U.S. Oil & Gas Industry M&A Trends 2023/24

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

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This article discusses trends in oil and gas industry M&A transactions in 2023 and the forecast for 2024, including market activity; specific sector activity in the upstream, oil field services, midstream, and downstream sectors; and transactional considerations.

Market Activity

2023 was eventful for the domestic oil and gas industry. The year was shaped by rapidly-changing geopolitical conditions, economic variables such as higher interest rates and increased material costs, new policies and regulations, and the ever-growing emergence of new technologies. According to KPMG, the current theses for oil and gas M&A deals now look to be centered around scaling up and optimizing assets, entering growing markets, and reducing general and administrative costs. According to analysis from Envernus, already in first quarter of 2024, there has been $55 billion worth of merger deals announced in the oil and gas E&P sector, while in all of 2023 there was approximately $190 billion worth of merger and acquisitions announced.

Oil and gas producers have been required by investors to become more disciplined in the management of their cash flows. Accordingly, an emphasis on returning surplus cash flow to investors through dividends and share buybacks as well as slowing additional drilling was prevalent in 2023. Instead of engaging in increased E&P activity, consolidation appears to be the continuing *raision d'etre* for deal activity in 2023/2024.

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

From 2009 to 2014, deal-making relied on stable oil prices between $70 and $80 per barrel. In 2015, oil prices fluctuated wildly, leading to uncertainty in deal making. Oil prices then stabilized, ranging between $42 and $52 per barrel beginning in June 2016, and that stability led to a moderate increase in oil and gas acquisitions and dispositions. 2017 brought similar stability at a range between $50 and $60 per barrel but deal value and deal count took a small dive, with experts citing lasting effects of caution arising out of the "lower for longer" business environment of the past several years. Oil prices reached a four-year high by October 2018 before plunging and leading to such a dismal level of activity in 2019. With the onset of the pandemic in 2020, demand plummeted and prices fell accordingly. As mentioned earlier, for a brief moment in time in April 2020, crude oil prices were negative, meaning producers were paying customers to purchase and store their produced oil. Natural gas producers also suffered in tandem with oil producers but the depression in the A&D market for U.S. gas companies has been longer-lived as the U.S. continues to enjoy a surplus of natural gas production volumes. Further, increased government scrutiny from the Biden administration has slowed the construction of much-needed pipelines to get produced natural gas from the wellhead to key domestic consumption markets and export terminals. As the country got vaccinated in 2021 and learned to live with COVID-19, demand for oil and gas began to rise again as did domestic oil production. In 2022, as a result of the Ukraine war and other economic factors (such as inflation) oil prices spiked reaching highs of $122.27 per barrel in June of that year. More recently, OPEC+'s output cuts of approximately 2.5 million barrels per day (mbpd) resulted in Brent oil prices rising to above $90/bbl and, in November of 2023, U.S. Henry Hub natural gas prices rose to $3.50/mmBtu.

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

Recent Trends

The oil and gas industry, like many industries around the globe, continues to be affected by higher interest rates, increased material costs, and new policies and regulations. As a result, the 2023 trend toward consolidation continues into 2024. As interest rates surged and labor and materials costs spiked due to inflationary pressures, many smaller independent oil and gas companies found it tougher to keep cash flow around the levels seen in early 2020/2021 when interest rates were much lower, causing stress on their balance sheets burdened with rising general and administrative expenses.

As a result, larger, better-capitalized producers have taken the opportunity to acquire reserves from smaller competitors who can no longer afford to support their overhead burdens. More specifically, companies are focusing on "capital discipline," which according to Business Insider refers to producers focusing less on output volume and more on achieving "bang for the buck." Accordingly, producers are reducing the number of rigs that they are running. This is a conscious effort to reduce marginal return type wells that, in a lower interest rate environment, might have been profitable to produce but don't meet the return expectations of the capital markets. An example is the recently announced sale of Endeavor Energy Resources to Diamondback Energy for approximately $26 billion. According to Business Insider, Endeavor has added "100,000 to 200,000 barrels of oil a day to oil output on average since 2019." Diamondback, which has followed the "capital discipline" being required by the capital markets, provided a letter to its shareholders stating that it plans to keep 2023 fourth-quarter oil production flat, with less capital than last year, with an emphasis on their "commitment to capital efficiency and value over volumes."

Another example of a recent consolidation transaction is the purchase of Pioneer by ExxonMobil for approximately $59.5 billion, Exxon's largest buyout since acquiring Mobil over two decades ago. This move provides ExxonMobil access to a major portion of the U.S. oil production reserves in the Permian Basin, which straddles the border between Texas and New Mexico and provides ExxonMobil with the ability to combine its current 570,000 net mineral acreage in the Delaware and Midland Basins with Pioneer's 850,000 net mineral acreage in the Midland Basin. Pioneer's CEO Scott Sheffield stated that, "the combination of ExxonMobil and Pioneer creates a diversified energy company with the largest footprint of high-return wells in the Permian Basin."

Similar to the ExxonMobil and Pioneer deal, APA Corporation (the parent of Apache Corporation) has recently announced its planned acquisition of Callon Petroleum Company. The main purpose for the transaction is to increase APA Corporation's production footprint in the Permian Basin. Most notably, Callon has approximately 120,000 net mineral acres in the Delaware Basin, which, according to the CEO of APA, will help to round out APA's production opportunities in both the Permian and Delaware Basins. This transaction is a further example of larger, public oil and gas companies engaging in consolidation transactions.

Overall, as the oil and gas industry heads into 2024, the M&A deal volume may not reach the levels seen in 2020–2022, but the industry as a whole should see an uptick from 2023 due to large public companies having expendable cash coupled with the overall trend of consolidation.

Industry-Specific Transactional Considerations

Deal Structure

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

Due Diligence

The cost of production is the first and foremost due diligence issue in oil and gas M&A. A low oil price environment demands an accurate cost of production picture. Due diligence must therefore be precise and complete. Even with oil prices beginning to rise towards the end of 2023, the capital markets are insisting that producers remain disciplined in their A&D activity and be cognizant of ESG issues. Engaging reputable industry consultants who are independent and not incentivized to close helps dealmakers gain a more accurate rendering of the cost of production. Additionally, due diligence concerning title issues, environmental liabilities, third-party processing and transportation agreements, and storage facilities continue to be necessary when conducting oil and gas due diligence.

Regulatory Requirements

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

Merger Enforcement Actions

Oil and gasoline are commodities that are regulated by the Federal Trade Commission (FTC), which aims to ensure that the market remains competitive by protecting all customers against anticompetitive conduct and unfair or deceptive practices. This process includes reviewing oil and gas mergers and acquisitions, all business conducted of oil and gas companies for antitrust violations, researching key issued affecting oil and gas competition, and monitoring pricing on markets in the United States.

A recent example of FTC action occurred in late 2023 in relation to the $5.3 billion cash-and-stock deal between Quantum Energy Partners and EQT Corporation (direct competitors in the Appalachian Basin). Here, the FTC approved a consent order that prevented the entanglements between the two companies and the exchange of confidential, competitively sensitive information. The proposed acquisition would make Quantum one of EQT's largest shareholders, and give Quantum a seat on EQT's board. These factors, along with the fact that Quantum was already an active investor in the natural gas production in the Appalachian Basin, led to a violation in antitrust laws by harming the competition in the industry.

The FTC's consent order gave way to structural relief that prohibited Quantum from occupying an EQT board seat, required Quantum to divest EQT shares, prevented anticompetitive information exchange, unwound a separate anticompetitive joint venture between the two entities, and imposed other additional restraints to protect competition. The FTC stated that "[a]s originally structured, this deal would have resulted in an illegal interlocking directorate, facilitated the exchange of confidential and competitively sensitive information, and otherwise stifled competition in the Appalachian Basin. The Commission's order provides innovative and comprehensive relief to protect competition, as well as the millions of Americans who rely on Appalachian Basin natural gas to heat and power their homes."

The ground-breaking FTC actions on Quantum Energy Partners and EQT Corporation deal are evidence that the FTC is acting upon deals that include anticompetitive provisions, and that when putting these deals together, it is crucial to have proper antitrust counsel review and advise on the transaction.

Recent Transactions

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

Seller / Buyer	Transaction Value	Date of Agreement
Endeavor Energy Resources / Diamondback Energy, Inc.	$26 billion	February 12, 2024
Pioneer Natural Resources Company / Exxon Mobil Corporation	$59.5 billion	October 11, 2023
Hess Corporation / Chevron Corporation	$53 billion	October 23, 2023
Magellan Midstream Partners, L.P. / ONEOK, Inc.	$12 billion	December 13, 2023
Callon Petroleum Co. / APA Corporation	$4.5 billion	January 3, 2024

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

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

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

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

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