KPMG

Consolidations continue

M&A trends in energy, natural resources, and chemicals

Q2'24

kpmg.com

Deal makers wait and see

Deal activity in the second quarter of 2024 (Q2'24) for the energy, natural resources, and chemicals (ENRC) sector was muted, with a quarter-over-quarter (QoQ) decline in both volume (30 percent) and value (40 percent). This wait-and-see attitude has not been limited to the ENRC sector. In the 2024 CEO Outlook Pulse Survey conducted by KPMG LLP (KPMG) in February and March, 48 percent of respondents said that they are waiting until 2025 to seriously pursue new dealmaking.

Two factors are encouraging deal makers to hit pause. First, interest rates remain high, although a recent slowdown in the pace of inflation opened the door to a September rate cut by the Fed. KPMG Economics expects three cuts by year-end, with one 50 basis point (bps) cut in September, one 25 bps cut in November, and one 25 bps cut in December; additional cuts are expected in 2025.

Second, the upcoming US elections in November are generating a high degree of uncertainty in the business community. Asked about the impact of the elections, 62 percent of CEOs in the Pulse Survey said they would not make significant investment decisions, such as capital investments and mergers and acquisitions (M&A) transactions, until after November.

Meanwhile, the oil and gas (O&G) industry led the ENRC sector in deal volume and value, most notably with the $22.5 billion acquisition of Marathon Oil Corporation by ConocoPhillips.[1] The deal was driven by strategic initiatives to access high-quality, low-cost supply inventory and to achieve economies of scale for improved efficiency and cost savings.

The chemicals industry remained quiet, with total deal value and volume continuing a decline that began in the first quarter of 2022. Chemicals companies in Europe have been seriously impacted by higher costs and tighter margins, bringing dealmaking to a virtual standstill. Even industry giants like BASF and LyondellBasell are considering new business models and conducting a strategic review of their assets.

The push toward renewable energy—with wind and solar operators seeking to minimize downtime and maximize supply—continued to fuel M&A activity as demand for reliable operations and maintenance providers grows.

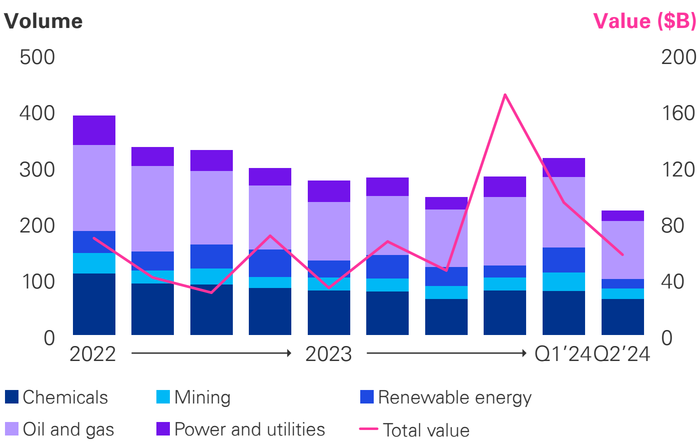
Michael Harling
Partner
Deal Advisory & Strategy
ENRC Leader

Q2'24 highlights

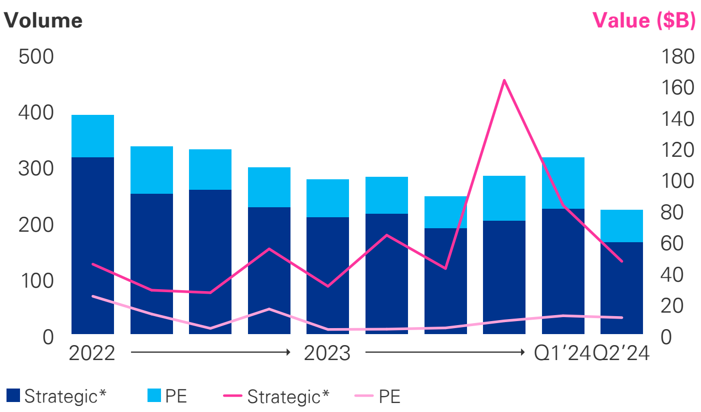
221 deals ▼ **30%** decrease QoQ

$57.1 billion deal value ▼ **40%** decrease QoQ

ENRC deal activity by subsector



ENRC deal activity by type



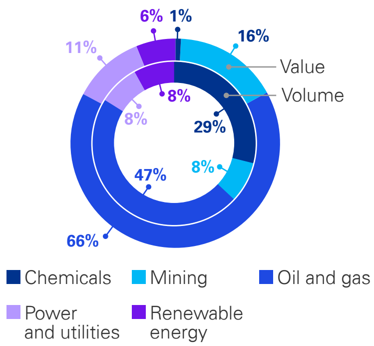
*Includes SPAC deal activity

[1] "ConocoPhillips to acquire Marathon Oil Corporation in all-stock transaction; provides shareholder distribution update," ConocoPhillips, press release, May 29, 2024

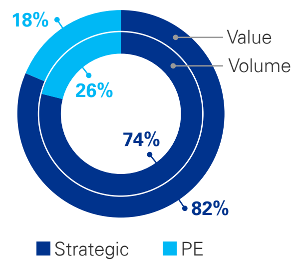
Q2'24 deal mix

Outer ring represents value. Inner ring represents volume.

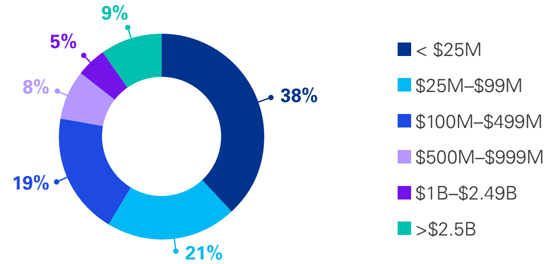
Sector mix



PE/Strategic mix



Value size mix



Top strategic deals

Acquirer	Target	Value (billions)
ConocoPhillips	Marathon Oil Corporation	$22.5
Schlumberger Limited	ChampionX Corporation	$7.8
Energy Transfer LP	WTG Midstream LLC	$3.3
SM Energy Company; Northern Oil and Gas, Inc.	Uinta Basin Oil and Gas Assets of XCL Resources, LLC	$2.6
Crescent Energy Company	SilverBow Resources, Inc.	$2.1

Top PE deals

Acquirer	Target	Value (billions)
CPP Investments, Global Infrastructure Partners	Allete	$6.2
Energy Capital Partners	Atlantica Sustainable Infrastructure	$2.6
Adani Renewable Energy, Brookfield Asset Management, Macquarie Investment Management Austria Kapitalanlage, Masdar Capital, TPG	Siemens Gamesa Renewable Energy (Indian Wind Turbine Business)	$1.0
Basalt Infrastructure Partners	AEP OnSite Partners	$0.3
Aethon Energy Management (Albert Huddleston)	Tellurian (Haynesville Upstream Assets)	$0.3

Deal data has been sourced from Capital IQ, Pitchbook, and KPMG analysis. The values and volumes data cited are for US deals announced between 4/1/2024 and 6/30/2024. Deal values are only presented based on publicly available deal data and are not exhaustive. Previously published statistics may be restated to incorporate new data and/or any change.

Oil and gas

Looking for premium reserves and streamlined operations

Many O&G companies continue to improve their financial stability, leading to additional cash reserves. Not surprisingly, some larger companies are pursuing acquisitions using their cash flow while reducing debt ratios. Major players are targeting overlapping assets, especially in premium reserve areas like the Permian Basin and Eagle Ford in Texas due to their proven low-cost hydrocarbon potential. Moreover, these areas offer long production life and economically viable assets.

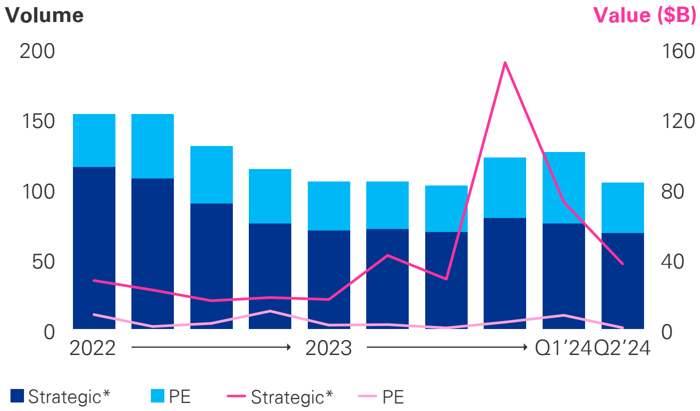
Additionally, O&G companies are rationalizing and restructuring their asset portfolios, looking to achieve economies of scale, reduce costs, and allocate resources more effectively. They are also enhancing efficiency through inventory management techniques designed to reduce waste, minimize downtime, improve overall productivity, and contain inventory costs.

Q2'24 highlights

104 deals ▼ **17.5%** decrease QoQ

$37.9 billion deal value ▼ **52.8%** decrease QoQ

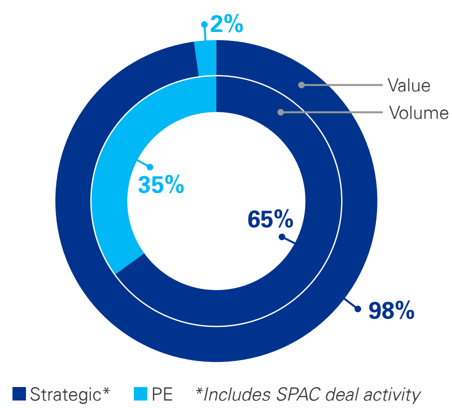
O&G deal activity by type



*Includes SPAC deal activity

Q2'24 O&G PE/strategic mix

Outer ring represents value. Inner ring represents volume.



*Includes SPAC deal activity

Top O&G deals

Acquirer	Target	Rationale	Value (billions)
ConocoPhillips	Marathon Oil Corporation	Enhance key oil-rich positions and achieve economies of scale, thereby increasing efficiency and reducing costs.	$22.5
Energy Transfer LP	WTG Midstream LLC	Establish a natural gas pipeline and processing network in the Permian Basin region.	$3.3
SM Energy Company; Northern Oil and Gas, Inc.	Uinta Basin Oil and Gas Assets of XCL Resources, LLC	Expand their portfolio, increase oil volumes, and extend low-breakeven inventory life.	$2.6
Crescent Energy Company	SilverBow Resources, Inc.	Strengthen its position in the Eagle Ford shale region with a focus on generating free cash flow.	$2.1
Matador Resources Company	Ameredev Stateline II, LLC	Expand its operational footprint in the Permian Basin by securing access to new acreage and production areas.	$1.9

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Power and utilities

Opportunities in infrastructure

Utility infrastructure demand is increasing, driven by the need to expand, upgrade and maintain substation and grid equipment. This trend makes businesses in testing, repair, maintenance, and protection solutions particularly attractive for investment.

Water resource management companies are increasingly prioritizing consolidation and expansion efforts to improve efficiency in managing the water cycle. Their strategic focus involves integrating acquisitions to streamline operations, expand customer connections, and enhance service delivery through advanced technology implementation.

Q2'24 highlights

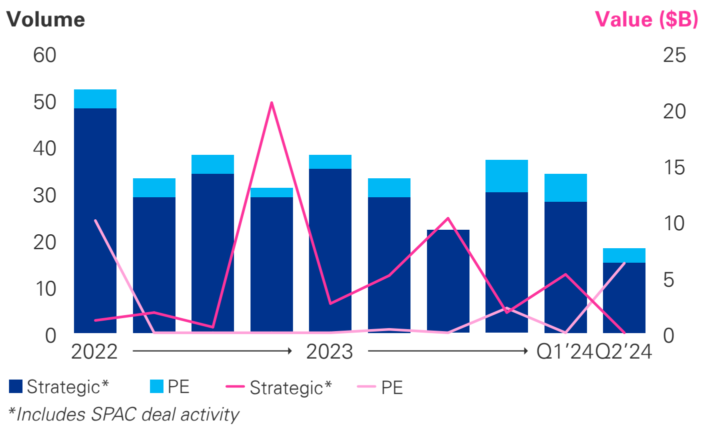
18 deals

▼ **47.1%** decrease QoQ

$6.2 billion deal value

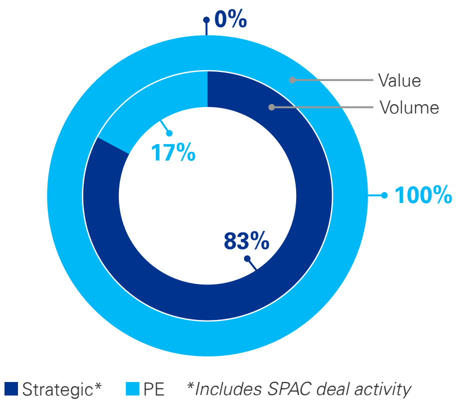
▲ **20.2%** increase QoQ

P&U deal activity by type



Q2'24 P&U PE/strategic mix

Outer ring represents value. Inner ring represents volume.



Top P&U deals

Acquirer	Target	Rationale	Value (billions)
CPP Investments, Global Infrastructure Partners	Allete	Advance ALLETE's "Sustainability-in-Action" strategy by supporting access to necessary capital and the transition of ALLETE to a private company.	$6.2

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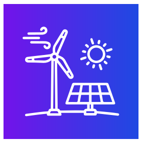


Renewables

Multiple drivers for green investments

Wind and solar operators continue to seek new ways to minimize downtime and maximize supply, thereby fueling M&A activity as demand for reliable operations and maintenance providers grows.

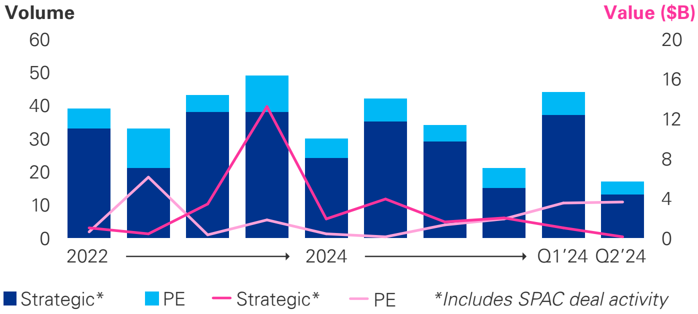
Investments in solar and wind assets are also driven by the development of data centers and the widespread electrification of various sectors such as transportation and heating.

Q2'24 highlights

17 deals ▼ **61.4%** decrease QoQ

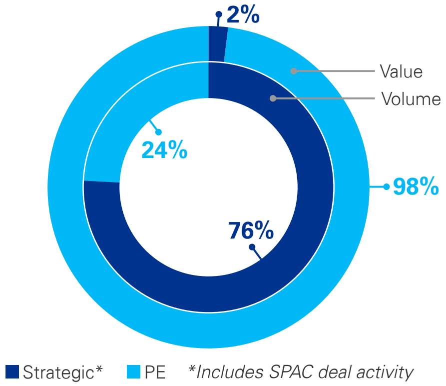
$3.6 billion deal value ▼ **17.7%** decrease QoQ

Renewables deal activity by type



Q2'24 renewables PE/strategic mix

Outer ring represents value. Inner ring represents volume.



Top renewables deals

Acquirer	Target	Rationale	Value (billions)
Energy Capital Partners	Atlantica Sustainable Infrastructure	Enhance Atlantica's financing capabilities, support growth, and maintain focus on safety, sustainability, and value creation.	$2.6
Adani Renewable Energy, Brookfield Asset Management, Macquarie Investment Management Austria Kapitalanlage, Masdar Capital, TPG	Siemens Gamesa Renewable Energy (Indian Wind Turbine Business)	Concentrate on core markets in Europe and the US, aiming for full integration of Siemens Gamesa and addressing operational challenges.	$1.0

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Chemicals

Opportunities through acquisitions

Chemical companies have increasingly adopted acquisition as a way to solidify their market presence. This involves tapping into the expertise and unique market positions of their acquisition targets, which often provide valuable avenues for growth and expansion.

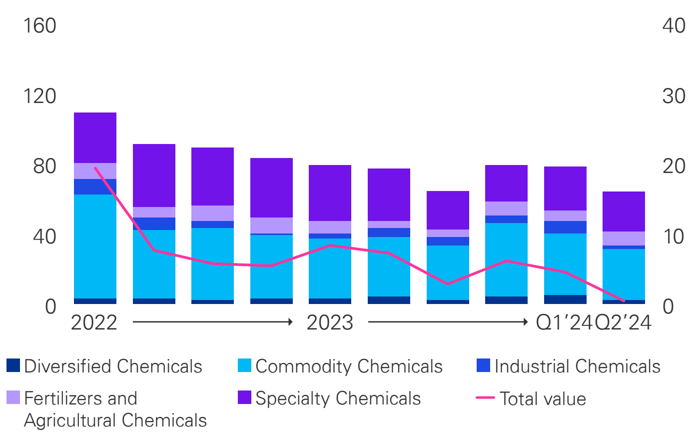
Market consolidation translates into business expansion opportunities and access to a wider customer base for those leading the initiative. Furthermore, it signals a transition toward a more competitive landscape, requiring companies to become more agile and responsive to maintain relevance.

Q2’24 highlights

64 deals ▼ **17.9%** decrease QoQ

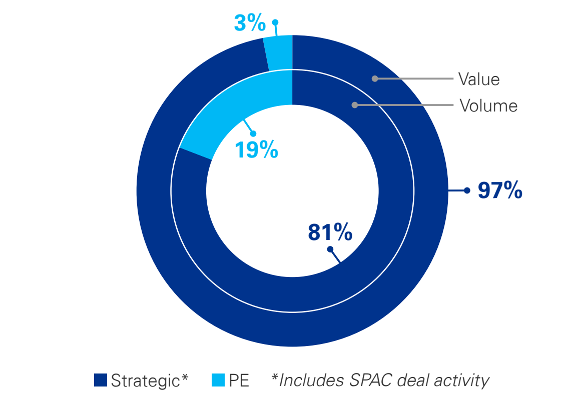
$0.4 billion deal value ▼ **90.8%** decrease QoQ

Chemicals deal activity by subsector

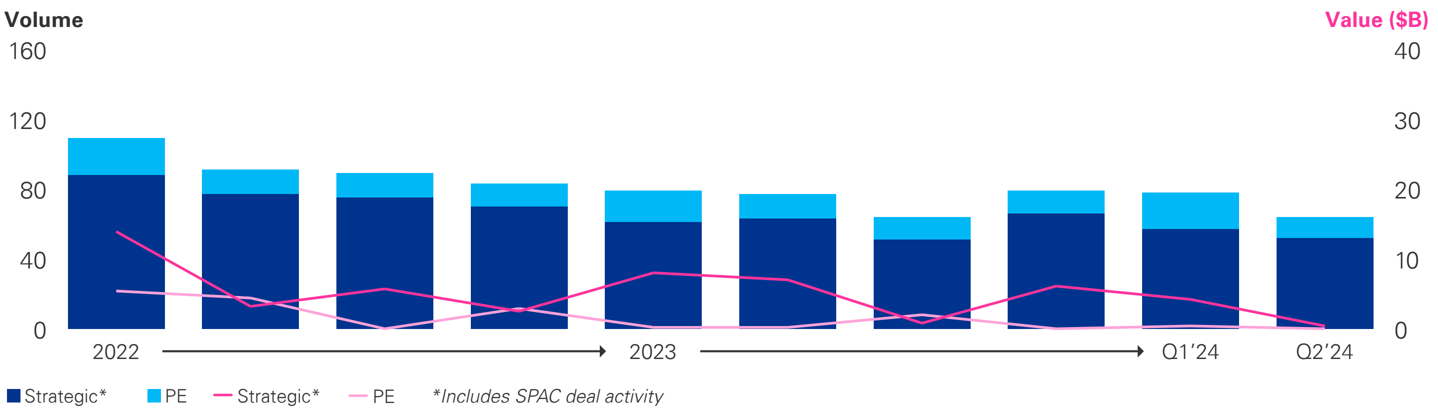


Q2’24 Chemicals PE/strategic mix

Outer ring represents value. Inner ring represents volume.



Chemicals PE/Strategic mix



Top chemicals deals

Acquirer	Target	Rationale	Value (billions)
Axalta Coating Systems Ltd.	CoverFlexx Group	Support Axalta's continued investment in its refinish (coatings) business.	$0.3

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PE and Strategic M&A deals

Strategic deals dominate

Strategic acquisitions (163) outpaced PE deals (58) in the ENRC sector, with most being domestic: 33 versus 16 strategic, and 38 compared to six PE.

Private equity investors, particularly those with a focus on sustainability, showed a growing interest in energy infrastructure companies that are contributing to clean energy advancements. This trend is primarily driven by the increasing global adoption of renewable and cleaner energy sources. These investments play a vital role in advancing low-carbon solutions, promoting sustainability, and enhancing grid resilience.

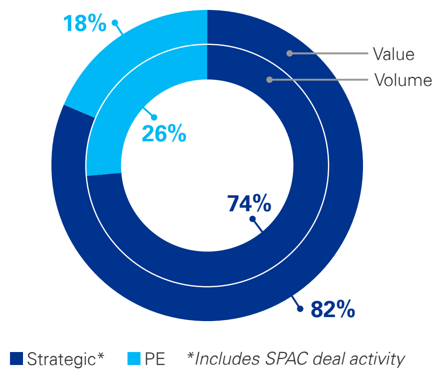
Q2'24 PE highlights

58 deals ▼ **37.0%** decrease QoQ

$10.5 billion deal value ▼ **9.8%** decrease QoQ

Q2'24 PE/strategic mix

Outer ring represents value. Inner ring represents volume.



Top ENRC PE deals

Acquirer	Target	Rationale	Value (billions)
CPP Investments, Global Infrastructure Partners	Allete	Advance Allete's "Sustainability-in-Action" strategy by supporting access to necessary capital and the transition of Allete to a private company.	$6.2
Energy Capital Partners	Atlantica Sustainable Infrastructure	Enhance Atlantica's financing capabilities, support growth, and focus on safety while expanding its sustainable infrastructure projects.	$2.6
Adani Renewable Energy, Brookfield Asset Management, Macquarie Investment Management Austria Kapitalanlage, Masdar Capital, TPG	Siemens Gamesa Renewable Energy (Indian Wind Turbine Business)	Concentrate on core markets in Europe and the US, aiming for full integration of Siemens Gamesa and addressing operational challenges.	$1.0
Basalt Infrastructure Partners	AEP OnSite Partners	Maintain a strong balance sheet and direct capital to regulated operations, to provide affordable energy.	$0.3
Aethon Energy Management	Tellurian (Haynesville Upstream Assets)	Strategically advance the development of the Driftwood LNG project and improve its financial stability.	$0.3

Deal data has been sourced from Capital IQ, Pitchbook, and KPMG analysis. The values and volumes data cited are for US deals announced between 4/1/2024 and 6/30/2024. Deal values are only presented based on publicly available deal data and are not exhaustive. Previously published statistics may be restated to incorporate new data and/or any change.

Locked box pricing for upstream O&G deals: A hybrid approach for sellers and buyers

A strategic part of successful M&A dealmaking is how and when the parties arrive at the final purchase price. In most cases, US dealmakers choose either the "completion accounts" approach or the "locked box" mechanism. However, for upstream O&G transactions, dealmakers traditionally use a hybrid approach to address the unique characteristics of that industry sector.

Locked box versus completion

Locked box is a way of determining the purchase price of a company based on its financial position at a specific point in time. To "lock the box" is to secure a final purchase price between a buyer and a seller before formally closing the deal. The price is agreed upon based on the effective date balance sheet. The buyer has to ensure their bid fully reflects the cash or debt acquired in the base price. The bid also needs to accommodate any variance between normal levels of working capital and the capital delivered at the effective date. There are no preliminary price adjustments and no need for a post-completion true up (although this can occur when there have been leakages in value).

For sellers, the locked box mechanism offers simplicity, speed, and the assurance of receiving a predetermined price at signing regardless of their company's performance, market fluctuations, or other factors. This approach streamlines the sales process by offering a definite transaction closure, mitigating the risk of market fluctuations, and requiring less management involvement. In addition, locked box deals encourage competitive bidding because bidders have a single reference point for valuation.

For buyers, a locked box deal allows them to take economic ownership earlier and have certainty over funding requirements at closing. However, buyers must be comfortable with the seller's control of operations after the effective date or face the risk of value leakage. With limited opportunity to re-address any surprises between effective date and closing, buyers need to rely on warranties and indemnities. In effect, they have one shot at the balance sheet, so proper due diligence is critical.

With the completion accounts approach, price is calculated on a debt free/cash free basis plus or minus a target—usually a historical average, level of working capital, and sometimes other adjustments. Price adjustments are then made post-close to reflect variances against this target along with any net cash/debt remaining at closing. Preliminary adjustments (usually seller estimates) are calculated just before closing to arrive at cash to be paid at closing, with a final true up conducted by the buyer 45 to 60 days after closing.

For sellers, the completion accounts approach allows for potential upside if the business is more profitable than expected during the transaction process. The approach can also prevent lengthy and expensive warranty claims. However, the completion accounts approach will often require more time and input from management.

For buyers, the completion accounts approach provides downside protection if the business is less profitable than expected during the transaction process. It also provides more potential areas for negotiation. In most cases, it is the best pricing mechanism when dealing with carve-out assets, as it does not require direct tracking of cash in and out of the business like the locked box approach.

A hybrid solution for upstream O&G transactions

O&G upstream deals are based on reserves that are being depleted during the course of the deal while also being affected by commodity price volatilities and other factors. To accommodate these variables, a hybrid model combining elements of both locked box and completion accounts is often employed. The box is locked, but working capital is assumed to be zero and adjustments can be made to the final price.

Here's how it works: Asset purchases of producing O&G assets are typically valued as of the effective date, with a settlement statement used at completion to true up for the net cash results of the assets between the effective date and closing. During the effective period, the buyer owes the seller for costs, and the seller owes the buyer for any cash received.

There are many issues related to the preparation of the completion settlement statement that could result in value leakage, but these issues are mostly preventable. For example, the preliminary settlement statement is generally delivered by the seller to the buyer five days before the closing date. A third-party advisor can focus on the preliminary settlement statement to help ensure the statement is aligned with the structure outlined in the PSA, as well as obtaining a high-level understanding of included and excluded items. By closely monitoring the preparation and delivery of the completion settlement statement, both parties can mitigate the risk of value leakage.

The final settlement statement is generally delivered by seller to buyer 90 days after the closing date. During this period, a third-party advisor can perform a detailed review of classification and accuracy of amounts included in the final settlement statement, including performing cut-off analysis and reconciliation to source data such as marketing statements.

For the upstream industry, a hybrid locked box mechanism solves the challenge of depleting-asset valuation. Carve-out transactions require—and private equity buyers typically prefer—completion accounts, while sellers looking to increase bid comparability and reduce friction in the transaction process may opt for the locked box mechanism. Every M&A deal is a unique combination of risk and reward where using the correct purchase price adjustment approach can save both parties significant levels of time, cost, uncertainty, and deal leakage that might otherwise impede or even prevent a deal.

Steve Binz
Managing Director Deal Advisory & Strategy

Ready and steady wins the race

As of July 17, 2024, the Federal Reserve Bank of Atlanta's GDPNow™ model estimates that real GDP growth rate in the second quarter of 2024 will be 2.7 percent.[2] KPMG Economics expects that real GDP growth will slow to 1.5 percent in the third quarter, a full percentage point behind the pace of the second quarter.

As noted in the introduction, many investors are waiting to see the results of the U.S. elections in November before moving ahead on deals. The two major political parties and their presidential candidates have different views on trade, immigration, economic policy, and government support for infrastructure development. Depending on the outcome, the U.S. could face more tariffs, lower labor supply, reduced incentives for development, and higher inflation. The election could also affect the global economy, as other countries adjust their policies and exchange rates in response to the U.S. stance.

An increasingly important factor for investors in the ENRC sector will be the need to harden power grids against extreme weather events such as floods, storms, drought, and heat waves. Utilities will have to use poles made out of materials stronger than wood, place poles closer together, aggressively trim or remove trees around power lines, or bury lines underground. Components such as covered conductors, transformers and switch gears will have to be replaced or upgraded more often. Interconnectivity between grids and with new energy sources such as renewables will have to be taken to the next level to increase resilience against future natural disasters. As a result, major contractors that specialize in building, repairing, and enhancing power grids may seek to acquire smaller, regional contractors to address growing needs or become an attractive acquisition target themselves.

O&G players are expected to maintain their focus on traditional energy sources, targeting strategic asset acquisitions in areas such as the Permian region, already responsible for almost 50 percent of domestic crude oil production. Investment decisions in these areas will likely shape the medium-term outlook for the industry. However, as the global economy cools somewhat, energy demand will drop, potentially affecting petroleum prices and M&A activity.

The circular economy will increasingly influence the chemicals sector, driving growth in environmental services businesses that enable circular waste model strategies, encouraging M&A due to the sector's resilience, large market size, and predictable revenue streams.

Investment in clean energy technology is projected to approach $800 billion in 2024 and surpass $1 trillion by 2030.[3] In addition, the Inflation Reduction Act (IRA) is poised to significantly enhance renewable energy M&A activity in 2024 by expanding the Loan Program Office's budget with $400 billion in debt capital for high-impact energy and manufacturing projects. Officials are aiming to allocate these funds swiftly before the November election. This will support continued interest in deals involving renewables and related areas.

Despite the current decline in deal activity, investment interest in the ENRC sector will continue to be bolstered and maintained by its essential role in the economy, limited impact by economic cycles, and the predictable, resilient nature of its revenue. These qualities make it a prime target for varied investor types, including PE firms, strategic buyers, and infrastructure funds.

Key considerations as we look ahead

Dealmakers should consider the following for transactions in Q3'24:

1. **Be patient**
   And remember that market timing is key in maximizing deal value.
2. **Take advantage of funding**
   For industries such as renewables and related areas.
3. **Expect more O&G deals**
   Focused on premium domestic reserves.

Arun Mani
Principal,
Deal Advisory
& Strategy

Brandon Beard
Partner,
Deal Advisory
& Strategy

[2] Federal Reserve Bank of Atlanta, atlantafed.org

[3] "TOP 10 Trends in Clean Energy Technology in 2024 - S&P Global Commodity Insights," S&P Global, press release, January 212, 2024

How we can help you

KPMG helps its clients overcome deal obstacles by taking a truly integrated approach to delivering value, leveraging its depth in the ENRC industry, data-supported and tools-led insights, and full M&A capabilities across the deal lifecycle.

With an ENRC specialization, our teams bring both transactional and operational experience, delivering rapid results and value creation.

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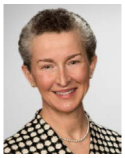

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With special thanks to:
Varun Angirish, Michael Gelfand, Mannat Gupta, Smarth Grover, Lara Volpe, Kathy Nichols, and Manojit Panda.

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DASD-2024-15787