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Chevron's Bid for Anadarko Creates 3 Important Questions

April 17, 2019

Conclusion

We would expect additional M&A after Anadarko's (APC) purchase by Chevron (CVX). Occidental (OXY) possible higher bid for APC according to news reports leaves at least one potential buyer looking. **Devon (DVN) and Pioneer Natural (PXD) appear most likely takeouts for Large cap corporate sellers in our view. Parsley Energy (PE) and WPX Energy (WPX) would be our SMID cap takeout candidates.** Our full list of potential buyers and sellers is located on page 2 Figure 1. Concho Resources (CXO), Diamondback Energy (FANG), and Pioneer Natural are positioned to sell down a material portion of their Permian acreage to bring forward cash to shareholders from parts of their portfolios that wouldn't be developed in the next ten years. We look at the three main questions we believe result from CVX's bid for APC

Question 1: Why was the market valuing APC so low?

The market use of EV/EBITDA(X) multiples for E&P valuation doesn't capture two important components of E&P valuation. First, the resource base is partially captured in PDP but the unbooked discovered resource is lost since it isn't producing cash flow. (Hess Corp (HES) relatively high multiple captures some of their Guyana unbooked resource.) **APC's stock was reflecting little to negative value for its Mozambique LNG as well as not valuing the upside from its DJ and Permian resource in our view.** The second reason is the capital intensity which is a function of both the corporate decline rate and the new producing assets that replace them. We see the market beginning to ask companies about their corporate decline rates but are confusing production growth rate decline as capital efficiency gain rather than just an artifact of math. Slowing production growth rate will lower corporate decline but this isn't a gain in capital efficiency. **APC's corporate decline rate below 20% compares favorably to most E&PS that are currently north of 30%.**

APC uniquely gives CVX 1) unbooked Mozambique resource upside as well as the ability to trade and market the uncommitted volumes, 2) Full delineated Delaware basin resource. APC drilled single wells across their entire acreage to capture operatorship, and 3) Gulf of Mexico (GOM) infrastructure to maintain production and optionality to new exploration. OXY's interest in APC could be to fill in offshore (GOM) and LNG (Mozambique) to finish out capabilities that other majors possess.

Question 2: What Majors are looking to acquire?

News reports suggest Occidental Petroleum (OXY) is considering a competing bid for APC after months of discussion with APC. Shell (RDS/A) appears to be the winning bidder for Endeavor (~300,000 net acres in the Midland Basin) based on news reports. Total (TOT) continues to focus on LNG assets in North America so Permian deal is unlikely in our view. BP just acquired BHP onshore assets so we would expect it to take some time before they act again given their gearing. Exxon (XOM) seems to be moving toward organic growth rather than corporate. ConocoPhilips (COP) hasn't been aggressive on the M&A front but we would expect them to add additional Permian acres in time. While we do expect a few additional deals over the next few years, asset purchases are more likely in our view. Obviously, CVX or OXY will be looking when one of them acquires APC. The market reaction to OXY's possible bid demonstrates that consolidation continues to be viewed negatively for the acquirer. As we have seen with multiple shareholder votes by buyers in the energy sector, both E&P and Oil Service, which are generally challenging, we would expect some smaller deals with "large" SMID cap like PE and WPX instead of large cap E&Ps.

Question 3: Which E&P will sell next?

Figure 1 below summarizes our thoughts on which companies are buyers or sellers beyond just the Majors. Most likely corporate transactions would be DVN, PXD for large cap and PE, WPX for SMID. DVN and PXD are currently considering options to accelerate cash return to shareholders which we believe would include looking at M&A as a seller. Both DVN and PXD have substantial Permian acreage (~280,000 net acres and ~680,000 net acres respectively versus APC's net 245,000). PE and WPX would allow a major to acquire without a shareholder vote for the acquirer. PE has ~192,000 net acres and WPX ~130,000 net acres. Concho Resources (CXO), Diamondback (FANG), and PXD appear as most likely to sell down the tail-end of their Permian inventory to accelerate cash return to shareholders. Noble Energy (NBL), which many have suggested, has a few more steps before we see them as a takeout candidate. We see numerous challenges to SMID cap merger of equals since the seller likely won't be able to restart an E&P.

Figure 1

Buyer	Lean Buyer	Neutral	Lean Seller	Seller
CNQ	CHK	APA	CDEV	LPI
DNR	CLR	AR	CPE	MTDR
ECA	COP	CNX	CXO	PE
OXY	MUR	COG	DVN	QEP
XEC	OAS	CVE	FANG	
	SM	EOG	HES	
	SRCI	EQT	JAG	
		GPOR	MRO	
		HPR	PVAC	
		NBL	PXD	
		PDCE	RRC	
		SU	WPX	
		SWN		
		UNT		
		WLL		
		XOG		

Source: Alden Securities LLC

Companies mentioned in this report:
APA,AR,BP,CDEV,CHK,CLR,CNQ,CNX,COG,COP,CPE,CVE,CVX,CXO,DNR,DVN,ECA,EOG,EQT,FANG,GPOR,HES,HPR,JAG,LPI,MRO,MTDR,MUR,NBL,OAS,OXY,OXY,PDCE,PE,PVAC,PXD,QEP,RDS/A,RRC,SM,SRCI,SU,SWN,TOT,UNT,WLL,WPX,XEC,XOG,XOM.

DISCLOSURE APPENDIX