



Oil and gas slowdown

What it means for M&A

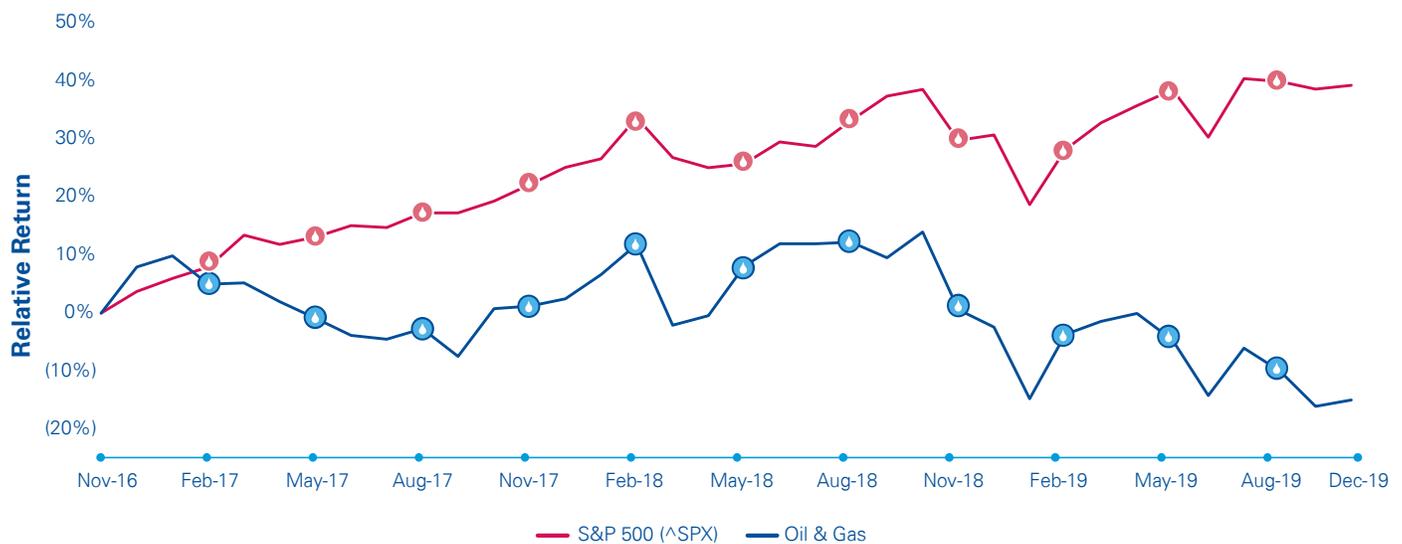




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"Okay, Houston, we've had a problem here."¹

Oil and gas has quickly become the out-of-favor sector of our economy. An underperforming capital market along with a halting M&A environment has meant stakeholders are facing challenging times as major sector peers continue to prosper.



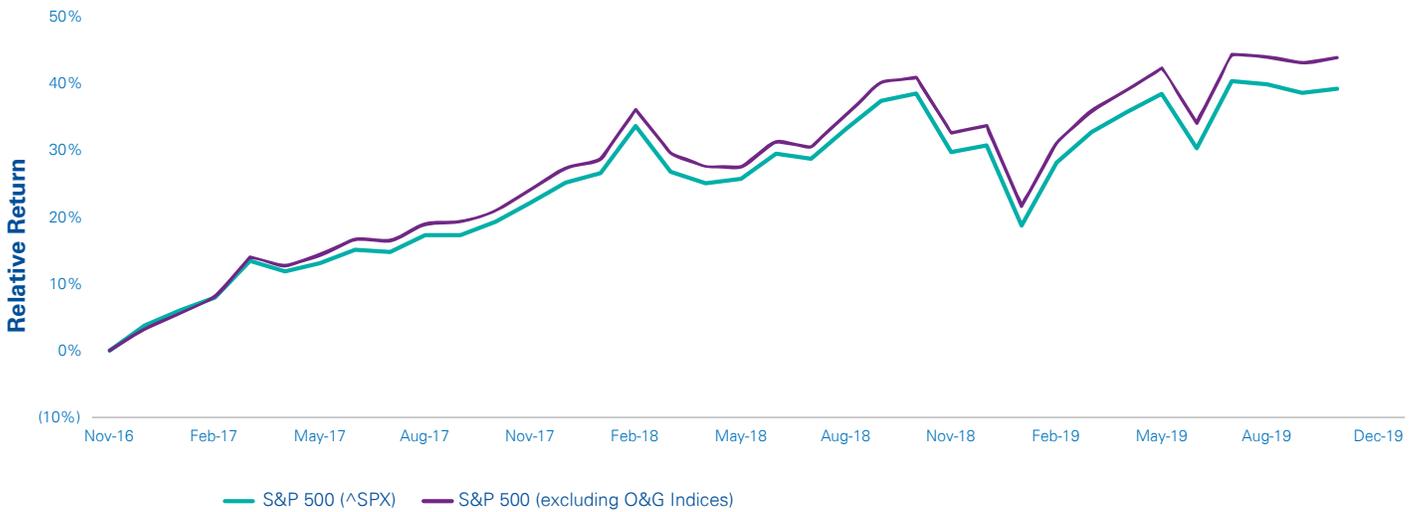
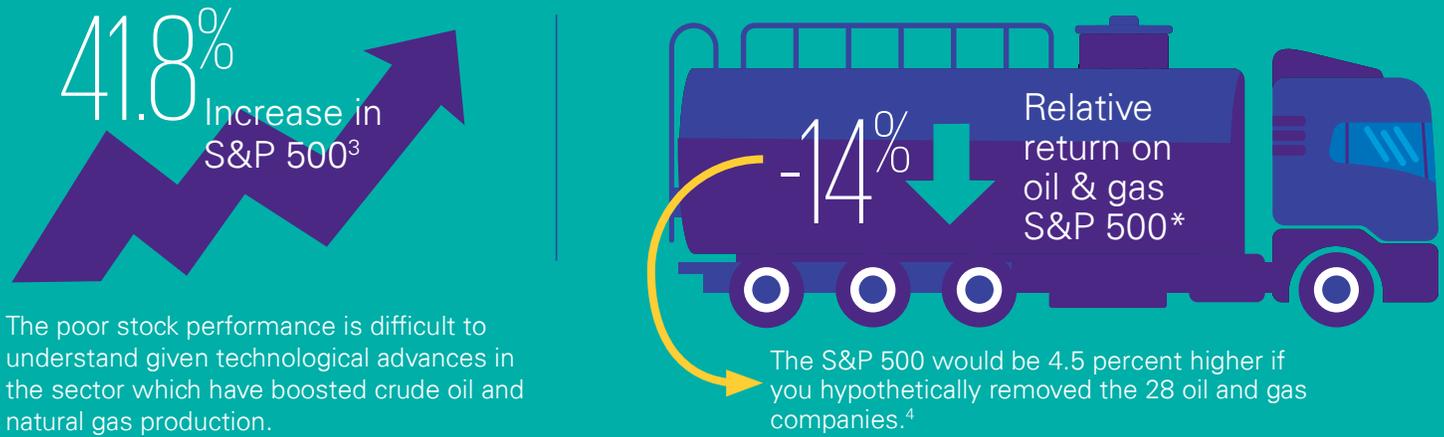
Capital market challenges for oil and gas companies²

Historical Index Price Trend (Last 3 years)

¹ Source: Words spoken by astronaut Jack Swigert during Apollo 13 mission.

² Source S&P Capital IQ, KPMG analysis

Since the last presidential election, we've seen a startling divergence in relative returns.



S&P 500 relative returns overall and returns excluding oil and gas companies⁵

Historical Index Price Trend

* These 28 participants represent the largest oil and gas companies trading on the NYSE and NASDAQ in the following subsectors: equipment and services, exploration and production refining and marketing, storage and transportation, and drilling and integrated oil and gas³. Today, oil and gas companies make up about 5 percent of the S&P 500 index, a significant drop from the 14 percent of the index they represented a decade ago.⁵

³ Source: Macrotrends, S&P performance by president.

⁴ Source: S&P Capital IQ, S&P 500 oil, gas and consumable fuels industry.

⁵ Source: Wall Street Journal, Investors to Big Oil: Make it Rain, Bradley Olson and Sarah McFarlane (November 1, 2019).

Oil trends



Innovation and technology are driving an increase in production capacity and the finite supply of crude oil is now appearing to be not so finite.

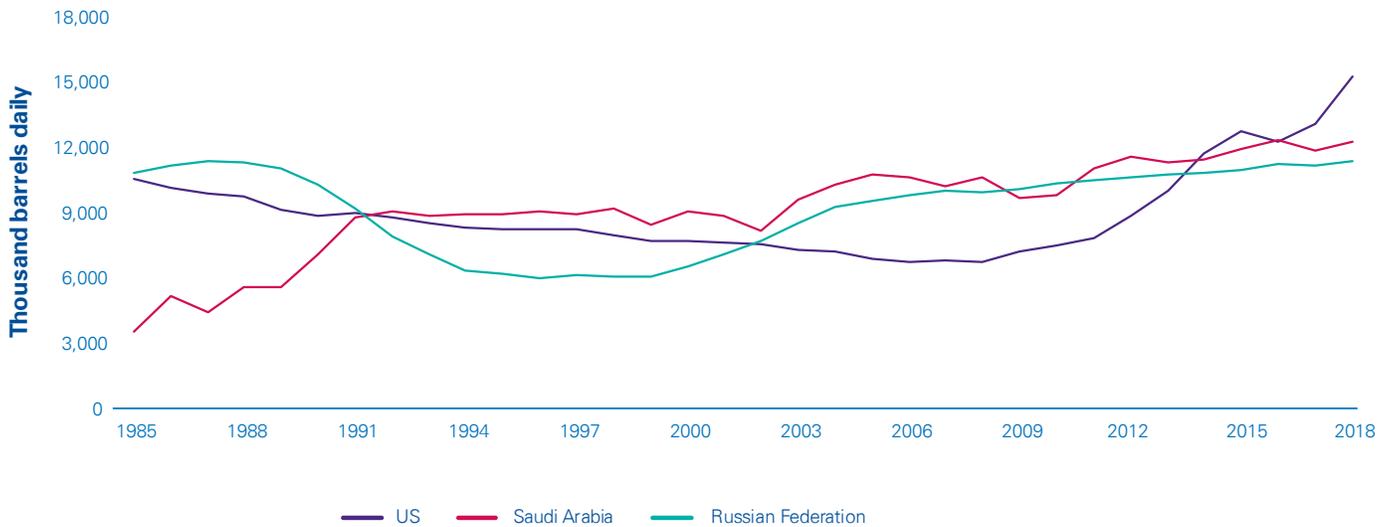


In the U.S., horizontal drilling and hydraulic fracturing have been the catalysts that have ensured U.S. crude oil production reaches unprecedented heights.



The U.S. is the world's largest producer of crude oil
15,311
barrels per day in 2018⁶

An increase of **17%** in 2017 with no clear signs of a slowdown⁷.



Oil production rates⁸

Historical Index Price Trend

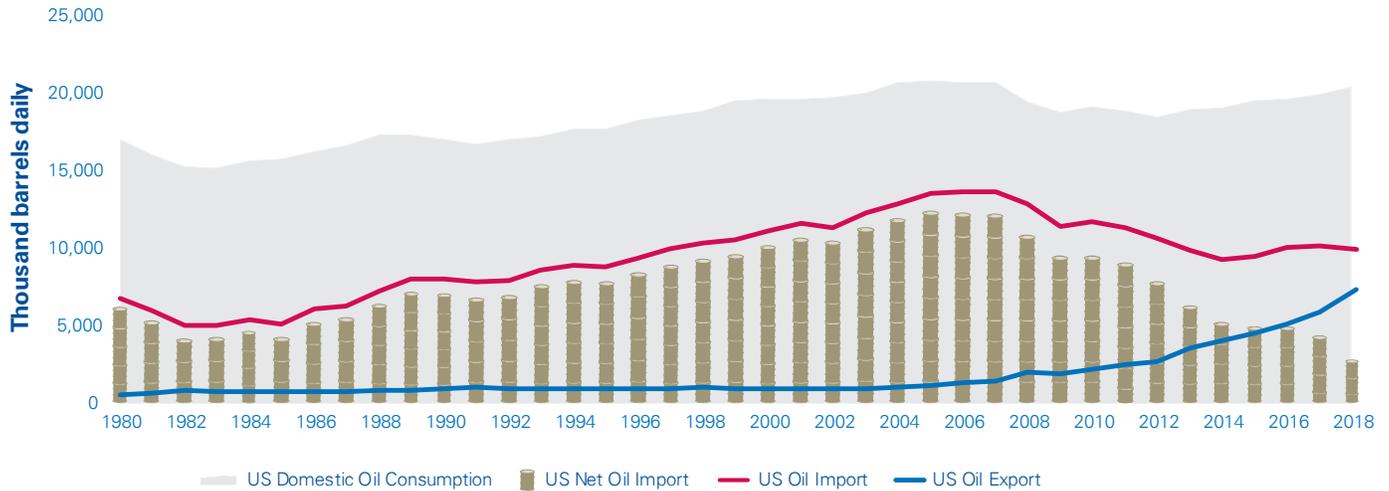
⁶ Source: S&P Capital IQ, KPMG analysis

⁷ Source: BP Statistical Review of World Energy 2019. Includes crude oil, oil sands, condensates (both lease condensate and gas plant condensate) and NGLs (natural gas liquids—ethane, LPG and naphtha separated from the production of natural gas). Excludes liquid fuels from other sources such as biomass and derivatives of coal and natural gas. BP.com, BP Statistical review of world energy (2019).

⁸ Source: BP.com, BP Statistical review of world energy (2019).

U.S. consumption trends

The U.S. is still a **net importer of oil**; however, the delta between imports and exports has **shrunk considerably**.⁹



U.S. oil imports, exports and consumption

15,311

barrels of oil produced domestically each day in the U.S.



20,456 barrels consumed daily in the U.S.¹⁰



Exports of U.S. crude oil has increased nearly

4 fold



⁹ Source: BP.com, BP Statistical review of world energy (2019).

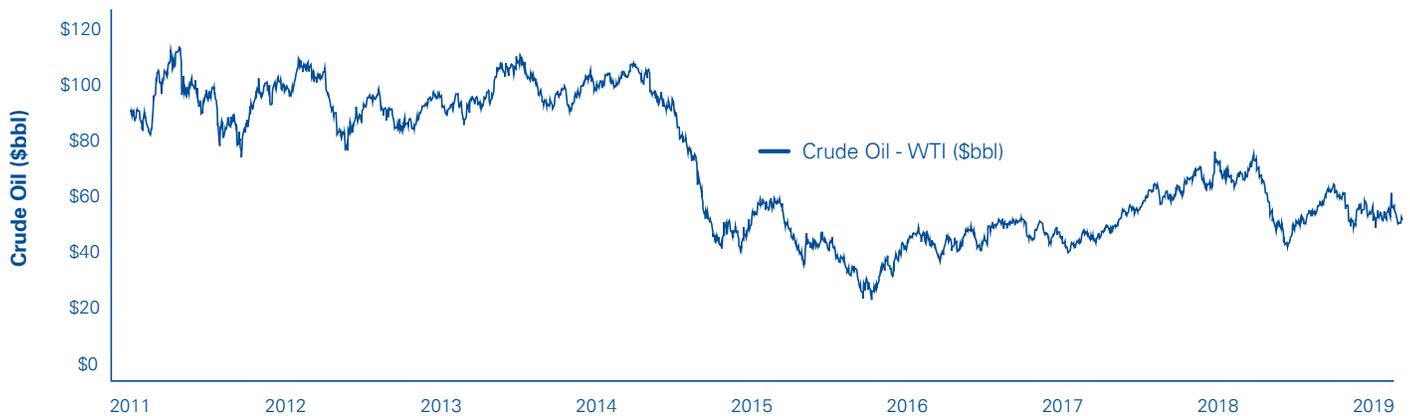
¹⁰ Source: BP.com, BP Statistical review of world energy (2019).

Oil prices are declining

There has been a 10 percent decline in U.S. per capita consumption since 2007 (BP Statistical Review of World Energy 2019) as EGS initiatives drive corporations and consumers to seek energy from “cleaner” sources.

With technology advances creating a flood of new oil to the marketplace, and a downward trend in per capita consumption of developed countries, supply fears have eased off, and with that oil prices have declined over the last 10 years.

With declining oil prices, producers have experienced a squeeze on their gross margins, impacting all participants that provide auxiliary services in the sector.



Crude oil costs¹¹

Historical Index Price Trend

¹¹ Source: eia.gov, Short-term energy outlook (November 13, 2019).

What does this mean for investors

Historically, private equity investments in energy had some of the shortest holding times on investments before profit realization on exit. However, low energy capital market and crude oil prices in the \$50–\$60 price range (natural gas in the \$2–\$3 price range) have led to a decrease in price/earnings multiples in the sector. This has caused investors to hold their investments until some sort of resurgence in transaction multiples occurs. As a result, M&A activity is relatively stagnant.

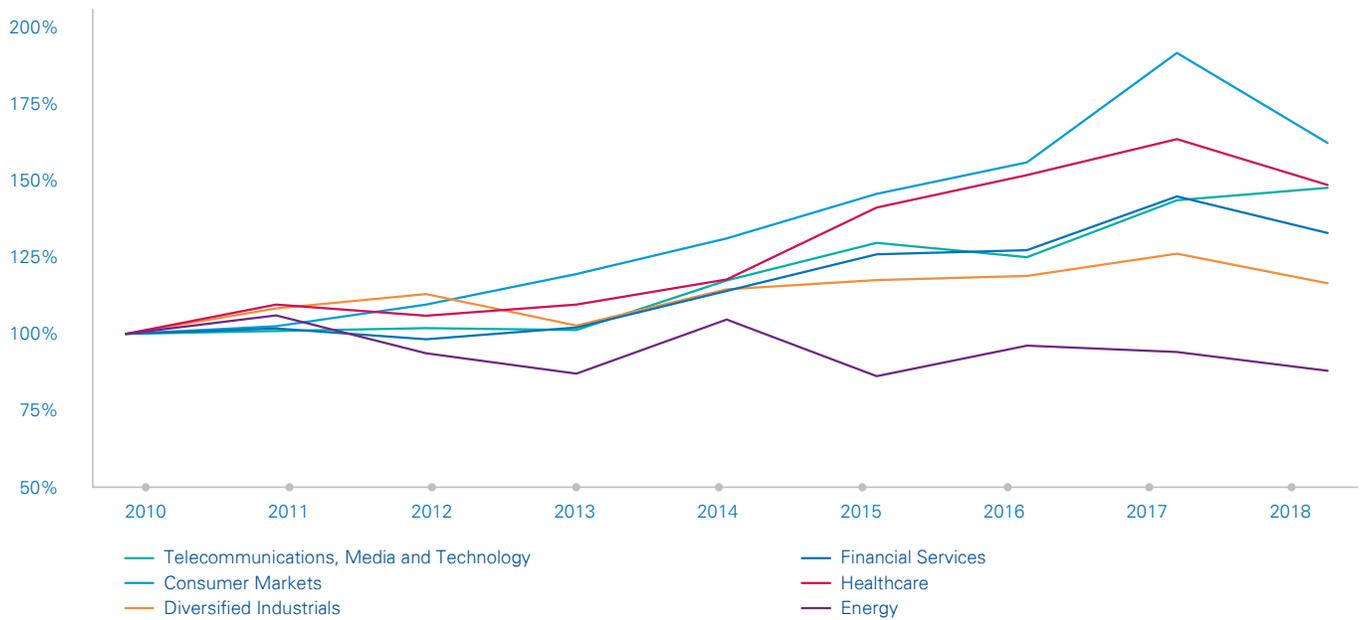
Private Equity (PE) hold times across all industries¹²

	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Materials and resources	5.72	4.73	6.46	5.96	6.64	6.58	6.38	6.10	5.94	6.18
Energy	4.02	4.32	4.89	4.43	4.59	4.64	5.53	5.24	5.87	5.97
Business products and services (B2B)	4.79	5.29	5.60	5.79	6.13	5.90	6.00	5.97	5.86	5.94
Healthcare	4.49	5.10	5.32	4.87	5.17	5.72	5.41	5.57	5.21	5.73
Consumer products and services (B2C)	4.56	5.27	5.96	5.59	6.33	6.02	6.27	5.76	5.82	5.69
Financial services	5.00	4.58	4.80	5.52	5.78	5.42	5.94	5.90	6.28	5.39
Information technology	5.07	5.37	5.40	5.41	6.02	5.48	5.44	5.56	5.51	5.05

¹²Source: Pitchbook (Global analysis of PE).

M&A activity across all industries

It comes as no surprise that with an increase in PE investment holding times has come a slowdown in the number of deals completed in the sector. In fact, energy is the only sector which has experienced a decrease in volume of deals completed relative to 2010 reported numbers:



Deals closed by sector¹³

Historical Index Price Trend

¹³ Source: Thomson One. Analysis by KPMG.

What lies ahead

There is no identifiable catalyst for a break out from the current environment for stakeholders.

Renewable energy momentum and environmental, social and governance (ESG) headwinds are placing ever increasing pressure on the oil and gas sector. As we approach a presidential election, political uncertainty is another factor which is denting confidence in the marketplace. Oil and gas companies fitting the adage, "you can be a good house (solid company) in a bad neighborhood (oil and gas sector)" face unique challenges when it comes to an exit.

Two visible remedies for companies looking for an exit:



1. Excel from a performance standpoint

- Oil prices historically have been cyclical in nature. Businesses now must endeavor to drive marginal cost down and reap the rewards when oil prices recover.



2. Execute financial engineering

- Although M&A has slowed down, there is still value to be gained in acquisitions and disposals. The brave stakeholder will seek out the valuable acquisition at this time, trusting that a recovery in oil prices will unlock the true value of their investment.

While the catalyst for change is not yet obvious, history has shown that oil and gas is a cyclical industry and will recover.

"Does anyone remember how to use a slide rule?"¹⁴

¹⁴ Source: Tool used by Houston Mission control to guide Apollo 13 crew back to earth safely.



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