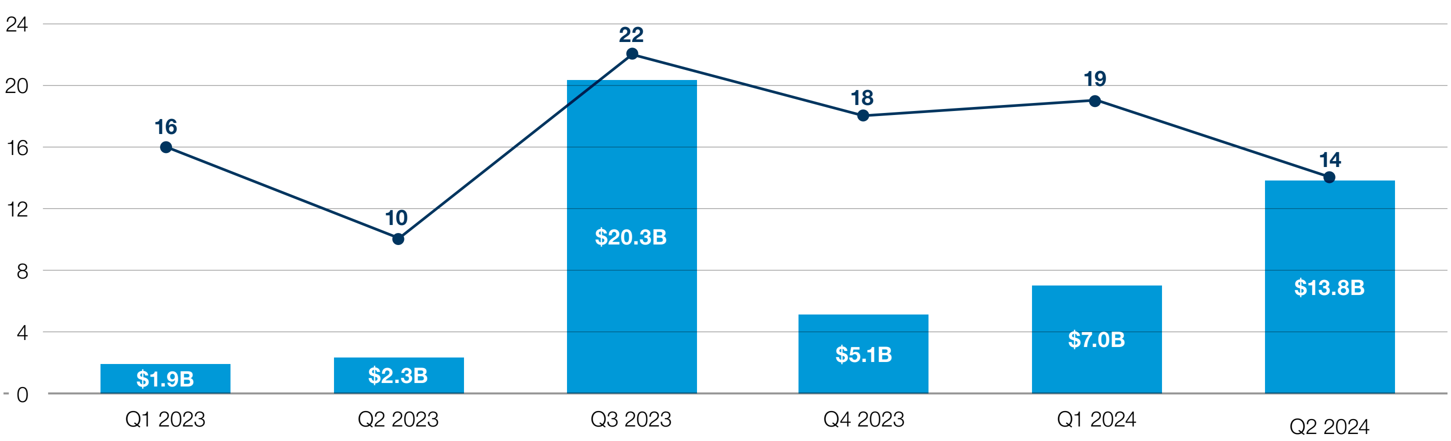
A&M ENERGY

Unlocking Value in Midstream Mergers and Acquisitions

Midstream M&A Continues at a Robust Pace.

The midstream oil and gas sector continues to experience a heightened period of consolidation. Mergers and acquisitions (M&A) have historically been used to stimulate growth, generate scale economies, and enhance strategic positioning. The midstream sector saw more than $20 billion in deals announced in the first half of 2024 versus $29.6 billion for all of 2023.[1] At the current pace, 2024 could be the biggest for midstream M&A since 2019.

Midstream Transactions per Quarter (Q1 2023 – Q2 2024)



Source: Alvarez & Marsal Insight Center

Transactions Often Fail To Deliver the Expected Value.

The challenge for midstream operators, particularly the consolidators, is realizing the potential benefits of transactions. While M&A is not a new strategy, the history of achieving expected results is mixed at best, with results skewed toward value destruction rather than value creation. The challenges to realizing merger benefits are numerous. Examples of common challenges include cultural differences, commitment to execution, changing market conditions, loss of key employees, issues missed during due diligence, and lack of governance and accountability for realizing targeted benefits, among others.

To overcome these challenges, organizations must properly outline and execute a well-thought-out and robust pre- and post-transaction plan. Failure to do so can result in missed opportunities or, worse, catalysts for crippling an organization. For example, in 2017, we witnessed a midstream company execute a transaction to acquire a 50 percent equity stake in an adjacent midstream storage company. The transaction was set to offer several synergies and be immediately accretive to the organization's distributable cash flows. Instead, a year later, the acquiring company was unable to capture its intended value and, as a result, sold the entire 50 percent equity stake in the company, taking a ~$700 million loss for the quarter, a ~$500 million loss in the obtained assets and a $300 million noncash loss on the transaction.

1. Alvarez & Marsal Insight Center, July 10, 2024.

When it comes to effective transactions, there is no single guarantee of success. However, with the right pre- and post-transaction planning and execution, many pitfalls can be avoided. Such plans start with target screening, due diligence, Day 1 planning, and integration management and execution.

A&M's Deep Experience With M&A Has Informed Our Perspective.

To date, Alvarez & Marsal has improved performance for more than 1,000 organizations in the energy sector, supporting more than $120 billion in transaction value and more than $20 billion in value creation.

Through this experience, we have wrestled with and solved some of the most common and difficult roadblocks to M&A value realization. Each of these issues can significantly limit the ability of companies to realize the expected value, and often they combine to cause value destruction in an otherwise value-creating transaction.

Common Issues in Midstream M&A.

Challenges with M&A in the midstream energy sector begin in the early phases of the transaction lifecycle and grow as the deal matures. Many organizations with an appetite for M&A find transactions go awry and issues arise through due diligence and transaction planning. Several factors can drive a transaction off track.

Gaps in due diligence can lead to a distorted view of valuation for the target company and its synergy opportunities. Oftentimes, the personnel responsible for getting the deal closed are not responsible for ensuring the synergies are achieved, leading to an inaccurate view of the target company's compatibility. Many buyers rely on high-level, top-down analysis to estimate potential synergies. The failure to dive deep into the target company's operations and financials can result in an inaccurate evaluation of the alignment of both businesses. As midstream operators seek economies of scale through consolidation, consolidators will need a thorough view on how the combined company will unlock more value than the two companies can independently. After all, the synergies are the rationale for the merger or acquisition. Strong due diligence confirms and validates the assumptions behind the synergy estimates.

Poor Day 1 planning is one of the most familiar challenges in the first few weeks after the deal is announced. Failing to take a rigorous approach to Day 1 increases the likelihood of disruptions to critical business operations, which can severely impact the combined entity's ability to deliver on Day 1.

Overly simplistic integration planning often stems from not having the right people and processes during planning. Ineffective integration planning, like Day 1 planning, leads to operational disruptions, failed synergy capture and long-term risks to business continuity.

Integration execution requires discipline and cross-functional coordination. Many organizations fail to realize the full benefits of a transaction and destroy value. This situation arises due to a lack of clarity and focus on the rationale for the transaction or cultural norms preventing the cross-functional coordination required to execute the integration priorities. Failed execution of integration priorities is responsible for the lack of delivered synergies and enterprise value. Studies show that synergies are typically realized one to three years after the transaction. For that reason, Alvarez & Marsal believes in a relentless focus on synergies and organizing integration activities around synergy achievement.

Overcoming the Challenges With Midstream M&A Throughout the Transaction Life Cycle.

Through our experience in midstream and adjacent sector transactions, we have developed a proven approach to support companies throughout all phases of the transaction life cycle. The approach is designed to directly address common challenges with midstream transactions, and accounts for nuances in business models, capital structures, cultural issues, regulatory requirements, contract structures and assignments, systems integration challenges, and operations integration synergies.

Reducing the risk of poor synergy capture and valuation begins with a clear identification of the investment thesis and "must-believes." With a clear set of "I must believe this to proceed with the transaction," a bespoke and thorough due diligence scope can be defined and executed. To prevent potential gaps, organizations will not only want to determine the total value of expected synergies, but also where they come from and the likelihood of their achievement. During diligence, buyers should develop a streamlined operating model.

At A&M we examine top-quartile peer OpEx/MCFE, G&A/MCFE and Capex spend metrics for the operations of like-assets that can help identify underwritable synergy capture opportunities.

Additionally, **A&M's proprietary PeerView peer comparison tool** provides visibility into market-leading category unit costs that inform the optimal operating model and help accelerate synergies. We compare asset efficiency and develop economic recommendations normalizing system parameters, such as contractual service level agreements, intensity of processing, geographic constraints, and environmental and regulatory risk. Concluding the diligence phase with a crisp understanding of the target's condition against the investment "must-believes" provides a foundation for an integration planning phase focused on the areas that provide the greatest EBITDA improvement.

Engaging the business early and at multiple levels during integration and Day 1 planning will help overcome potential operational performance challenges. Employee engagement requires extensive change management efforts, visible commitment, ownership from leaders of both organizations and a shared understanding of cultural core values. Early alignment brought on by consistently engaging the organization in change efforts can help improve the effectiveness of the transition and create an integrated platform for growth.

Consistent and clear integration-tracking and monitoring success metrics during integration execution prevent potential loss of value. While transaction-specific metrics are developed as part of the planning phase, several measures are often reviewed upon completion of integration planning and throughout the first 100 days. Key decision and risk escalation protocols should be established and actively used to mitigate potential program and change management risks. Well-defined synergy targets are not enough to ensure targets are met. They should be organized as individual projects, integrated into operating budgets and linked to business processes to drive accountability for their achievement.

Mitigating the Toughest Challenges in Midstream M&A

Priorities	Challenge	Mitigation
Due Diligence	• Detailed, obtainable and accurate synergy targets • Identification of legal, financial and cultural risks • Integration risks and operational challenges	• Outlining synergy origin and determining likelihood of attainment • Checklists covering all aspects of the organization • Clear identification of the investment thesis and "must believes"
Day 1 Planning	• Communication and transparency across the business • Strong employee morale and engagement • Business alignment, horizontally and vertically	• Early engagement at multiple levels of the organization • Extensive development of change management efforts • Shared understanding of cultural core values
Integration Planning	• Program and change management risks • Development of go-forward blueprints • Rightsizing and downsizing the execution management structure	• Defined decision, priority and risk escalation protocols • Representation from all business areas • Communication with leadership on key team member involvement
Integration Execution	• Successful execution of integration priorities • Accountability with synergy achievement • Achieving the maximum deal value	• Synergy targets organized as projects, integrated into operating budgets and linked to business processes • Clarity and focus on the rationale for the transaction • Cross-functional coordination and discipline with delivery

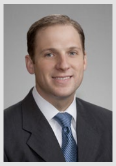
A Robust Approach Improves Outcomes in M&A.

The midstream M&A landscape will continue to evolve. However, successful transactions will always include a robust approach to pre- and post-transaction strategy, planning and execution.

Our approach is based on a structured and fact-driven process to shepherd a transaction from the initial hypothesis through execution and operationalization of the acquired asset or entity, while working with management, bankers and staff to drive the end-to-end process and realization of the intended results.

Alvarez & Marsal has partnered with several midstream operators across the M&A lifecycle using a proven approach to addressing common challenges with midstream M&A. If you have any questions or would like to discuss how we can support your organization, please reach out for more information about our services and expertise.

Key Contacts



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ABOUT ALVAREZ & MARSAL

Companies, investors and government entities around the world turn to Alvarez & Marsal (A&M) for leadership, action and results. Privately held since its founding in 1983, A&M is a leading global professional services firm that provides advisory, business performance improvement and turnaround management services. When conventional approaches are not enough to create transformation and drive change, clients seek our deep expertise and ability to deliver practical solutions to their unique problems.

With over 10,000 people providing services across six continents, we deliver tangible results for corporates, boards, private equity firms, law firms and government agencies facing complex challenges. Our senior leaders, and their teams, leverage A&M's restructuring heritage to help companies act decisively, catapult growth and accelerate results. We are experienced operators, world-class consultants, former regulators and industry authorities with a shared commitment to telling clients what's really needed for turning change into a strategic business asset, managing risk and unlocking value at every stage of growth.

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