Portfolio optimization drives divestments and dealmaking

Fluctuating commodity prices have led to an increased focus on capital allocation for oil and gas companies making long-term investment decisions against a global backdrop of shifting energy trends, changes in both supply and demand and in the wider capital markets. Companies are constantly assessing what geographies, asset types and areas of the value chain offer the best opportunities. The frequency of portfolio reviews has increased, with 60% of the executives reviewing their portfolio at least twice a year. This dynamism makes portfolio management a core activity for most businesses in the sector and leads to strategic decision-making: currently more than 85% of oil and gas executives report they plan to divest during the next two years.

As a result, portfolio optimization is one of the major items on boardroom agendas and has resulted in robust levels of M&A activity, particularly in upstream. The total reported deal value for oil and gas transactions in 2017 was US$344 billion, with upstream deal value at its second highest over the last five years, according to EY's *Global Oil and Gas Transactions Review 2017*. Oil majors with significant cash flow needs are divesting mature or late-life assets, even as they actively acquire and consolidate their position in key basins. In 2017, divestments by the majors of over US$23.1 billion was on par with acquisitions of US$23.2 billion.

87% are planning to divest within the next two years

57% of oil and gas companies expect to see more divestment activity due to industry consolidation over the next 12 months

67% of oil and gas companies prioritized value over speed in their last divestment

70% say they held onto assets too long when they should have divested

For 97% of executives, the top divestment driver is the business unit's weak competitive position in the market – up from 63% in 2017. Major international oil companies are selling off mature assets to strengthen their balance sheets and pay down debt. However, they are retaining the decommissioning liabilities, which increases the marketability of these assets and thus the ability to achieve higher valuations given the reduction in risk. In another case, divestments of Canadian oil sands assets from international to Canadian companies were driven by consolidation and flight to core assets, on the part of buyers and sellers, rather than valuation. Use of more innovative deal structures, such as issuing shares in favor of cash, have also helped drive an increase in deal value. Other innovative deal structures that are now being used include deferred and contingent considerations in transactions rather than cash. This, in turn, implies that more risk-sharing is taking place, as headline valuations are being broken up by risk exposure.

Oil and gas executives also highlighted that they wish to divest, in order to invest: technology is facing increased attention with 90% of oil and gas companies planning to invest to improve operating efficiency and address changing customer needs. Technology is also playing a crucial role in decision-making, with over 95% using data analytics to leverage and understand the true value of a non-core asset in their last divestment. Market demographics are encouraging downstream investment, highlighting the range of strategic options available and the scope within the value chain. With many oil and gas projects operating as joint ventures, successful companies in the sector need to be as adept at managing relationships with parties as diverse as state-sponsored to private, niche regional technology specialists, as they are at managing their portfolio of businesses and assets.

Changing tax landscape drives divestments

64% say tax policy changes are a geopolitical driver in their plans to divest

40% of oil and gas executives indicated that over the last 12 months highlighting tax upsides to purchasers better enabled them to drive value

Analytics delivers value

97% of oil and gas companies leveraged advanced analytics to understand the true value of a non-core asset in their last divestment

56% of oil and gas companies say they expect to make greater use of prescriptive analytics for portfolio decisions over the next two years

Delivering digitization through divestments

73% say the changing technology landscape is directly influencing their divestment plans

78% of oil and gas companies are divesting to fund new technology investments to improve operating efficiency (90%) and address changing customer needs (60%)

Across all sectors, those that conduct portfolio reviews annually are twice as likely to exceed performance expectations for divesting "at the right time."

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The oil and gas sector is constantly changing. Increasingly uncertain energy policies, geopolitical complexities, cost management and climate change all present significant challenges. EY's Global Oil & Gas Sector supports a global network of more than 10,000 oil and gas professionals with extensive experience in providing assurance, tax, transaction and advisory services across the upstream, midstream, downstream and oilfield subsectors. The Sector team works to anticipate market trends, execute the mobility of our global resources and articulate points of view on relevant sector issues. With our deep sector focus, we can help your organization drive down costs and compete more effectively.

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