M&A DEAL ANALYSIS
"A new era in the US shale industry"

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ExxonMobil

PIONEER
NATURAL RESOURCES

BOCCONI STUDENTS FOR COMMERCIAL AND INVESTMENT BANKING

M&A DIVISION

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M&A DEAL ANALYSIS

Acquirer: ExxonMobil
Target: Pioneer Natural Resources
Deal value: $59.5 billion
Sector: Oil and gas
Type of M&A: Strategic
Exit multiple: 6.01x
Announced date: 11/10/2023
Completed date: TBC

Acquirer details
ExxonMobil
Founding year: 1999 (merger with Mobil)
Headquarters: Houston TX, United States
CEO: Darren Woods (2017 - Present)
Number of employees: 62,000 (as of 31/12/2022)
Market Cap: $434.8bn
EV: $454.7bn

- LTM Revenues: $364.1bn
- LTM EBITDA: $78.4bn
- LTM EBITDA margin: 21.5%
- LTM EV/EBITDA: 5.80x
- LTM EV/Sales: 1.25x

(All financial data as of 16/10/2023)

Company industry: petroleum and chemical manufacturing

Target details
Pioneer Natural Resources
Founding year: 1997
Headquarters: Irving TX, United States
CEO: Scott Sheffield (2019 - Present)
Number of employees: 2,000 (as of 31/12/2022)
Market Cap: $57.8bn
EV: $63.4bn

- LTM Revenues: $20.1bn
- LTM EBITDA: $9.9bn
- LTM EBITDA margin: 49.2%
- LTM EV/EBITDA: 6.40x
- LTM EV/Sales: 3.15x

(All financial data as of 16/10/2023)

Company industry: oil & gas exploration and production

Deal Overview

The 11th of October 2023 marked the start of a new era in the American oil industry. After a week of rumors, the Texan giant ExxonMobil announced the acquisition of the entirety of Pioneer Natural Resources' equity stake in a $59.5bn transaction that is set to unleash a wave of consolidation in the US shale oil industry.

Founded in 1999 from the merger of Exxon and Mobil, ExxonMobil was the largest American corporation in the oil sector in 2022, with revenues amounting to nearly $398bn. The Texan-based corporation experienced a notable growth in the past couple of years, largely attributable to the growth in oil prices brought by the Russian invasion of Ukraine. In 2022 ExxonMobil recorded respective revenues and earnings growth rate of 44.83% and 144.44%, strongly rebounding from the pandemic downturn (Exxon posted the first annual loss as a public company in 2020). These extremely positive results came with a notable increase in the company's liquidity, with ExxonMobil amassing a substantial cash pile over the year.

This sudden recovery pushed the company to look for potential acquisitions. The considerable cash availability allowed ExxonMobil to dream big. Founded in 1997 by Scott Sheffield, Pioneer Natural Resources is a Texan-based oil and gas company listed on the NYSE. With a market capitalization of nearly $60bn, Pioneer Natural Resources is one of the largest US companies operating in the oil industry and the pre-eminent operator in the Permian Basin, the largest oil field in the United States. Located between Western Texas and New Mexico, the Permian Basin produces about 5.8mn barrels a day, accounting for almost half of the national production of around 13mn barrels a day.

The acquisition of Pioneer Natural Resources will give ExxonMobil a competitive advantage over its competitors. As a result of the transaction, ExxonMobil will be able to double its daily output from the Permian wells, reaching around 1.3mn barrels a day. The acquisition has been positively assessed by analysts, with Andrew Dittmar from Enverus describing the takeover of Pioneer Natural Resources as "a significant win" for ExxonMobil.

Industry Overview

As the world begins to see the negative implications of climate change, the major players in the oil industry look for new ways of lowering their emissions and shifting towards cleaner energy sources. To adhere to international agreements setting targets for carbon emissions and compete with cleaner energy, which is becoming progressively cheaper, the oil industry has been focusing more on sustainability. Nevertheless, it takes a lot of resources to extract oil from the ground, which is why natural gas has been making waves lately as an alternative source of fuel with less harmful effects. Natural gas emits about half as many greenhouse gases per MWh compared to petroleum products such as gasoline or diesel. Thus, the oil industry can be expected to slowly lose its power in the following decades as the fossil fuel will partially get replaced by more sustainable sources.

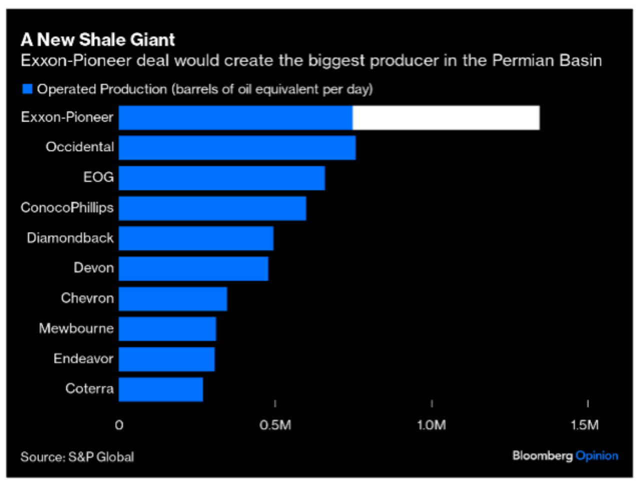
As the market shifts away from hydrocarbon energy over the long-term, it has become critical for powerhouse companies in the oil industry to efficiently deploy capital to remain competitive. Currently, high oil prices have created financial opportunities for portfolio optimization and investment into sustainable initiatives which could support the energy market leaders when the demand for oil plateaus by 2030.

By a large margin, the top 3 global producers of oil are USA, Saudi Arabia and Russia which is why their geopolitical actions so often send shockwaves through oil prices and the global economy. In February 2022 Russia started a full-scale war against Ukraine, which led to embargoes and price caps being put on Russian crude oil, immediately skyrocketing its prices, which peaked in June 2022 at over $120/barrel, as many western powers met supply concerns that overlapped with a rise in demand from post-pandemic economic growth. The next 12 months, however, were characterized by a slow yet clear decrease in crude oil prices as the industry adapted. After dropping to below $70 multiple times in June 2023, Saudi Arabia and Russia – respectively the second and third largest crude oil producers in the world - announced that until the end of 2023 they would cut back how much oil they supply to global markets (by 1 million barrels a day - Saudi Arabia). This naturally caused the prices to rise back up but not to the heights that many analysts predicted, and only for about 3 weeks. It became clear that because both Chinese and European economies are going through a rough year the demand for oil around the world is down (USA hit the lowest demand level in 22 years). Furthermore, US producers such as Exxon increased their production by around 5%, partially filling the drop in supply. The latest shift was due to the recent outbreak of war in Israel, which caused a spike in prices due to the risk of Iran being directly brought into the conflict, which would force the Western powers to fully embargo its oil, further cutting the supply of oil on the market. It remains to be seen how new geopolitical events will continue to swing the industry and its price levels, but it's clear that until the world lowers its reliance on oil, such wild fluctuations will be commonplace as the commodity will continue to be used as a political tool.

Deal rationale

The acquisition of Pioneer by Exxon is groundbreaking and will give Exxon a competitive advantage over its competitors in the Permian. For this reason, experts predict a tumultuous M&A market in the following months and years. This similarly happened in 2017 when Exxon bought drilling rights in the Permian basin, a move that was quickly followed by competitors aggressively carrying out purchases in the same area. Just as a reminder, Exxon's main competitors are Chevron, Shell, and BP.

Pioneer owns oil wells in the Permian basin. As we can see in the graph below, production in this area is still very fragmented. Making it a fertile ground for potential mergers and acquisitions. The E&P business is extremely capital intensive, making economies of scale and scope crucial to succeed. Therefore, this industry prefers few but big companies rather than many but small players. Moreover, Exxon management believes the sum of the parts of the merger is greater than the sum of the individual parts, making the deal accretive. Note on the side, this deal is the biggest in the industry in the last 20 years.



Pioneer is a best-in-class operator in the basin. It has low balance sheet leverage, competitive unit costs and little to no exposure to potential drilling curbs on federal land. In addition to that, it has strong free cash flows, making it a great target for an acquisition from a bigger player, in this case, Exxon. Even though Exxon pursues an all-stock deal, so will not have any debt repayment outflows.

Revenue synergies

With this deal, Exxon will become the biggest producer in the Permian Basin by far. It will have the equivalent of almost 1.3 million barrels of oil per day, based on 2023 volumes. In addition to that, Exxon is looking to increase production by 11% through 2027, to ultimately reach 2 million barrels a day. Pioneer immediately will add $5bn in free cash flow. By the end of the decade, this figure will rise to $10bn. Exxon's CEO said that the merger would be profitable even in case oil prices were to go as down as 35$ per barrel (on 15/10/2023, oil closed at almost $91). This gives plenty of room to Exxon, suggesting that the deal will ultimately help to increase its profitability.

Cost synergies
Pioneer has one of the lowest extraction costs in the Permian Basin, which combined with the new technology from Exxon will lead to extremely low unit costs. The management team expects to reduce annual costs by about $2bn. Two-thirds of these savings will come from improved resource recovery. Efficiency improvements, Capex and OpEx, are responsible for the remaining part. Fortunately, job cuts will be minimal. Improved resource recovery will be reached with Exxon's technology: Exxon uses 4-miles horizontal wells drilling, while the market standard is ½ mile drilling. Therefore, fewer drills will be necessary in the Basin, drastically reducing costs for the combined company.

Other synergies
The acquisition will improve energy security and will accelerate the net-zero goal. With the combination of Pioneer's land in the basin and Exxon's technology and know-how, we will see improvements in the operations of the combined companies which will lead to a lower environmental impact. Exxon had set a goal to net zero emissions in the Permian by 2030.

Firstly, the know-how will be extended to Pioneer which will leverage it to reduce emissions as much as possible. According to Exxon's management, the goal of Pioneer will be to reach net zero in 2035, if not sooner. Prior to the acquisition, Pioneer aimed to reach net-zero by 2050, therefore this acquisition could potentially lead to reaching it 15 years prior than the initial goal. Secondly, the deal happened with great timing, because in April of this year Scott Sheffield, the CEO of Pioneer, announced retirement at the end of the year. Therefore, the transition should be easier, and Exxon will not have any internal resistance from Pioneer management. The management of Exxon is excited about this new operation and believes there is great compatibility between the two companies. This will ease the transition and will potentially generate more synergies.

Deal Structure

The acquisition was announced on Thursday, October 11th. The merger is an all-stock transaction that values Pioneer at $59.5bn, based on ExxonMobil's closing price of $253 per share on October 5th. The all-stock transaction leverages Exxon's near-record high share prices, as investors have snapped up more of Exxon's shares following the surge in oil and gas prices after the breakout of the War in Ukraine. Exxon could have afforded to pay all-cash, through a combination of debt and the cash coming from the recent record earnings: its free cash flow last year was 20 times that of 1999, the year of the $75bn merger with Mobil. However, the deal structure allowed the two companies to reconcile their price disagreements according to people familiar with the matter.

The final price represents a 18% premium to Pioneer's closing stock price on Thursday 5th and a 9% premium to its 30-day-volume weighted average price on the same day. Pioneer's shareholders were willing to accept the lower premium in return for a stake in Exxon, whose shares are perceived to be very attractive by many in the oil industry. The deal values Pioneer at an enterprise value of approximately $64.5bn, including net debt, and Pioneer's shares at 12 times forward earnings, relatively low compared to its historical records. Exxon's stock also trades at the same multiple. Following the deal announcement, Exxon's shares fell 2.8% on Friday whereas Pioneer's shares closed up 9.1%.

The board of directors of both companies have unanimously approved the transaction, which is expected to close in the first half of 2024. Pioneer's CEO will become a director on Exxon's board when the merger will be complete. The acquisition is still subject to approval by Pioneer's shareholders and regulators, but the deal will most likely go through since the companies' combined holdings in the Basin only make up a fraction of global oil production and regulators have often taken the view that oil products compete in the global market.

Risks and Implications

Short Term

As a result of the deal, 45% of Exxon's total oil production will come from the Basin: Exxon will double down its oil production to 1.3mn barrels per day and the merged company aims at raising output to 2 million barrels of oil equivalent per day within four years. The merger will unite two of the largest acreage holders in the region, making Exxon the Basin's dominant oil producer: together, the companies will have an estimated 16bn barrels of oil equivalent resource in the Permian. Furthermore, it will allow the group to drill longer wells to reach deeper into the layer of shale resources. The area is the most prolific oil deposit in the US, with a lot of sites yet to be drilled that could be quickly brought online to increase Exxon's capability of keeping pace with global demand.

The deal, however, is not bereft of any risks. Firstly, the increased reliance on US shale oil further exposes Exxon to potential market volatility and fluctuating crude prices, which could negatively impact profitability and returns from the acquisition in case of sudden declines. Still, according to analysts, Pioneer's barrels are among the cheapest in the industry, at a price of 10.50$ per barrel. Changes in consumer demand for oil, geopolitical issues and changes in oil supply from OPEC+ countries are some of the most important factors that could affect oil prices. The ongoing conflict in Ukraine can also have important repercussions: with the EU trying to reduce its reliance on Russian gas and accelerating its transition to renewables, there may be reduced demand for fossil fuels.

On top of that, the merger is attracting criticism from environmental activists who were expecting Exxon to shift towards cleaner energy sources, such as solar and wind. Instead, the company is doubling down on "dirty oil", which production in the Permian is draining water supply in the area. The company's commitment to recycling water used in fracking and plans to cut carbon emissions are steps towards sustainability, but may not be enough to appease critics. Moreover, the proposed cuts do not involve carbon emissions produced by consumers, a course of action that has been criticized for undermining climate-change targets by perpetuating oil consumption. Increased activism against the production of more oil and concerns about climate change may lead to tighter regulations and taxes on carbon emissions in the US, posing additional risks to the merged company's operations. The Biden administration has been critical of big oil companies for not intervening to alleviate gasoline prices, and it already intervened in the past to encourage automakers to switch to electric vehicles and utilities to speed up the transition to renewable energy. By consolidating its operations in the US, Exxon is betting that the US energy policy will not move against fossil fuels in a major way.

Finally, the deal puts pressure on Exxon's competitors, particularly Chevron, to pursue acquisitions in the Permian to remain competitive. This may lead to further consolidation in the US shale industry, leading to both opportunities and risks for all players involved. Careful navigation of these risks will be crucial for the merged company's success in the short term.

Long Term

The acquisition may pose long-term risks due to Exxon's resolve to stick to oil production despite forecasts of declining fossil fuel usage and increasing importance of renewables in the coming decades.

According to the International Energy Agency, the demand for fossil fuels will peak before 2030, whereas Exxon believes that oil consumption will remain robust for many decades, driven by commercial transportation and the chemical industry's feedstocks. The peak would mark the beginning of the end for oil and other traditional energy sources, with the process being accelerated by the recent energy crisis that followed the war in Ukraine. While companies like BP are targeting significant cuts in oil and gas production by 2030, Exxon is making a massive bet on the longevity of oil demand.

Exxon has established a low-carbon unit in 2021 to invest $17bn by 2027 in climate friendly technologies like carbon capture to reduce emission from the fracker's operations, but will continue to spend up to $25bn per year on its fossil fuel business. Exxon's CEO, Darren Woods, stated that the company will stick to activities closely related to its core oil business, such as carbon capture and storage and hydrogen, an approach that falls short of what many stakeholders have been urging oil giants to do - invest in renewable energy. This limited commitment to renewable energy may undermine Exxon's ability to adapt to the changing landscape of energy consumption.

Market reaction

As we said before, big deals in the E&P industry have often come in waves, as major acquisitions from oil giants put pressure on their competitors to keep up. The trend has its origins in the late 90s, when BP's $48.2bn acquisition of Amoco set off a series of deals that led to the creation of oil "super majors", including the mergers between Exxon and Mobil and that between Chevron and Texaco. More recently, following the beginning of the Covid-19 pandemic in 2020, ConocoPhillips bought Concho Resources and Shell's assets in the Basin for just under $20bn combined, Pioneer acquired Parsley Energy and DoublePoint Energy for $11bn and Chevron snapped up Noble Energy for $5bn. Now that the oil business in the Permian went from growing to mature and drilling for new oil discoveries became less profitable, the companies operating in the area have few options other than acquiring rivals to extend their acreage. Since oil prices have recovered from 2 years ago and sellers think that they can get good deals, experts believe that a new wave of consolidation is approaching.

A possible candidate for acquisition is CrownRock, another important oil and gas private equity-backed company in the Basin which in the last months has started talks with investment banks for advisory on a potential sale. Currently, the company has a valuation of around $8 bn. The acquisition of Pioneer may pose a challenge for Chevron and Occidental Petroleum Corp for the dominance on the Permian basin of West Texas. Both posted record annual profit in 2022, and Chevron is trading at 5-year record price. Chevron is Exxon's biggest competitor, having almost $10b in cash-on-hand and $30bn in FCF. It could finance the acquisition almost entirely with cash. The acquisition of CrownRock would help then Californian oil company to close the gap with Exxon and become a predominant player in the Permian basin. In the following months, we will see how things play out in the Permian basin.

Deal Advisors

ExxonMobil
Financial advisors: Citi, Centerview Partners
Legal advisor: Davis Polk & Wardwell LLP

Pioneer
Financial advisors: Goldman Sachs, Morgan Stanley, Petrie Partners LLC and Bank of America
Legal advisor: Gibson, Dunn & Crutcher LLP

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