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Client Alert Commentary

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Trends Influencing Oil & Gas Mergers and Acquisitions

While oil and gas M&A activity declined slightly in 2013, the industry seems poised to reward players who understand the market's signals.

M&A activity in 2013 reveals some interesting trends driving the market. With favorable oil prices and market liquidity, independents, large-caps and state-owned oil companies have been very active. Specific deal structures are gaining popularity and shareholder activism can present both perils and promise.

Upward Trends

- **Oil Prices**: General agreement on that the oil price outlook favors oil weighted mergers and acquisitions.
- **Available Capital**: Availability capital and a favorable corporate finance market favor deal flow.
- **Independents**: Larger cap independent energy companies looking to grow positions or for transformational deals to kick start a company can quickly accomplish their goals through corporate acquisitions.
- **Shareholder Activism**: Presenting both upsides and downsides, shareholder activism in the upstream segment continues to influence M&A activity through divestitures, MLP creation and spin-offs.
- **Consolidations**: As larger companies can provide the structure and balance sheets to more easily sustain and fund growth, consolidation is likely to continue.
- **Oil Acquisitions**: Gas-weighted producers continue to show interest in balancing their portfolios by acquiring oil assets.
- **Favorable** Targets: Smaller independent producers, many active in favored basins and "pure plays," will be targets for consolidators and positioning activity.
- **Innovative Structures**: Structures favorable for larger deals — some permitting MLP acquisitions of C-corps — may continue to spur more activity.
- **State-owned Oil Companies**: Outside the US, especially in Asia and the Caspian Sea regions, state-owned oil companies continue to be active, driving half of the 10 largest deals in 2013.
- **Strong Valuations**: In the near term, investors will likely focus on offshore and continental onshore oil and gas transactions because of favorable valuations.

Downward Trends

Just as every coin has two sides, the following trends will continue to place downward pressure on oil and gas deals.

- **Gas Unattractive**: Gas-weighted companies likely will not materially drive M&A transactions. These independent companies typically focus on a single horizon and have shown little interest in adding further gas assets.
- **Independents Choosing Organic**: Near term, many independents — logical buyers who already enjoy significant opportunities — have settled in on organic growth that is consuming free cash flow. Most appear cautious about adding more inventory at this point.
- **Major Reluctance**: The major oil companies — typically not first movers — have been slow to enter the oil weighted resource plays and have yet to come to terms with valuations required for late entry. Likely they will be more active in the longer term.
- **Shortcut to IPOs**: Larger PE backed companies — typically targeted for acquisition — may avoid growth through mergers or acquisitions and head directly into the public markets through IPOs.
- **Stifling Activism**: Shareholder activism has made many C-suites wary of potential opposition to deals. Many companies targeted by activist shareholders have been aggressive in divestiture related repositioning efforts.
- **Premiums at a Premium**: Current valuations for many target companies in favored plays make it difficult to pay expected take out premiums.

For additional detail on how to successfully structure oil and gas transactions as well as recent legal developments, please view Latham's webcast ***Year in Review: 2013 Energy M&A***, available on demand.

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