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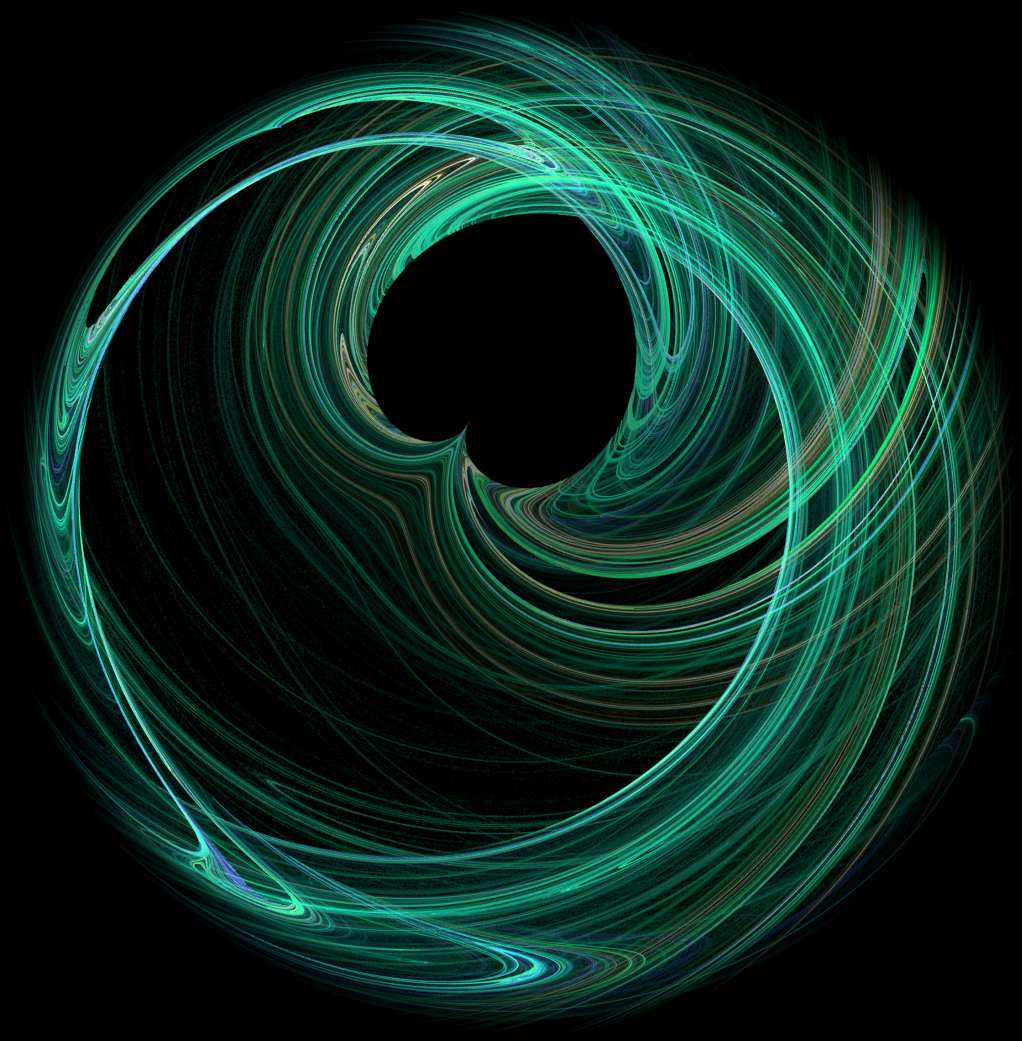


2021 oil and gas M&A outlook:
Consolidation through the price cycle

Contents

Methodology

Deloitte's 2021 oil and gas M&A outlook leverages Enverus's global M&A database, updated on January 6, 2021. The data includes all reported 2020 upstream, oilfield services (OFS), midstream, and downstream transactions valued at more than $10 million, excluding those between related parties and government lease sales and licensing.

Executive summary

The spread of COVID-19 greatly affected the oil and gas industry as demand for energy declined, compounded by supply uncertainty from OPEC+, leading to lower, more volatile commodity prices. Revenues and earnings declined substantially, leading to not just a pullback in capital spending and lower rig count, but also lower mergers and acquisitions (M&A) activity. There were only 205 deals across the sector in 2020, the lowest number in more than a decade. Deal value fell below $30 billion in the first half of the year, also the lowest in the decade, but rebounded to almost $170 billion in the second half. The impact was felt across all segments, with oilfield services (OFS) being hit the hardest.

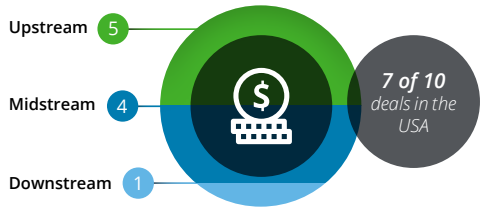
Key 2020 takeaways:

Sector deals

There were 258 deals across the sector in 2020, down from 433 in 2019, with value declining from $347 billion in 2019 to $218 billion in 2020.

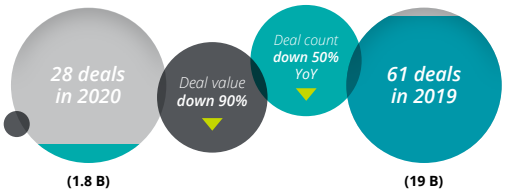
Global deals

Of the 10 largest deals globally, five were in upstream, four were in midstream, and one was in downstream. Seven of the 10 were in the United States.



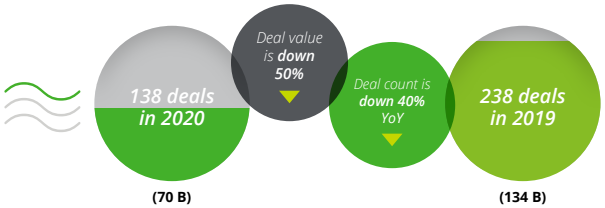
OFS

OFS was hit the hardest, with deal value and count down 90% and 50%, respectively, year on year. There were only 28 deals worth $1.8 billion in 2020, compared with 61 deals worth $19 billion in 2019.



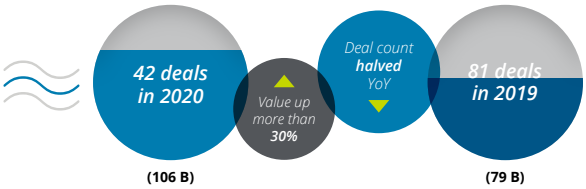
Upstream

Upstream deals also declined significantly, with value and count down 50% and 40%, respectively, year on year. Though there were several North American all-stock, low or no-premium transactions, that did not translate into a broader pickup in upstream dealmaking. There were 138 deals worth $70 billion in 2020, compared with 238 deals worth $134 billion in 2019.



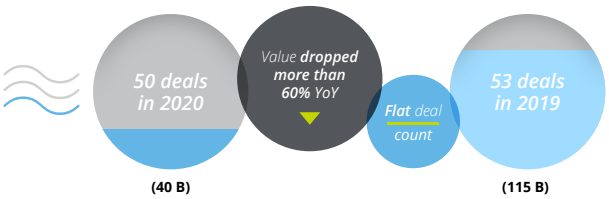
Midstream

Midstream proved more resilient, with PipeChina's $55.5 billion acquisition of Sinopec's and PetroChina's assets offsetting lower deal count. Midstream deal count halved year on year, but value was up more than 30%. There were 42 midstream deals worth $106 billion in 2020, compared with 81 deals worth $79 billion in 2019.



Downstream

Downstream value declined year on year, partially offset by a single large transaction: Marathon Petroleum's $21 billion sale of its Speedway retail business to 7-Eleven. Middle Eastern NOCs investment slowed substantially in Asian markets in 2020, and the absence of Middle Eastern-initiated megadeals like Saudi Aramco's 2019 acquisition of Sabic for $69.9 billion was a large blow to deal value. While deal count was flat, value dropped by more than 60% year on year. There were 50 downstream deals worth $40 billion in 2020, compared with 53 deals worth $115 billion in 2019.



Four trends shaping dealmaking in 2021:

1 Continued consolidation across the sector

The industry likely needs to hit the reset button. The more than 100 upstream and OFS bankruptcies in 2020 can help reduce the significant debt overhang weighing on dealmaking and increase the number of asset packages on the market at attractive prices. Based on current oil prices, bankruptcies will likely remain elevated, helping the industry to discharge excess debt. However, many companies are still overspending, overleveraged, and often overextended. Consolidation to achieve economies of scale can drive costs down so they can operate within their cash flows, as access to outside capital has dried up for many—otherwise, the sector may find itself in the same position during the next economic shock.

2 Increase in nontraditional capital sources

New sources of capital are needed, or the industry may need to rethink how it finances both organic and inorganic growth. Since 2016, equity issuance, IPOs, venture capital, and private equity investments have dropped to almost zero—replaced often with debt. Oil and gas sector debt issuance has continued to rise, spiking to more than $240 billion in 2020, $98 billion of which was in the second quarter alone. Companies will need to boost performance compared with other sectors to attract other traditional sources of capital, as well as find other, less traditional sources to support growth post-2020.

3 All-stock deals in the Permian and beyond

2020 saw several high-profile, all-stock, low-premium upstream deals, many of which focused on the Permian. This trend will likely continue into 2021 as companies try to get deals across the finish line while balancing commodity price risks and wide valuation spreads between buyers and sellers. Higher prices could boost larger-scale consolidation outside the Permian in plays like the Eagle Ford, but it remains early days. That trend could also start moving into the midstream and downstream as companies grapple with long-term uncertainties around energy demand. Dealmaking has been sluggish in recent years, but that should change as companies reposition themselves for an uncertain future post–COVID-19 and potentially take advantage of countercyclical investment opportunities.

4 The energy transition accelerates

Despite the pandemic, the energy transition continues to accelerate, with several companies making high-profile low-carbon target announcements in 2020. As environmental, social, and governance (ESG) investing grows and renewable generation expands, oil and gas companies are expected to face more scrutiny from investors. Divesting higher-carbon assets and acquiring lower-carbon oil and gas, as well as renewables and electrification, will likely play a role in how oil and gas companies can build more resilient portfolios while potentially boosting their return on capital in volatile commodity markets.

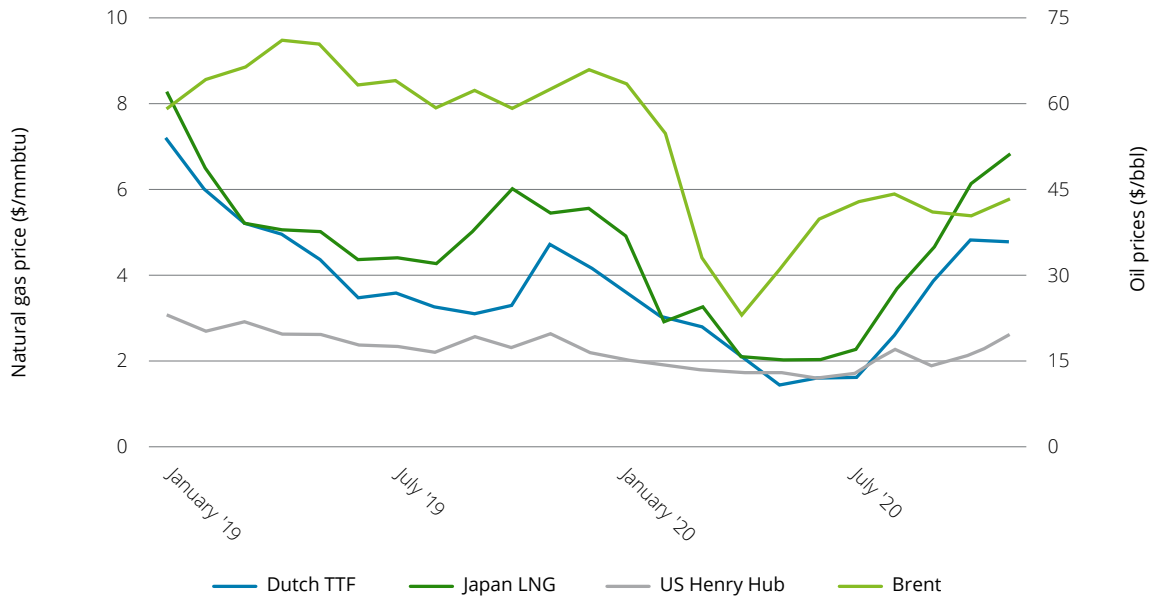
COVID-19 undermined market fundamentals in 2020

Business across several industries faced a challenging 2020 following the spread of COVID-19 and subsequent decline in economic activity. At its second-quarter bottom, US GDP fell almost 10% year on year, and market volatility increased by a factor of four.[1] The oil and gas industry has been one of the hardest hit by the pandemic, with energy industry revenues declining by 54%, primarily because of increased remote work and lower industrial demand for energy and materials, including fossil fuels and petrochemicals.[2] While refiners have borne the brunt of the decline in fuel demand, the impacts of COVID-19 have been felt throughout the sector, with declining production leading to reduced midstream throughput, drilling activity, and oil and gas production. The drop in demand has been compounded by uncertainty in supply caused by ongoing OPEC+ (Organization of the Petroleum Exporting Countries, plus other non-OPEC countries such as Russia) disputes over production levels.

Though market fundamentals have improved rapidly since May lows, the recovery has been uneven. US vehicle miles traveled fell 40% in April before partially rebounding over the summer, but still remain down by more than 10%.[3] However, after plunging close to 80%, the number of commercial flights remains 35% below pre–COVID-19 levels.[4] Considering that gasoline and jet fuel comprise 45% and 5% of US fuel sales respectively, the drop in driving and flying has hit refiners hard.[5] The sharp fall in energy demand, and the subsequent partial recovery, is evident in commodity prices (figure 1).

As Deloitte outlined in its series "Building resilience in oil, gas, and chemicals," refiners and petrochemical producers cut throughput and shifted yields to adjust to changing market conditions and have adapted to the next normal, but the sector is far from being out of the woods. In our 2021 oil and gas industry outlook, we highlighted several challenges facing oil and gas.

Figure 1. Global oil and gas prices fell sharply as COVID-19 spread

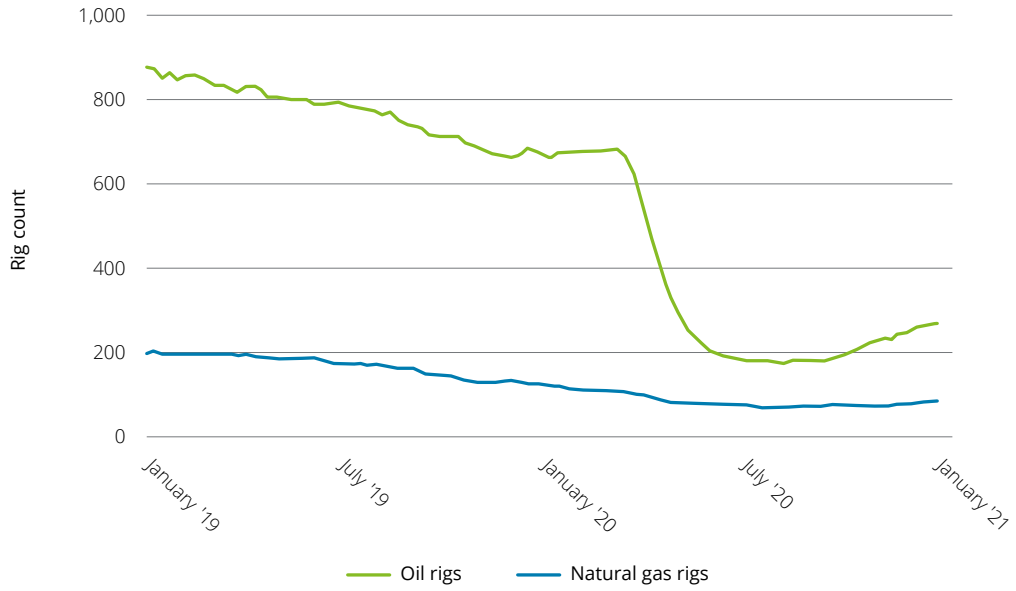


Source: International Monetary Fund commodity price data[6]

US upstream and OFS companies are still reeling from lower oil prices and cut their rig count accordingly as drilling activity has dropped (figure 2). Any rebound in drilling and completions could prove slow at best because of continued low prices and demand, as well as uncertainty from OPEC+, leading to chronic underinvestment in the sector. Lower production will weigh on midstream companies as well, with US production dropping from 13 million b/d to 11 million b/d since March, leading to lower pipeline throughput, lower gathering and processing utilization, and longer-term concerns about overcapacity.

Fuel demand, commodity prices, and therefore oil and gas activity will likely not fully recover until broader economic activity returns to pre–COVID-19 levels. However, based on recent vaccine announcements, we presented in our Q4 US economic forecast that the United States could begin to normalize through 2021 as retail, restaurant, and industrial activity bounces back, though uncertainty remains depending on if there is continued economic relief. Expansive policy support is expected to reduce downside risks in Asia, and increased consumer and business sentiment portends that the Eurozone is preparing for a recovery.[8] Over the course

Figure 2: US oil-focused rigs bore the brunt of the COVID crash



Source: Baker Hughes Rig Count[7]

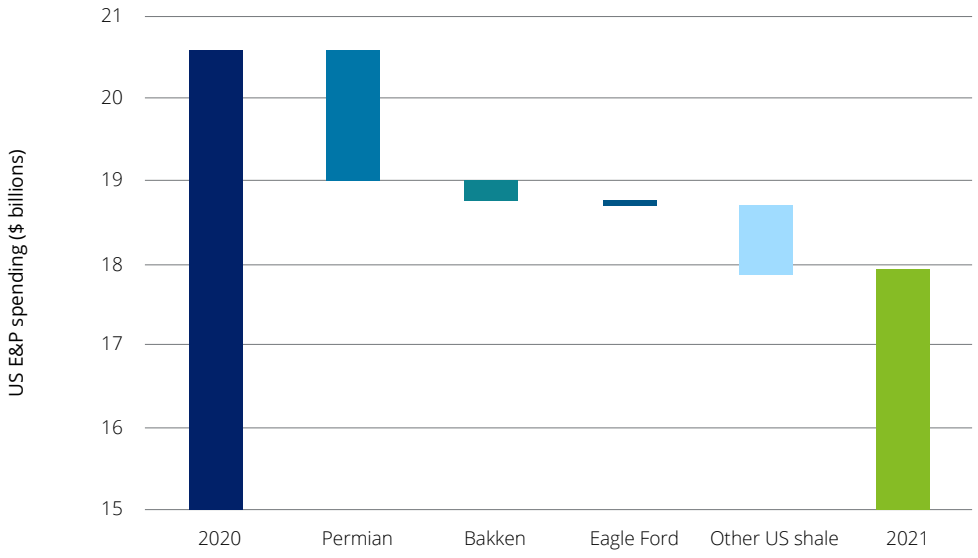
of 2021, oil and gas earnings should rise as companies cut costs and commodity prices stabilize, potentially leading to increased M&A even as capex remains subdued (figure 3).

Energy markets are already feeling the impact of positive economic sentiment following the December 2020 vaccine announcements, with Brent futures closing above $50 in December, a nine-month high.[9] Global oil prices received a second shot in the arm, rising to $55, following OPEC's January announcement that it would keep overall production levels steady, but that Saudi Arabia would voluntarily cut an additional 1 million barrels per day to help stabilize the markets.[10]

Oil and gas dealmaking flatlined in the first half of 2020, but recovered in the second half

Deal count for transactions larger than $10 million across upstream, OFS, midstream, and downstream has fallen since 2016, though overall deal value has held mostly flat due to

Figure 3. Top US E&Ps are expected to cut 2021 shale spending by 13%



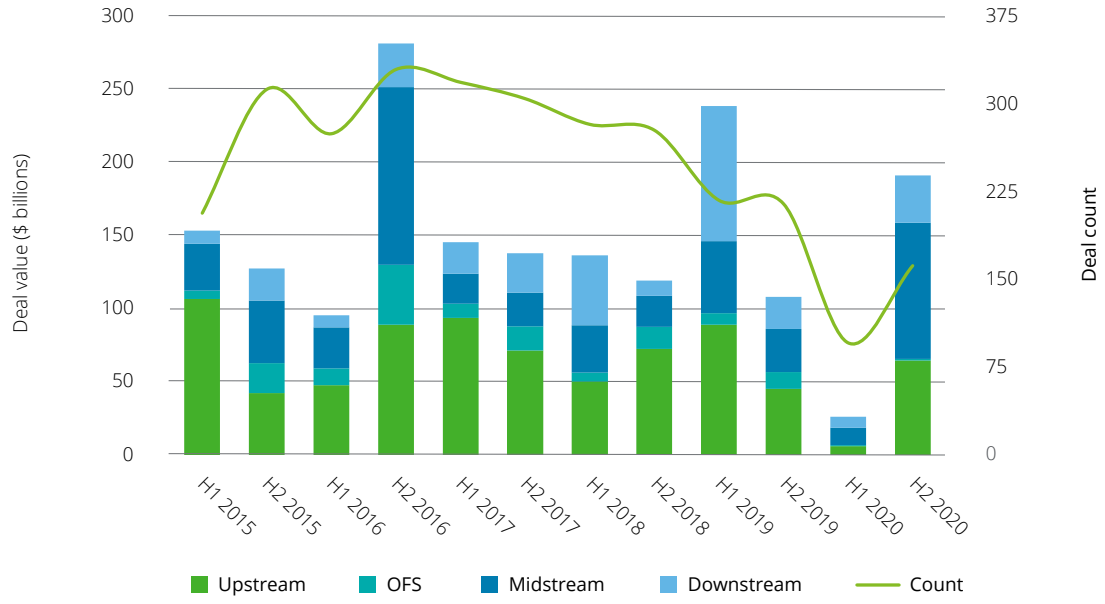
Source: Rystad Energy[11]
Note: Data includes 23 US oil-focused operators accounting for 41% of 2020 US tight oil output.

larger transactions in the second half of 2020 (figure 4). At 258 transactions, 2020 had the lowest number of deals in more than a decade as the M&A market deteriorated in the first half of the year.

Deal count remained flat in the second half of 2020, but value recovered substantially outside of OFS, driven by a handful of large transactions, including PipeChina's $55.5 billion acquisition of Sinopec's and PetroChina's midstream assets, Marathon Petroleum's sale of its Speedway retail business for $21 billion, and several large, all-stock US upstream mergers. Despite the steep decline in US shale activity and the subsequent fall in domestic capital spending, seven out of the 10 largest deals in 2020 were in the United States (figure 5).

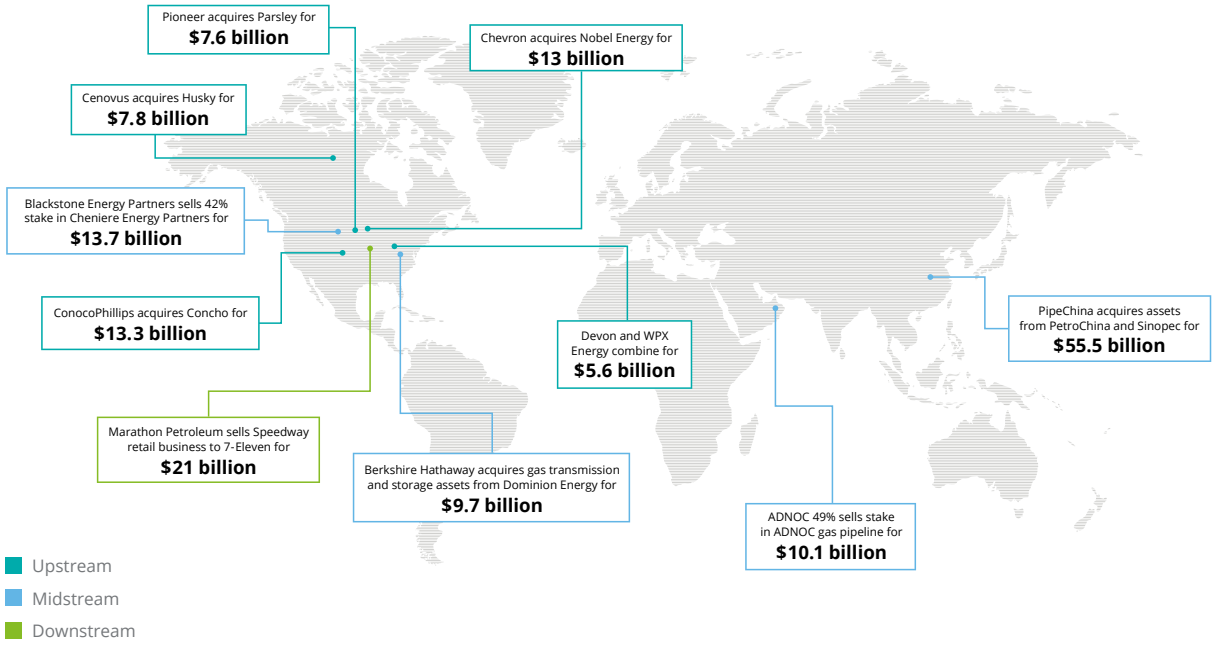
While all segments were affected, OFS value fell most sharply, followed by upstream at 90% and 50%, respectively, with the impacts being felt more acutely in the second quarter as economic interruptions peaked. Midstream deal activity remained the most robust, with several large transactions outside of China involving institutional and nonstrategic oil and gas investors (including Brookfield Infrastructure Partners, Blackstone Infrastructure Partners, and Berkshire Hathaway, among others) continuing to increase their energy exposure as part of their long-term portfolios, even as other investors reduced their oil and gas investments in the face of lower prices. Unlike prior years, there were no signs of major refinery consolidation, but outside of the Speedway sale, several smaller terminal and retail transactions boosted deal value following the first-half bottom, with deal value rebounding from $7 billion to $32 billion as deal flow doubled between the first and second halves of the year.[14]

Figure 4. The global oil and gas M&A market dropped sharply in 2020's first half, but deal value recovered in the second half



Source: Deloitte analysis of Enverus data[12]

Figure 5. Seven of the 10 largest oil and gas M&A transactions in 2020 were in the United States



Source: Deloitte analysis of Enverus data[13]

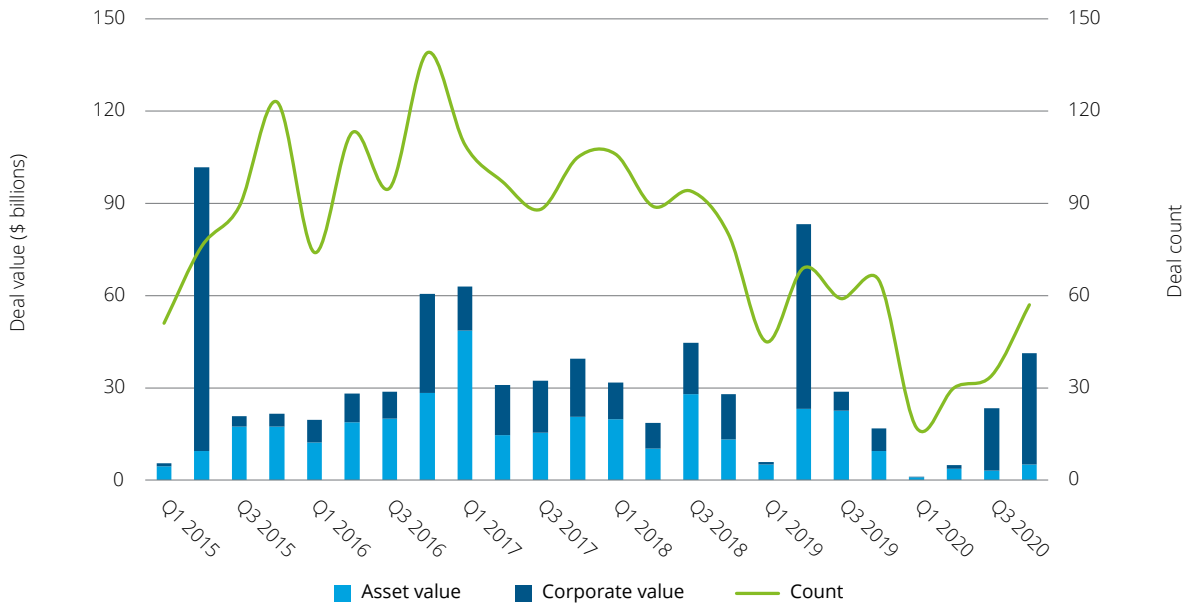
2020 M&A sector by segment

Shale consolidation drove upstream dealmaking rebound

Following an unprecedented low first half of the year, upstream deal value returned to pre–COVID-19 levels even as deal count remained anemic (figure 6). However, unlike previous years, much of the deal value was driven by corporate consolidation, despite the lack of megadeals such as Shell's 2015 BG acquisition for $81.9 billion or Oxy's 2019 Anadarko acquisition for $57 billion. Only two upstream transactions were larger than $10 billion: Chevron's $13 billion acquisition of Noble Energy, announced in July, and ConocoPhillips's $13.3 billion purchase of Concho Resources, announced in October.[15] Both transactions represented a shift in M&A, with a focus on lower-premium, all-stock, corporate consolidations with an eye to the Permian, which remains the single largest region for drilling and M&A activity (figure 7). Other transactions with significant Permian exposure and opportunities for operational synergies included Devon's merger with WPX, Pioneer's acquisition of Parsley, and Diamondback's acquisition of Guidon Energy and QEP. While not Permian-focused, EQT's acquisition of Chevron's Appalachian position represented a push to consolidate Marcellus upstream and midstream assets.[16]

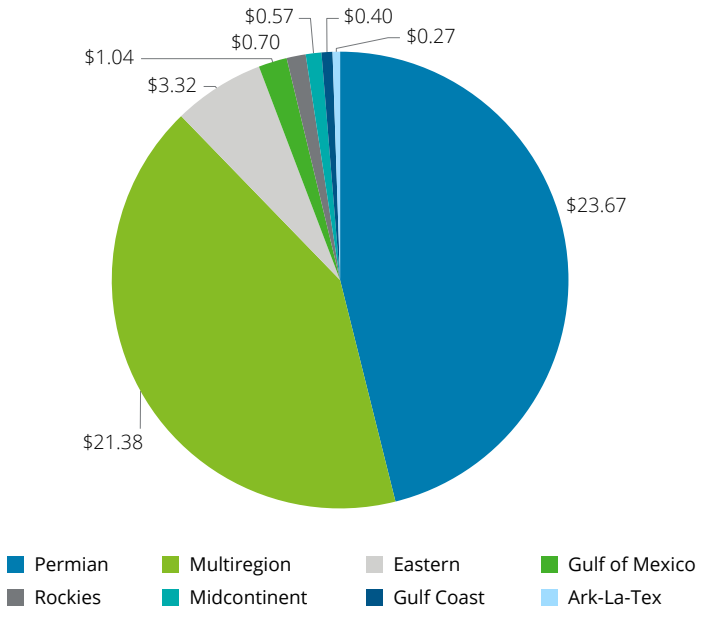
Much like overall deal activity, the United States remained the largest source of upstream dealmaking, representing 53% of deal count and 73% of deal value, followed by Canada at 17% and 15%, respectively.[18] The five largest deals were all in North America, with four being in the United States. The fifth was Cenovus's acquisition of Husky Energy for $7.8 billion in October, a transaction focused on Canadian assets, primarily oil sands. The transaction will also provide Cenovus access to refining assets to reduce its exposure to WCS crude price risks.[19] Going forward, valuation uncertainty will likely impede many potential transactions; however, all-stock and low-premium deals have helped reduce buyer's risks and gotten some deals across the line. All-stock and other similar transactions with a significant equity component provide upside benefits to the sellers while reducing the buyer's call on cash and the need to tap chilly equity and debt markets. As oil prices stabilize and companies exit bankruptcy, we should see all-stock consolidation expand further outside the Permian, including in the Bakken and Eagle Ford in the United States and the Montney and other unconventional plays in Canada.

Figure 6. Global upstream deal count has continued to decline since 2016, but value has proven more resilient



Source: Deloitte analysis of Enverus data[17]

Figure 7. The Permian was the biggest target by value in 2020 US upstream deals



Source: Deloitte analysis of Enverus data[20]

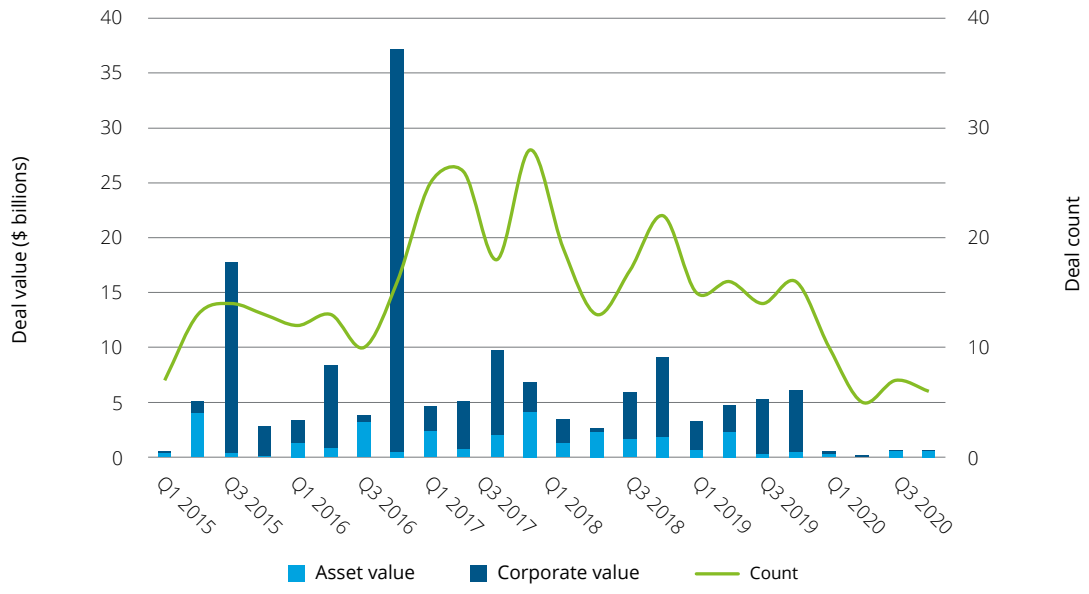
OFS dealmaking collapsed in 2020

Lower upstream spending hit OFS demand directly, particularly for US onshore, where the rig count declined from 800 to 300 in less than three months.[21] There were 71 deals worth $21 billion in 2018 and 61 deals worth $19 billion in 2019, but only 28 deals worth $1.9 billion in 2020—a 50% drop in count and 90% drop in value (figure 8). Only two deals were valued at more than $400 million: Liberty's acquisition of Schlumberger's OneStim US onshore pressure pumping assets for $452 million and Weir's divestment of its oil and gas division for $405 million. 2020 was the first year since 2013 that no OFS transaction exceeded $1 billion, reflecting poor market fundamentals.[22]

The sector continues to face challenges managing an oversupplied, highly competitive market combined with stressed financials. After several high-profile drilling contractor deals in 2018 and 2019, such as Transocean's $3.4 billion acquisition of Songa and Ensco's $4.2 billion merger with Rowan (now called Valaris), appetite for further consolidation has been limited.[24] This is in part because many companies' legacy asset bases may prove difficult to monetize unless equipment is retired across many service lines, including drilling and pressure pumping. Additionally, like upstream, concerns around valuations and financing remain a challenge to dealmaking. Unlike the upstream, however, OFS M&A dealmaking is not expected to accelerate in 2021 because of continued headwinds from lower demand and overcapacity in key markets.

Potential bright spots in 2021 and beyond could include venture capital investments and joint ventures to commercialize untapped or otherwise underutilized technology portfolios. For example, Schlumberger and OMV have teamed up to deploy DELFI AI and digital offerings across OMV's operations to improve efficiencies through digitalization.[25] While these transactions are relatively small in total dollar amounts, they may have the potential for longer-term efficiency gains, boosting both productivity and service revenue as digitalization continues to spread throughout the broader oil and gas industry.

Figure 8. Global OFS deal count and value dropped significantly in 2020, with little indication of improvement



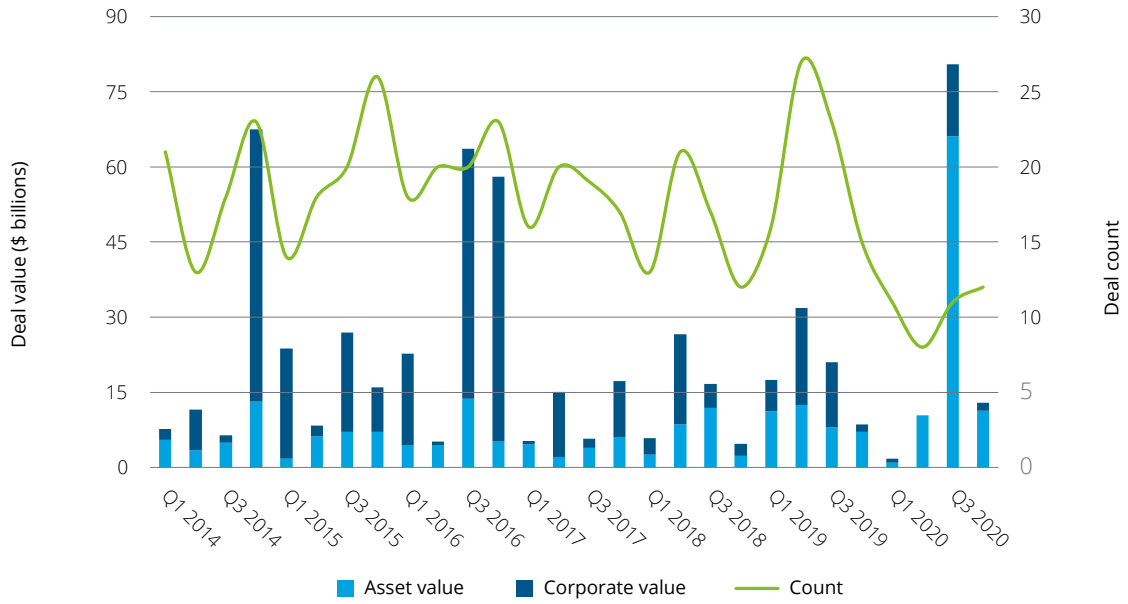
Source: Deloitte analysis of Enverus data[23]

Megadeals continue to drive midstream transactions

Like other segments, midstream deals declined in 2020. However, like in 2014 and 2016, megadeals valued at more than $10 billion drove deal value upward (figure 9). There were nine midstream transactions larger than $1 billion and three larger than $10 billion in 2020. At $55.5 billion, PipeChina's acquisition of Sinopec's and PetroChina's midstream assets was both the largest deal in the segment, as well as across the entire oil and gas sector, in 2020. Six of the nine largest deals involved institutional and non-oil and gas buyers and focused primarily on gas and liquefied natural gas (LNG). Berkshire Hathaway acquired gas transmission and storage assets from Dominion Energy in July, including its LNG portfolio, for $9.7 billion. Also in LNG, Blackstone Energy Partners sold 42% stake in Cheniere Energy Partners to Brookfield Infrastructure and Blackstone Infrastructure Partners for $13.7 billion in August, and Shell sold a 26.25% interest in Queensland Curtis LNG common facilities to Global Infrastructure Partners for $2.5 billion in December. ADNOC sold interest in its gas infrastructure in June and October to different buyers, including GIP, GIC, Brookfield, and the Abu Dhabi Pension Fund for $10.1 and $2.1 billion, respectively. Lastly, Allianz Capital Partners acquired 75% stake in Galp Gás Natural Distribuição for $1.1 billion, including both equity and debt, in October.[26]

The pullback in drilling activity and lower commodity prices reduced interest in gathering and process assets, with the number of those deals declining from 23 to eight year on year.[28] However, despite low prices, long-distance pipeline and other long-lived assets should continue to attract institutional investors, both in the United States and internationally, because of their more predictable long-term cash flows. One challenge to further investment will likely be the energy transition, as investors look to reduce the risk of stranded assets and shore up their ESG credentials. However, even with reduced demand growth for traditional fossil fuels, midstream assets may have substantial value for alternative uses, including transporting biofuels, carbon dioxide, and hydrogen in a lower-carbon economy.

Figure 9. Despite a slow year, megadeals drove up global midstream deal value in 2020



Source: Deloitte analysis of Enverus data[27]

A single deal drove 50% of downstream deal value in 2020

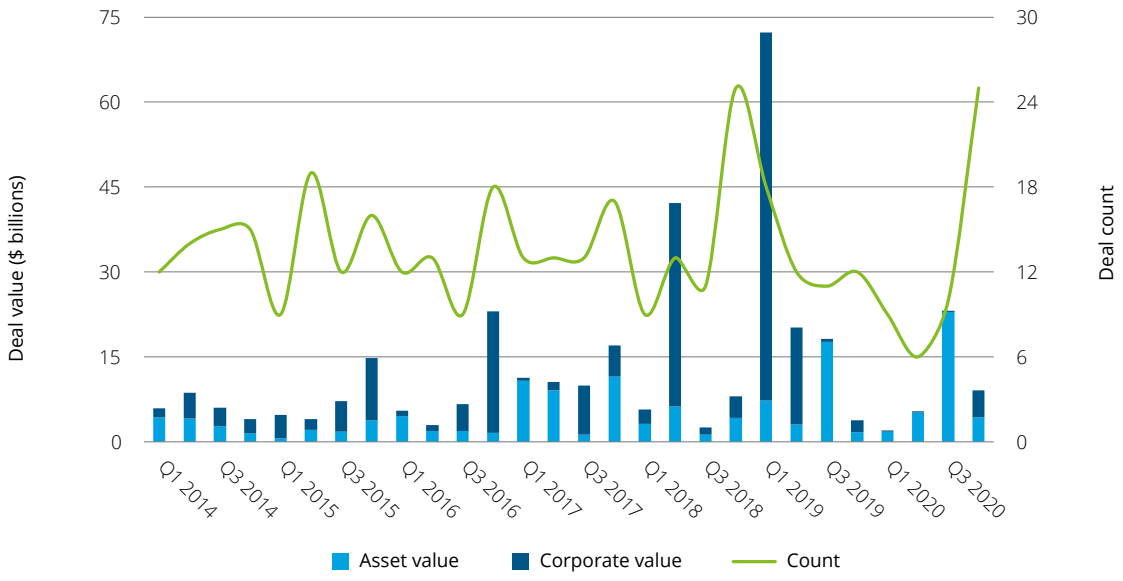
Compared with other segments, downstream saw less of a drop in deal value and volume, despite the turmoil in the fuel markets and the rapid shifts in refinery utilization and yields in the face of COVID-19 (figure 10). Perhaps unsurprisingly, out of the top five largest transactions, two primarily involved retail business, with the other three involving terminals and storage assets—and none targeted refineries.

The lack of large refining deals reflects a natural slowdown after several years of large-scale consolidation, as well as near-term market volatility and longer-term energy transition concerns. The International Energy Agency projects that 1.7 million barrels of refining capacity will be retired in 2020 and 2021.[29] US refining earnings could fall by 20% over the next decade if lower throughput is not offset by lower costs, driven by reduced utilization in the near term by lower demand because of COVID-19 and in the long term by tighter fuel efficiency standards, electric vehicles, and export market competition.[30] In fact, refineries that may have otherwise been marketed have been converted to renewable fuels production or shut down due to poor market conditions. While the majors and larger national oil companies have invested heavily in petrochemical integration in the past, fewer large-scale petrochemical deals were seen in 2020 compared with 2019, reflecting the impact of COVID-19 on economic uncertainty in Middle Eastern and Asian markets.

Stress in the refining business could lead many downstream operators to invest more toward distribution and retail in a push to capture higher margins and increase market share. For example, some of the majors who had historically downplayed the space are now considering their retail footprint as a competitive advantage in a more customer-centric, digitally connected, and lower-carbon world. We expect that retail M&A could increase in 2021 and beyond as market participants work to develop business models that have a brighter future over the energy transition.

Roughly 40% of downstream transactions were in the United States in 2020, led by Marathon Petroleum's $21 billion sale of its Speedway retail business to 7-Eleven in August. This stands in stark contrast to 2019, where three Middle East deals totaled $71 billion alone, more than the entire value of 2020 downstream deals.[32] That was driven in part by both increased refining and petrochemical integration, which has taken a backseat in the face of COVID-19, and the push to increase capacity in refineries well-suited to target Asian export markets. As the global economy recovers from the pandemic, we should see a shift back to large-scale M&A in the Middle East and Asia-Pacific regions, including in refineries and retail, that we expect to pick up more broadly.

Figure 10. 2020 global downstream transactions rebounded in the second half



Source: Deloitte analysis of Enverus data[31]

Four trends for 2021: 2020 has set the stage for a nascent recovery

COVID-19 drove 2020 dealmaking down, with upstream consolidation delayed, the majors' and other large producers' divestment plans deferred, and investment in international downstream stalled. However, the energy transition has continued at pace, if not accelerated, during the pandemic, and private equity continues to rethink how it approaches investing in oil and gas, with limited exit opportunities reducing the sector's attractiveness. If anything, continued investment in lower-carbon energy assets will likely continue, but we could see an uptick in activity across oil and gas as well. In the case of upstream and midstream M&A, the second half of 2020 was a period of recovery. The other segments will likely recover in 2021 as the economy returns to growth. Four trends could drive deal activity throughout the year: *industry reset, new capital needed, consolidation continues, and the energy transition is accelerating*.

1. Industry reset

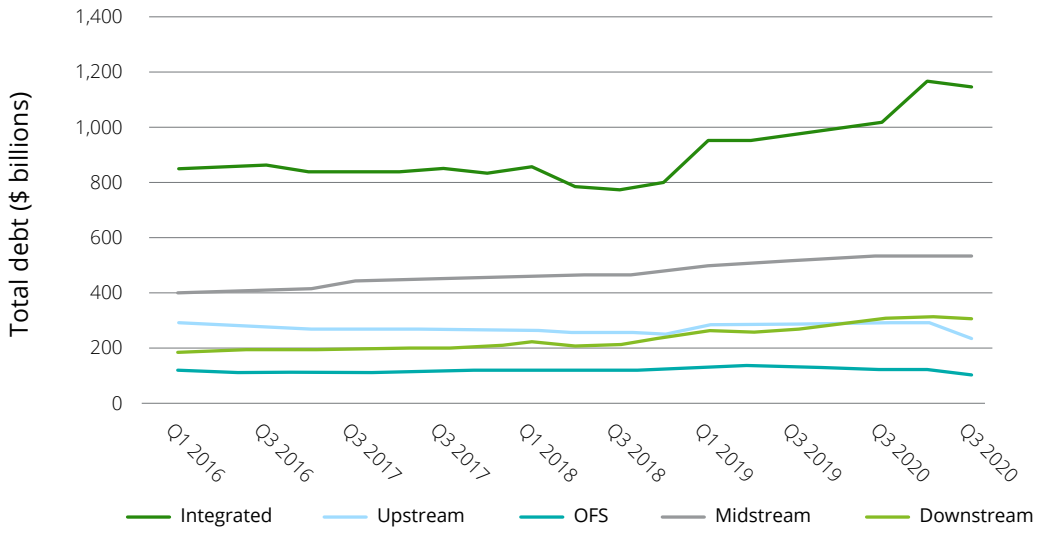
Following a rough five years after the 2014 oil price crash, the industry has strived to become leaner and more efficient. Despite those efforts, COVID-19 hit an already stressed industry, and most companies should rethink how they approach M&A. More than 100 upstream and OFS companies have entered bankruptcy in 2020, and impairments have risen across the sector.[33] Restructuring will likely slow in 2021, but the number of bankruptcies is expected to remain elevated as debt becomes due and financing remains a challenge for the industry with current price levels putting downward pressure on the economics for many producers. While only five US midstream companies entered bankruptcy in 2020, both midstream and downstream operators face significant financial stress with weakened balance sheets postpandemic.[34] Furthermore, as upstream companies restructure, they will likely try to terminate some of their gathering, processing, and pipeline contracts, creating counterparty risk for pipeline operators and disrupting deliveries to refineries.[35]

While 2021 should be a period of recovery for the sector, debt levels have risen for multiple segments since 2015, most notably for integrated, midstream, and downstream companies (figure 12). Brent prices are well above their sub-$20/bbl April 2020 lows; however, they are expected to remain range-bound, with futures trading near $50/bbl over the next few years.[36] Many companies may need to deleverage, putting downward pressure on the M&A market. The lack of financially strong buyers could delay large-scale divestures by the majors and large upstream producers. Similarly, higher debt levels may limit the attractiveness of further consolidation in midstream and downstream. However, as companies finalize impairments, bankruptcies reduce liabilities, and debt is restructured or discharged, the drag on M&A should lessen, and dealmaking could return to pre-2020 levels in 2021, with financially more secure companies catalyzing significant increases in dealmaking in the 2020s.

2. New capital needed

The industry continues to face a capital crunch, with limited new investment from outside the sector. In 2018 and 2019, the capital markets dried up, with many oil and gas companies focusing on spending within their cash flows—and as investors focused on higher returns, often found in other sectors. 2020 continued the trend of lower investment, except for debt issuance, which reached a five-year high in the second quarter following the spread of COVID-19 (figure 13). Over the past five years, initial public offerings (IPOs), follow-on equity issuances, venture capital, private equity, and private investment in public equity (PIPE) have dropped almost to zero. Growing investor interest in renewable and "green" sectors could further compound the sector's difficulties in tapping traditional sources of capital.

Figure 11. Debt has continued to rise across the sector globally

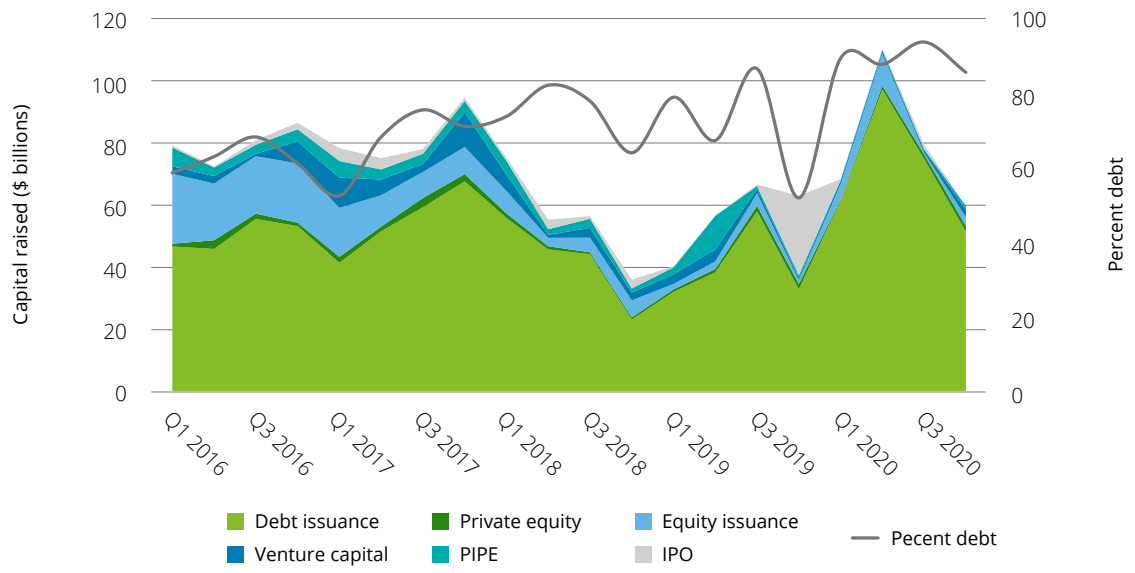


Source: Deloitte analysis of S&P Market Intelligence data and analytics[37]
Note: Data includes quarterly reported total debt for global oil and gas sector for companies with market capitalization exceeding $50 million as of December 31, 2019.

For the sector to attract external investors, oil and gas companies will likely need to boost returns in line with other sectors. The challenge may be more acute for private equity investors who experienced the 2014–2016 oil price crash. However, since mid-2019, all segments except midstream have underperformed the power and utilities sector, with OFS underperforming since the prior oil price crash (figure 13). Since mid-2014, US oil and gas stocks fell 60%, while the S&P rose 80%.[39] Oil and gas companies now constitute only 2% of the S&P 500, compared with more than 15% only a decade ago.[40] Unsurprisingly for many investors, oil and gas has proven volatile while not outperforming less risky sectors. While some may have higher risk tolerance, particularly private equity and venture capital, the lower returns combined with limited exits will likely continue to limit investor interest. More reliable sources of capital will likely return in the long term once companies restructure, commodity prices improve, and returns stabilize, but that could prove a multiyear process, starting with companies focusing more on their balance sheets rather than their drilling inventories.

In the short term, more creative strategies can boost returns, even in strained market conditions. For example, privately held Chrysaor's 2020 acquisition of publicly traded Premier Oil allowed it to go public through a reverse merger, echoing a similar transaction between Talos and Stone Energy announced in 2017.[41] That allowed Chrysaor's private backers an opportunity to exit without facing the frozen IPO market.

Figure 12. The global oil and gas sector continues to rely on debt



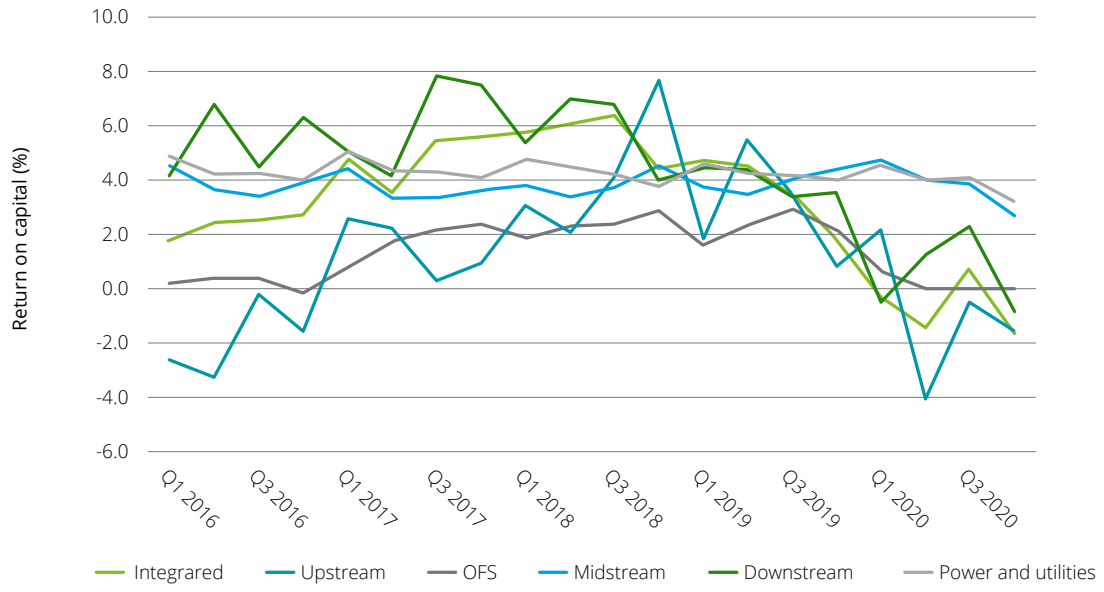
Source: Deloitte analysis of S&P Market Intelligence data and analytics[38]

Similarly, special-purpose acquisition companies (SPACs) could provide more permanent capital into the sector. However, SPAC opportunities may be few and far between for the sector because many more recently formed energy SPACs are eyeing clean energy rather than oil and gas deals.[42] Other structures, such as DrillCos, have helped finance growth in the past and could be more widely used as an alternative to corporate debt. More creative uses of financing combined with M&A could provide one avenue for outside investors to tap into the industry while mitigating downside risks. If commodity prices stabilize, a more resilient oil and gas sector could attract new capital, albeit in different forms and potentially with more strings attached.

3. Consolidation continues

Upstream deal value in 2020 was driven by US shale consolidation, with several all-stock, low-premium transactions. Deal premiums for US corporate upstream transactions have halved since 2014 (figure 14). The lower premiums have helped mitigate the wider bid-ask spread due to price volatility and uncertainty, but some sellers have balked at the lower valuations—something buyers have partially offset by offering stock rather than cash, which can preserve upside to the sellers. The all-stock deals also

Figure 13. Commodity price volatility has reduced the sector's return on capital globally

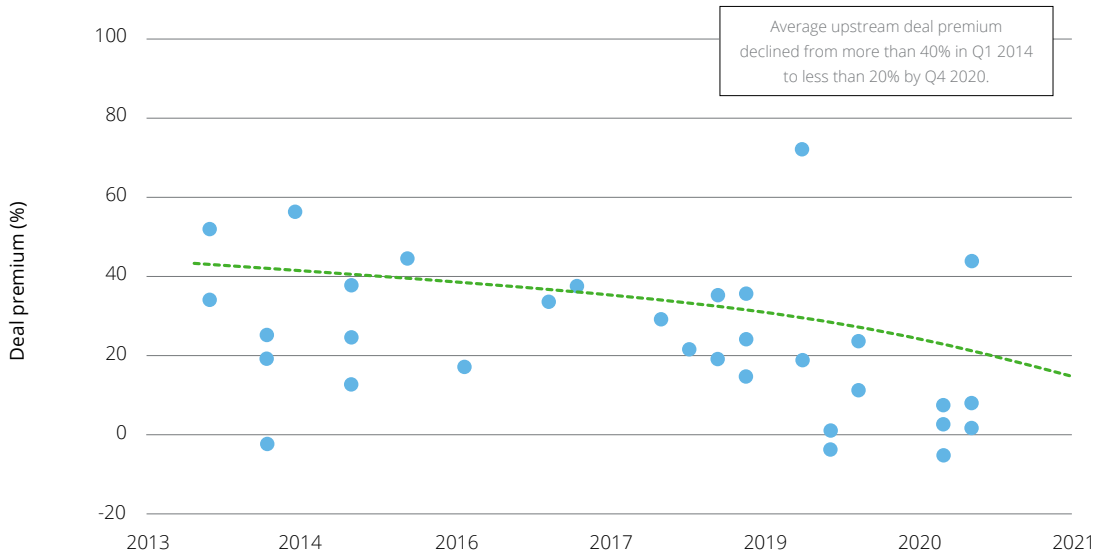


Source: Deloitte analysis of S&P Market Intelligence data and analytics[43]

have the benefits of reducing the cash call on buyers who are capital-constrained. The trend has been particularly beneficial to those with stronger share prices, offering an opportunity to consolidate a fractured industry at attractive prices. Upstream consolidation will likely spread outside of the Permian if oil prices remain north of $50. While most of the larger upstream deals in 2020 focused on players with Permian positions, other plays, like the Eagle Ford and Haynesville, continue to be fragmented, making them potentially ripe for renewed dealmaking in 2021.

While the lower-premium, all-stock transactions have occurred mainly in upstream, their rationale applies to other segments as well. For example, both midstream and downstream are facing lower demand in the near term, with substantial longer-term uncertainties. Consolidation could increase market power, provide economies of scale, lead to synergistic cost reductions, and increase competitiveness. Over the past few years, there have been large-scale mergers in the pipeline and refining business, but fewer deals targeted gathering and processing, storage, and exports. In 2021, we could see the lower-premium, high-stock trend expand beyond its upstream roots, driving consolidation across the entire sector. Appetite for lower-premium, high-stock deals could subside if oil prices rise sustainably.

Figure 14. US upstream deal premiums have declined substantially in 2020



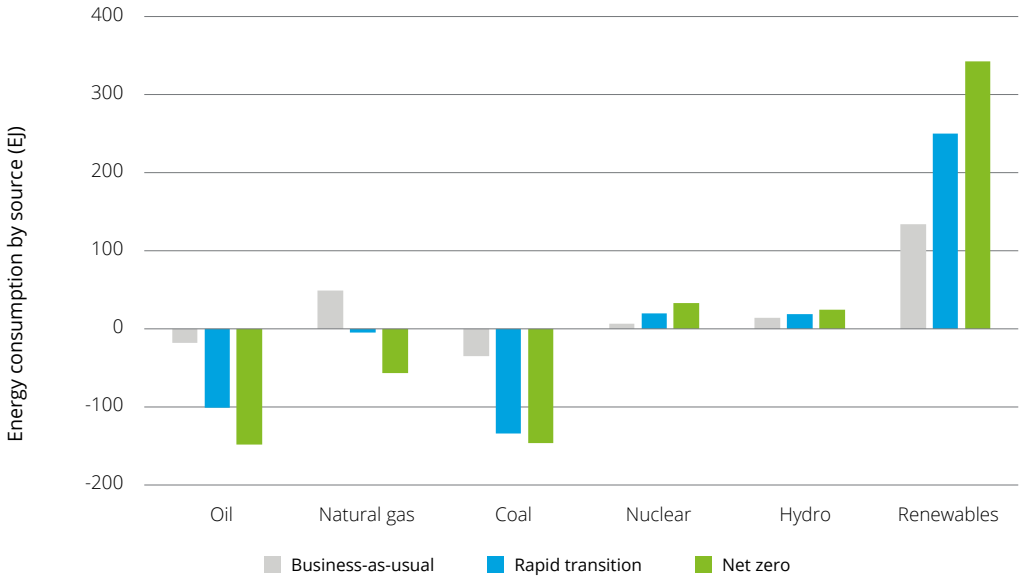
Source: Deloitte analysis of Enverus data[44]
Note: Deal premiums are based on transaction amount and company enterprise value prior to deal announcement.

4. The energy transition is accelerating

Oil and gas management teams and their investors have seen their return on capital decline, even as ESG scrutiny has increased. Many of the largest oil and gas companies have shifted their strategy to respond to changing market conditions. Since the end of 2019, more than five oil and gas companies have targeted net-zero carbon emissions by 2050 on at least a Scope 1 and 2 basis,* with some targeting more ambitious Scope 3 emissions targets. That number will almost surely increase, as the demand for renewable energy is expected to grow by up to a factor of 10 by 2050 globally, with demand for fossil fuels decling over the same period (figure 15). The shift has implications beyond greenfield investment; it also has a bearing on M&A strategy because renewable dealmaking is expected to rise in 2021.[45]

In our 2020 oil and gas M&A outlook, we highlighted the increase in oil and gas spending on power and renewables, and the subsequent move by some of the majors to divest higher-carbon oil and gas assets. Following the spread of COVID-19, divestments have slowed as the number of buyers dwindled, though with some large exceptions. For example, bp sold its global petrochemicals business to INEOS for $5 billion in June, a deal that sidestepped lower valuations challenging upstream transactions.[47] That could free up capital to invest in renewables and net-negative carbon technologies, as well as to fund other oil and gas projects and M&A opportunities. Other large oil and gas companies will likely pursue a similar strategy of rebalancing their portfolio through strategic divestitures of oil and gas assets and reinvestment in low-carbon opportunities outside the sector.

Figure 15. Global renewable energy consumption will likely grow rapidly through 2050



Source: bp Energy Outlook 2020[46]
Note: Chart illustrates potential change of energy consumption by source between 2018 baseline and 2050 across three scenarios.

**Scope 1 emissions refers to direct emissions from operations. Scope 2 emissions include indirect emissions from purchased energy. Scope 3 emissions cover all indirect emissions including those in the value chain such as customer emissions from consuming fossil fuels.*

It is not just divestitures, with several upstream acquisitions in part driven by lower-carbon assets. For example, ConocoPhillips highlighted the low carbon-intensity of its Permian portfolio following its October acquisition of Concho Resources.[48] That is not just a one-off. Looking at the four largest upstream deals in the Permian in 2020, all of them involved buyers with lower flaring intensity than the sellers.[49] By leveraging best practices and increased access to infrastructure, buyers can lower flaring to boost their ESG credentials and monetize the produced natural gas.

To date, much of the lower-carbon M&A has focused on upstream, but we expect it to spill over into midstream and downstream. One way to cut flaring is by increasing access to gas processing and takeaway capacity, indicative of potential for deals targeting midstream infrastructure. On the downstream side, a few refineries have been shuttered and others converted to renewable fuels like biodiesel. As alternative fuel production capacity increases, this should open a new avenue for dealmaking in the early 2020s.

Toward a brighter future

Oil and gas M&A collapsed in the first half of 2020 as COVID-19 spread, but recovered across most segments in the second half as energy prices stabilized. However, lower spending and rig counts in 2021 could drag on deal activity, as the industry seems hesitant to invest in the face of uncertainty. That was apparent in 2020 deal flow, with count remaining down even as value recovered. Additionally, even though shale spending dropped dramatically over the course of the year, the United States remained the largest source for deals. That could open opportunities for countercyclical investment by those with stronger balance sheets, spurring further dealmaking.

Four trends will likely shape 2021 transactions, with companies focusing on resetting the industry, finding new sources of capital, driving consolidation, and accelerating the energy transition. Despite the challenges the oil and gas industry faced in 2020, 2021 could be a period of growth followed by transformation as companies push to boost margins, cut emissions, and prepare for the energy transition. Strategic mergers, acquisitions, and divestitures can play a key role in building organizational resilience and leveraging core capabilities to increase performance through the commodity price cycle and as the energy landscape evolves.

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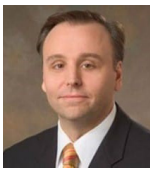

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