Middle Market Energy M&A
Lessons from 2018 and Expectations for 2019
Roadmap

■ Takeaways from 2018 – Upstream, Midstream and OFS
■ Private Equity – Year in Review
■ Expectations for 2019
■ Will the Capital Markets Make a Comeback?
■ Equity Currency
2018 Deal Trends - Upstream

- $60 billion in acquisitions of non-conventional assets (half in Permian)\(^1\)
- 2018 was a tale of two stories – Q1 to Q3 strong; Q4 came to standstill
- Public M&A up; A&D down in Q4 with drop in oil prices
- Equity used as currency
- Activity picked up outside of the Permian
- Failed processes
- Midstream issues – revenue/volume commitments
- Reduced capex (takeaway constraints, oil prices, capital discipline)

\(^1\) Per Wood Mackenzie
2018 Deal Trends - Midstream

- Strong Q1 to Q3 with a pause in Q4
- Bulk of total deal value for all of energy M&A
  - IDR simplifications
  - Take private transactions
- More JVs
- Commercial agreement terms impact deal execution
  - Dedication issues
2018 Deal Trends - OFS

- Noticeable uptick in deals into market in Q1 – early Q3
- Multiple bid deals/late exclusivity in process, if any
- Many deals pulled or abandoned by Q4
  - Spread in Bid/Ask prices
  - Drop in commodity prices
  - Lack of confidence in seller’s projections
  - Critical analysis of deal value – fear of overpaying
- Successful Deals in Q4 – technology / market specific opportunities
- PE to PE / Strategics on sideline
- Takeaway constraints in Permian
Private Equity – Year in Review

- PE funds are holding assets longer
- Lots of dry powder
- More involved in midstream
- More buying and selling among PE funds
- Strategic buyers cautious and fewer cash bids
- PE dealmaking response
  - More earnouts
  - R&W insurance policies
  - Equity consideration
  - Limited scope non-competes
Expectations for 2019

- More emphasis on upstream public M&A rather than A&D
- For upstream A&D to return need capital markets to open up and bid/ask spreads to narrow
- Buyers will remain cautious
  - Priority shift from growth to capital discipline and living within cash flow
Expectations for 2019

- Steady flow of $100-200 million deals in midstream
- Larger midstream deals more challenging, but see infrastructure funds as buyer
- More midstream JVs
- Water midstream deals
  - New companies formed
  - Careful negotiations of commercial agreements
Expectations for 2019

- Continued use of R&W insurance
  - May see more zero seller recourse policies
  - Increased use of post-closing adjustment escrows
  - Interplay of limited escrows, NWC methodology and R&W insurance
- Anti-trust and CFIUS should play a larger role
- More buyer friendly deal terms
  - Lower valuations due to market slowdown
  - More earnouts
  - More alternative financing (other than stock)
- More pre-exit restructurings
- NOLs
Capital Markets Comeback?

- IPOs – tough year for energy in 2018
  - No midstream IPOs
  - One upstream IPO
  - Five OFS IPOs, all early in the year

- Equity capital markets stalled due to depressed stock prices; target multiples may be higher than issuer

- High yield bond market dropped off in early December and has only recently returned
More Equity Currency?

- Significant Issue in Upstream
- Private Placements, Private Equity and Monetization
- How Large is the Seller’s Stake?
  - Shareholder Approval
  - Affiliate status
  - Schedule 13 filings and Section 16
- Lockups
- Rule 144
- Registration Rights
- Transfer Agents
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