLP two months later. In June, in the second-largest midstream deal, Loews Corporation acquired all outstanding units of MLP Boardwalk Pipeline Partners. However, in July, FERC moved to preserve MLPs' tax benefits on accumulated deferred income, leading Enbridge to improve the deal for Spectra.[40] MLPs also became more financially attractive in the last quarter of 2018 due to higher business volumes and cash flows.[41]

Private equity continued to show interest in the midstream sector, deploying creative deal-making approaches. In a notable example, a private equity firm formed a joint venture with a natural gas midstream operator to acquire an oil and natural gas gathering and processing company from another private equity firm.[42] In fact, half of the top 10 midstream deals involved private equity firms.[43] In addition to the aforementioned Brookfield Infrastructure Partners/Spectra deal, private equity firm Global Infrastructure Partners acquired Devon Energy Corporation's whole interest in EnLink Midstream Manager, and private equity fund North Haven Infrastructure Partners acquired the Delaware basin subsidiaries from Brazos Midstream Holdings, which was backed by private equity firm Old Ironsides. In another example of a private equity–backed deal, Flatrock Midstream provided capital for Lotus Midstream's acquisition of Occidental Petroleum's Centurion pipeline system and New Mexico gathering system. Outside North America, infrastructure investor Wren House Infrastructure acquired private equity firm ArcLight Capital Partners' stake in North Sea Midstream Partners, which operates natural gas transportation and processing facilities in the United Kingdom.

Special purpose acquisition companies (SPACs) provided another avenue for deal-making in the context of public-market dysfunction, offering investors great flexibility. In November, SPAC Kayne Anderson Acquisition Corporation closed a deal with Apache Corporation for $2.5 billion to create a debt-free and cash-rich corporation—Altus Midstream Company, which bills itself as "currently the only publicly traded, pure-play, Permian Basin Midstream C-corporation."[44]

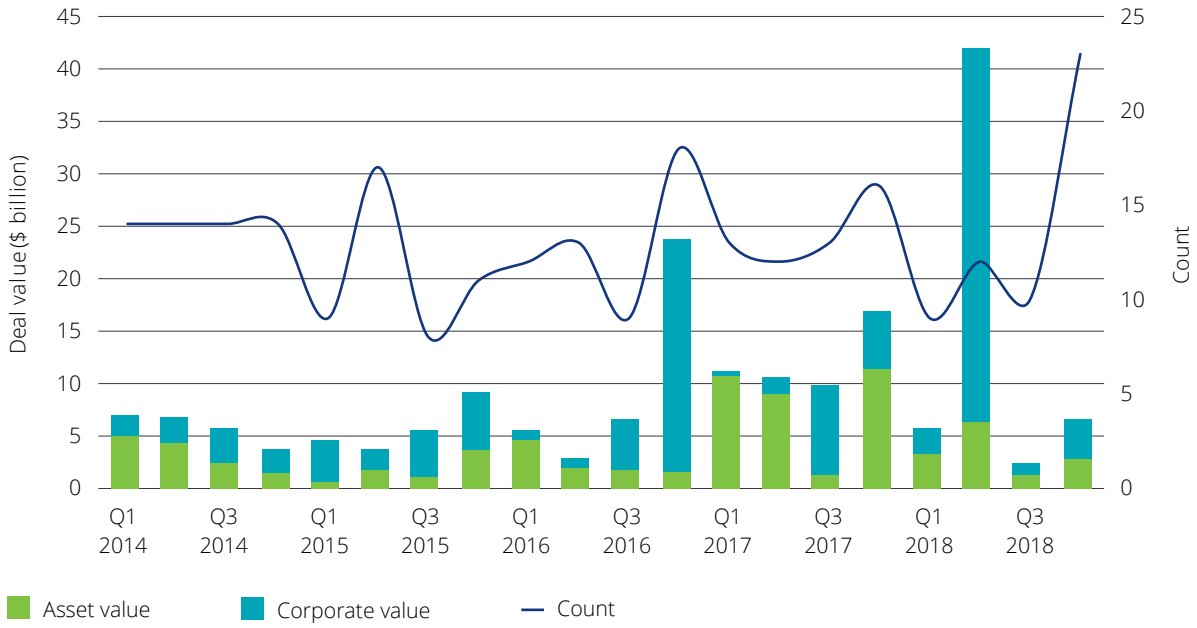
Two of the top 10 midstream deals outside of North America involved the acquisition of European assets. In addition to the aforementioned Wren/North Sea Partners deal, a European and a Korean consortium of investors acquired EDF's stake in the Dunkirk LNG terminal. What would have been the largest midstream deal—Hong Kong–based CK Infrastructure Holdings' acquisition of Australia's APA Group for $17 billion—was cancelled on national security grounds.[45]

Looking ahead, infrastructure bottleneck relief and shrinking price differentials are likely on the horizon. Plains All American Pipeline added a daily capacity of up to 350,000 barrels with the launch of its Sunrise pipeline from the Permian to Cushing in November, and other pipeline companies have sped up pipeline completion and/or expansion timelines at a time when falling oil prices may temper production and slow deal flow in 2019.[46]

Downstream: A record deal and quarterly deal count

The record downstream deal value in 2018 was attributable to a deal in this segment that topped the lists of largest deals in 2018 and of largest downstream deals ever (figure 13). Marathon Petroleum acquired Andeavor for $35.6 billion, allowing the independent refiner to vault past Valero to become the largest US refiner by capacity, and past Phillips 66 to become the largest by market capitalization.[47] The acquisition expands Marathon Petroleum's reach to the western US market. The combined company should continue to reap a global competitive advantage from its low-cost domestic supply and be able to capitalize on two regulatory changes moving in two different directions. The first one is the International Maritime Organization's bunker fuel requirements to lower sulfur emissions by 2020. The combined company should be well positioned to serve this market from its bicoastal port presence. The second one is the planned US rollback of standards for car emissions, which are to remain frozen at 2020 levels, yielding an expected increase in US gasoline demand of up to 400,000 barrels per day.[48] However, the Marathon megadeal was not indicative of a broader global trend. The deal count in the refining segment halved, as did the diversified deal count.

Figure 13. One deal drove a record downstream M&A deal value



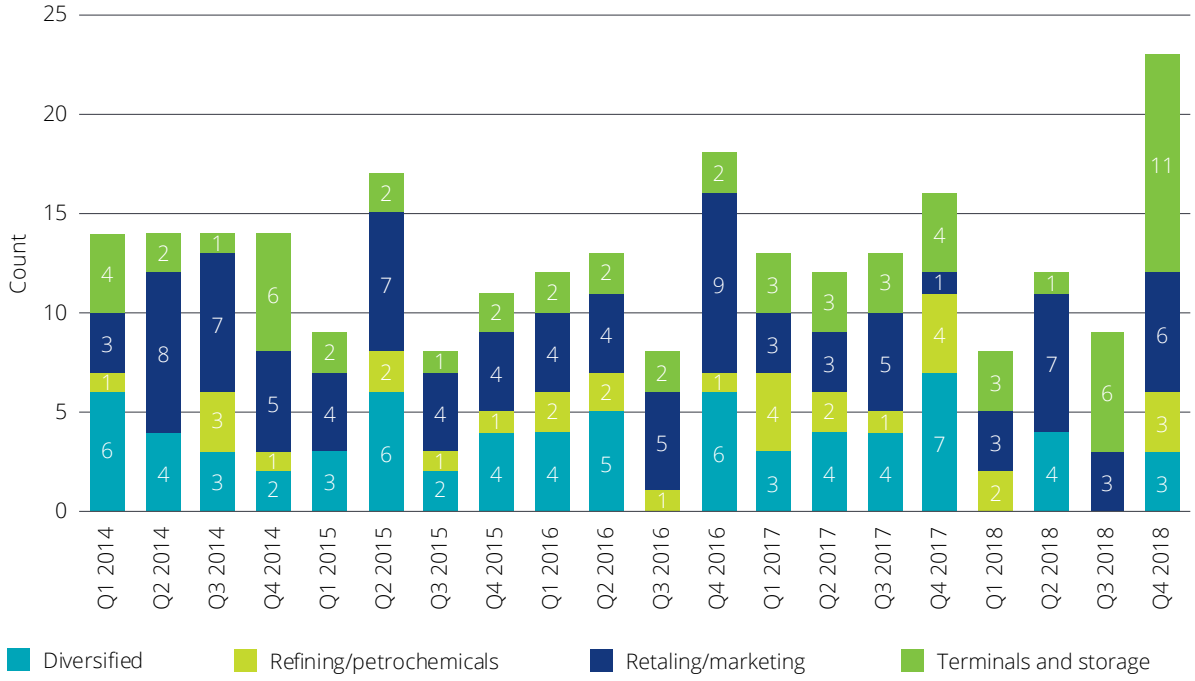
Source: 1Derrick's M&A Database

Overall, activity rose in the retail/marketing and terminals/storage segments, which both saw deal counts increase by more than a third. The largest deal outside of North America also involved the acquisition of a rival to create a national industry leader. Motor Fuel Group acquired MRH GB for $1.6 billion to form the United Kingdom's top gas station and store operator.[49] In another instance of the long-running trend of majors divesting retail and distribution assets to smaller players, Shell sold its Argentinian gas station network to Raízen Energia for $916 million.[50]

The terminals/storage segment appears ripe for increased activity as North American industry players seek to grow export markets. All the 2018 deals in this segment occurred in North America and Europe. The segment recorded the second-largest downstream deal—and a top 10 deal overall: the Canadian government's $3.4 billion acquisition of Kinder Morgan's Trans Mountain pipeline transporting Alberta's oil sands to Canada's west coast for export, mostly to the United States. The Canadian government plans to triple the pipeline's capacity to serve the Asian market.[51] Incidentally, 2018 saw a collapse of activity in Asia, which typically accounts for a third of M&A downstream value but only accounted for 2 percent in 2018.[52]

Almost half the deals in the last quarter were in the terminal and storage segment, leading the deal count to spike to a record quarterly high (figure 14). Deal values, however, stabilized in the fourth quarter after yo-yoing from a record high in the second quarter to a record low in the third quarter.

Figure 14. Terminals and storage drove a record quarterly M&A deal count



Source: 1Derrick's M&A Database

Looking ahead

Given that a recovering oil and gas industry did not realize its potential for increased M&A activity under more favorable conditions throughout the first three quarters of 2018, it is unlikely to do so now that the industry's fortunes have experienced a setback. Regardless of the price of oil going into 2019, worrisome signs continue to loom over the global economy. Financing could also be a challenge, because concerns about the global economy are impacting most industries, unlike the situation after the 2014 industry downturn. M&A activity will likely remain muted as the return of confidence is delayed and equity markets remain closed. While debt financing for deals under $100 million have eased, the stock market volatility has many lenders on edge. However, the valuation gap between buyers and sellers may shrink in 2019 and there is potential for well-capitalized companies and private equity firms to take advantage of other companies continuing to high-grade and prune their portfolios by divesting noncore assets.

A key upstream question going into 2019 is whether strong US shale production growth will continue or be undercut by falling prices, infrastructure constraints, and/or a demand slump. Midstream players may in turn need to balance their drive to overcome infrastructure bottlenecks with caution about overcapacity risk should production levels dip. Downstream, refiners' record profitability is likely at risk as bottlenecks disappear and price differentials narrow. More generally, the downstream sector can be expected to continue displaying its historical resilience to market disruption. Meanwhile, the OFS sector—still struggling to regain lost margins—appears to be in the most vulnerable position. Overall, large and liquid oil and gas players will likely be in the best position to ride the cycle and perhaps take advantage of a probable shift to a buyer's market. For the rest, consolidation may be key to weathering a period of deepening uncertainty.

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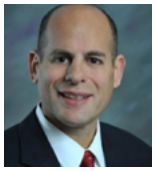

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