AP CAPITAL RESEARCH

M&A Deal of The Week

CHEVRON X HESS

WRITTEN BY
Samuel Thompson

EDITED BY
AVISH PATEL

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Executive Summary

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Deal Summary

- On the 23rd of October, Chevron (CVX) announced the acquisition of oil and gas giant Hess Oil (HES) for an all-stock transaction valuing Hess' equity at $53 Billion. The enterprise value of Hess Oil is $60 billion.
- This is the biggest acquisition in Chevron's history. The acquisition of Hess Oil is expected to increase Chevron's output by more than 10%.
- This comes after the $64 billion acquisition of Pioneer Natural Resources by ExxonMobil and Chevron's $6.3 billion acquisition of PDC Energy INC in August. The Russia and Ukraine war caused energy prices to soar. Oil & gas companies have generated excessive profits, resulting in them increasing their stock buybacks and seeking M&A targets to distribute their large cash pile, strengthen their position and remain competitive in the industry.
- Shareholders approved the acquisition of Hess for $171 per share, initially a premium of 10.3%, but this later shrank to 3.1% (Bloomberg) due to poor earnings results from Chevron, causing the share price to fall, affecting the share premium in the all-stock deal.
- Chevron's current market capitalisation is $275.3 billion, and Hess' is $48.05 billion.

Deal Advisors

Chevron:
Lead Advisor: Morgan Stanley
Secondary Advisor: Evercore

Hess:
Lead Advisor: Goldman Sachs
Secondary Advisor: J.P. Morgan

Key Figures

- Chevron Market Cap: $275 Billion
- Chevron EV/EBITDA: 5.21x
- Offer premium: 10.3% [$171/share]
- Cost Synergies: $1 billion
- Hess' Market Cap: $48 Billion
- Hess' EV/EBITDA: 10.25x
- Hess' Enterprise Value: $60 Billion
- Hess' Equity Valuation: $53 Billion

Company Information

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Chevron

- Chevron Corporation is a Fortune 500 Oil and Gas giant based in the United States. They operate in all stages of the refining process, distribution and the production of fuel, petrochemical products, lubricants and additives. and this control over both production, distribution and retail is one of the reasons why they have been so successful.
- Founded in 1879, it has grown through acquisitions of potential competitors and operates in over 180 countries globally. The acquisition of Hess remains the largest in Chevron’s history.
- Chevron's 2023 Q3 earnings equalled $6.5 billion, equating to an EPS of $3.48, beating analyst estimates of $2.95. However, Q3 2023 earnings are down almost 52% compared to last year’s Q3 2022 earnings of $11.2 billion and EPS of $5.78. Their current EV/EBITDA is 5.98x, and they also have a trailing P/E of 9.88 with a forward P/E of 10.82.
- Chevron’s CEO said the oil industry was entering a period of consolidation, which offered a “unique and compelling opportunity” to bulk up its offshore presence in Guyana through the acquisition of Hess, while also entering the Bakken oil fields to help meet demand in the US.

Hess

- Hess Oil, founded in 1919, focuses on the extraction and production of Crude Oil and Natural Gas. Hess is known for its Bakken oil field in Montana and North Dakota, as well as their Offshore Guyana site, Stabroek Block, of which Hess owns a 30% share. This was Hess’ most significant oil discovery, allowing them to become a serious player in the oil industry in 2019, and this led to the extraction of over 220,00 barrels/day onwards from Feb 2022, equivalent to almost $20.2 million/day.
- Their current Q3 2023 earnings are $504 million in net income, which is an EPS of $1.64, which surpassed analyst estimates of $1.24. However, their current earnings are slightly down from Q3 2022 earnings of $515 million with an EPS of $1.67, a 2% decline. Their current EV/EBITDA is 10.25x; their trailing P/E is 31.04, with a forward P/E of 15.41.
- Hess's Q3 2023 barrel production was up 13% YoY with 395,000 barrels of oil equivalent per day (boepd), with Bakken increasing their net production by 14% [190,000 boepd] and Guyana by 10.2% [108,000 boepd].

Deal Rationale

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Guyana

- Guyana in South America holds great significance to Chevron and other oil and natural gas companies as since the discovery of the Liza field in 2015 by Hess, there have been estimates of over 11 billion oil barrels in reserves in the Stabroek Block in Guyana, with room for more as further extraction and exploration develops.
- This is attractive to firms such as Chevron and ExxonMobil as they have bumper profits due to higher prices and sanctions on Russian oil and gas, resulting in a flurry of acquisitions in the energy sector.
- Hess has a 30% share of Stabroek Block, located in the offshores of Guyana, which is rich in oil production. The key benefit of this block is that it holds over 11 billion barrels in reserves.
- Stabroek Block has the potential to produce more than 2 million barrels a day. The asset yields high cash margins, which Chevron will benefit from.

Bakken Oil Fields

- The Bakken oil fields in Texas and New Mexico will add another 465,000 acres of "high-quality, long-duration inventory supported by the integrated assets of Hess Midstream", and this, combined with Hess' Gulf of Mexico assets will assist in an "increase of asset sales and generate $10 to $15 billion in before-tax proceeds through 2028". During Q3 2023, Hess produced around 190,000 barrels/day, equivalent to $15.5 million/day.

Results of the acquisition

- As a result of this acquisition, Chevron is predicted to experience run-rate synergies of $1 billion/year. However, this is just an estimate and may vary depending on performance during the next few quarters.
- The rationale for an all-stock deal is due to volatile energy prices. Hess wanted to avoid settling for a specified price because they may regret an all-cash deal should there be further upside to energy prices. By combining the two companies, Hess' shareholders can benefit from additional upside and a substantial increase in dividends in Chevron stock.
- The acquisition is expected to be accretive to cash flow per share in 2025 once the Yellowtail development project goes live.
- The deal is expected to increase its production and free cash flow growth rate over the next five years, allowing it to return more value to its shareholders.
- The cost synergies are expected to be realised within a year of the acquisition.
- The acquisition will help to diversify Chevron's portfolio, which up until now has been concentrated in the Permian Basin in Texas and New Mexico, which will continue to give them stability in both domestic and international markets.

Final Thoughts

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The acquisition of Hess is significant as it shows that even though there are subsidies and encouragement from governments to become more environmentally friendly, especially in European nations, Big Oil firms still choose to double down on fossil fuels. This is not good for reaching the agreements as stated in the Paris Agreement in 2015, but it does show promise of an uptick in the global economy even though Chevron's earnings were relatively poor. This means that even though there is an emphasis on becoming more sustainable, energy companies will not voluntarily transition to clean energy, which begs the question, does the energy sector require higher rates of government intervention?

We already know that the energy sector is a natural monopoly and therefore requires regulation of prices, which, due to the Russia and Ukraine war, has led to higher prices and higher profits at the expense of the consumer. Sure, there has been an increase in windfall taxes on firms operating inside the UK, but this is not sustainable as a windfall tax is a one-off tax, not a solution to this problem.

SAMUEL THOMPSON
M&A ANALYST
Sjbt2015@gmail.com

AVISH PATEL
AP Capital Director
avishpatel92@gmail.com

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