ExxonMobil to acquire Pioneer Natural Resources in $59.5bn deal

Introduction

On October 11th, Exxon Mobil Corp [XOM:NYSE] announced its plans to acquire Pioneer Natural Resources [PXD:NYSE] in an all-stock deal for $59.5bn, or $253 per share, representing a premium of 16% to Pioneer's closing price on October 5th. The implied enterprise value of the transaction, including debt, is approximately $64.5bn, and Pioneer shareholders will receive 2.3234 shares of ExxonMobil for each unit of PXD. The merger emphasises Exxon's long-term commitment to fossil fuels as prices surge and is the company's largest buyout since acquiring Mobil in 1999 for close to $80bn. This article further discusses the deal's structure, rationale and implications.

About ExxonMobil

Exxon Mobil Corporation is one of the largest publicly traded companies in the world and operates as an oil and natural gas producer. The company explores and produces integrated fuels, lubricants, chemicals, and refined products for the automotive, trucking, aviation, and shipping industries.

Founded by John D. Rockefeller in 1870, Standard Oil was the largest petroleum company in the world. In 1911, due to antitrust actions, the Supreme Court ruled the company as a monopoly. This decision forced a separation into several separate entities, two of which were the predecessors of Exxon and Mobil. The firm, which took its present name in 1999 per the merger of Exxon and Mobil, is vertically integrated across the entire petroleum and gas industries and has its headquarters in Spring, Texas.

ExxonMobil is the largest non-government-owned company in the energy industry and produces about 3% of the world's oil and about 2% of the world's energy. The company's operations are grouped into three categories, which include Upstream (oil exploration & extraction and wholesale operations), Product Solutions, and Low Carbon Solutions. Additionally, there are several standalone divisions, such as Coal & Minerals, and participation in hundreds of subsidiaries.

Upstream

The upstream division is responsible for about 70% of the business's revenue, and as of 2021, it possessed around 30bn barrels of oil and 38.1bn cubic feet of natural gas in reserves. In the U.S., the major operations are in the Permian Basin, Bakken Formation, and the Gulf of Mexico, with natural gas activities managed exclusively by subsidiary XTO Energy. Globally, they have significant holdings in Canada (including the Kearl Oil Sands Project), Europe, Africa, Asia and a joint venture with Shell Oil in California called Aera Energy LLC. The company had a significant presence in Russia, collaborating with Rosneft. However, following the 2022 Russian invasion of Ukraine, ExxonMobil decided to withdraw from the country entirely and initiated a lawsuit against the Russian federal government.

Product Solutions

ExxonMobil formed its Product Solutions division in 2022, combining its previously separate Downstream and Chemical divisions into a single company. This unit oversees retail, chemical development and sponsorship agreements (NASCAR). The company also operates 21 refineries worldwide, and in 2021, its global average refining capacity was 4.6m barrels per day, with the United States producing about 1.77m barrels per day.

Low Carbon Solutions

The Low Carbon division intends to lower emissions in hard-to-decarbonize sectors such as heavy industry, commercial transportation, and power generation using a combination of lower-emission fuels, hydrogen, and carbon capture and storage. The company is designing its inaugural large-scale plant dedicated to producing low-carbon hydrogen, situated within its refining and petrochemical complex in Baytown, Texas. The project is set to become the world's largest low-carbon hydrogen project.

Following losses in 2020 due to the COVID-19 pandemic, the largest O&G companies posted record-breaking net profits for 2022. More robust demand was already increasing the price of gas and oil, and more recently, the cost of energy was driven, above all, by Russia's war against Ukraine. In 2022, ExxonMobil reported $399bn in revenue and a net income of $55.74bn, with a profit margin of roughly 14%, a significant improvement in all aspects YoY. Altogether, the five Big Oil companies reported combined profits of nearly $200bn in 2022. The abundance of cash led American firms to reward their shareholders through stock buybacks and higher dividends, while European producers have invested most of the windfall profits. The oil giants continue to invest in hydrocarbon energy exploration as investors pressure companies to maximize profits rather than invest in lower-margin renewable energy. Upstream O&G have historically had returns of 15-20%, while most renewables projects have delivered around 8%. A recent study by The International Energy Agency forecasted global investments in the area to increase by about 11% to $528bn in 2023, the highest level since 2015.

Despite its economic success, the company has been involved in environmental controversies, oil spills and climate change scandals. Most notably, Exxon waged a decades-long campaign to deny climate change and its connection to the burning of fossil fuels, even though internal research indicated the contrary.

About Pioneer

Pioneer Natural Resources Company, headquartered in Irving, Texas, is engaged in onshore oil and gas drilling exploration and production in the United States. It operates in the Cline Shale in the Permian Basin, where the company is the largest acreage holder. As of December 31, 2022, the company had 2.38bn barrels of oil equivalent of proved reserves, of which 41% was petroleum, 23% was natural gas liquids, and 28% was natural gas. In 2022, the company produced 649 thousand barrels of oil equivalent daily.

Pioneer has been involved in many high-profile acquisitions. Examples include the 2004 acquisition of Evergreen Resources for $2.1bn, the 2021 acquisitions of Parsley Energy for $4.5bn and DoublePoint Energy for $6.4bn. These acquisitions had the primary objective of expanding acreage, boosting production, and achieving operational synergies in the Permian region. By integrating these companies' assets, Pioneer aimed to realize significant cost savings and streamline operations. The shale industry is going through a consolidation movement as big oil companies are high in cash and doubling down on drilling for oil and gas. Specifically, they compete for the best drilling areas in the Permian Basin, North America's largest source of crude. The robust exploration has depleted some of the Permian's highest-quality drilling targets, and companies with cash from unprecedented profits are looking for other acquisition opportunities to ensure future production. Investors are closely watching as vast untapped reserves ensure the sustainability of substantial dividends in the future.

In 2022, Pioneer Natural Resources generated its highest revenue of roughly $24.3bn, figures increased by 66 YoY. During this time, the company had a net income of approximately $7.8bn and a profit margin of 32%, both higher than the previous year.

Deal Structure

On the 11th of October 2023, Exxon Mobil [NYSE: XOM] signed a deal to acquire Pioneer National Resources [NYSE: PXD] at $59.5bn valuation. Earlier this year, the two parties entered talks for a potential merger. However, it was not until September that Exxon [NYSE: XOM] approached Pioneer [NYSE: PXD] with a position of strength. Indeed, its stock trading at near all-time highs, and $30bn of cash on hand originated from a capitalization on elevated energy prices and an efficient streamline of operations towards highly profitable oil & gas production. This implied that Exxon [NYSE: XOM] entered deal negotiations with its stock regarded by investors as a valuable currency. Although Exxon [NYSE: XOM] could afford to pay with a combination of its cash on hand and borrowing, the transaction was structured as an all-stock deal that allowed the two companies to reconcile their price disagreements. Exxon [NYSE: XOM] will pay a smaller premium while Pioneer [NYSE: PXD] could allow its shareholders to benefit from the deal's cost and revenue synergies by giving them more than 10% of the combined entity. According to people familiar with the matter, a crucial element of this deal was the relation between CEOs Darren Woods and Scott Sheffield with the latter admitting that "Darren has been very fair in the negotiations" helping the transaction to unfold unexpectedly quickly.

Exxon [NYSE: XOM] paid a relatively low premium on Pioneer's [NYSE: PXD] share price, 16% on the unaffected share price and 9% of the prior day closing. This small growth between both shows that the stock remained relatively stable through negotiations and investors had an accurate grip on the low premiums in the energy & petrol space. The 9% premium is in fact in line with recent transactions in the industry and slightly higher than what Exxon [NYSE: XOM] paid for CCUS. However, CEO Denbury believes this "still strikes us as slightly low for a company with the unique scale and quality of inventory held by Pioneer." With the deal valued at $59.5bn, or $253 per share, Pioneer [NYSE: PXD] shareholders will receive 2.3234 shares of Exxon [NYSE: XOM] for each Pioneer [NYSE: PXD] share they own. Furthermore, at this value, the deal is expected to be significantly accretive for Exxon [NYSE: XOM]. Indeed, its 2024E EV/EBITDA multiple is trading at 6.5x versus an implied 5.4x pre-acquisition and its FCF yield is expected to increase from 7% to 8% post-acquisition. Lastly, with this deal, Exxon is paying $4.5 million for each of Pioneer' [NYSE: PXD] high-quality locations and $3.7 million for all locations. While this is significantly higher than recent M&A transactions where nothing has traded north of $3 million per location, it remains a strong opportunity for Exxon [NYSE: XOM] to create a leading combined entity.

Deal Rationale

The rationale of this transaction for Exxon [NYSE: XOM] is to become the largest shale producer in the Permian basin, itself the biggest and most lucrative U.S. oilfield. As underlined in the deal structure, this also comes at a time where Exxon [NYSE: XOM] is in a position of power and can afford to go on a shopping spree as part of its aggressive inorganic growth strategy. Combined with an attractive price obtained through effective negotiations, this highlights the strong timing and strategical perspective for Exxon [NYSE: XOM] to step in and acquire Pioneer [NYSE: PXD]. This transaction also underlines the willingness of Exxon [NYSE: XOM] to be the first mover in the large-scale Permian M&A and proves that the shale sector is becoming a more mature business. It also sets a precedent for future deals such as Chevron's $53bn acquisition of Hess and contributes to the industry's overall consolidation.

From an operational perspective, Pioneer [NYSE: PXD] represents a unique Permian portfolio that offers such scale, quality, and high proportion of operatorship and undeveloped acreage that mitigates risk of interference from parent wells. In addition, Darren Woods expects Pioneer [NYSE: PXD] to hold 6,300 net locations of high-quality inventory, well locations that generate a 10% return at a WTI price of below $50, and 16 years of drilling activity at its current rig rhythm. Furthermore, Pioneer [NYSE: PXD] is the second largest holder of inventory in the Permian area and merging it with the currently fourth would create an unrivaled industry leader. The combined entity would be just shy of 18,000 drilling locations. While no figures are yet available this will yield strong cost and revenue synergies. As a result, this deal is ensured to be accretive to financial but also operational metrics.

Chevron & Hess

On the 23rd of October, less than two weeks after ExxonMobil announced its acquisition of Pioneer for $59.5bn, Chevron sent another shock wave through the O&G industry by announcing it would acquire Hess Corporation for $53bn. Hess, just like its acquirer, is an American energy producer; it is most notably engaged in the exploration and production of crude oil and natural gas with leading positions offshore Guyana, the Bakken shale play in North Dakota, the deepwater Gulf of Mexico, and the Gulf of Thailand.

It is interesting to note that Chevron didn't answer ExxonMobil with a Permian basin deal of its own, but the deal has the same aim: leading the race for the last available sources. The transaction is also expected to be accretive to cash flow per share in 2025, and achieve run-rate cost synergies around $1 billion before tax within a year of closing. The acquisition consideration is structured with 100 percent stock utilizing Chevron's equity. It is expected to close in the first half of 2024, subject to regulatory approvals and other customary closing conditions. In aggregate, upon closing of the transaction, Chevron will issue approximately 317 million shares of common stock.

Market Reaction and Outlook

ExxonMobil's stock closed on the 10th of October at $110.45, and on the 11th of October at $106.49, meaning the stock decreased 3.6%. Volume was multiplied by a factor of four over these two days, from 14 to 58 million shares. Pioneer Natural Resources' stock closed on the 10th of October at $237.41, and on the 11th of October at $240.82, meaning the stock increased 1.4%. Volume was multiplied by almost 20, compared to its average, with 21 million stocks changing hands. The positive news for Pioneer seems to have pushed other shale players' stocks higher too: Diamondback Energy, Devon Energy, Marathon Oil, SM Energy, APA, and Warren Buffett-backed Occidental Petroleum were all up on the day of the announcement.

Regarding antitrust worries, experts and lawyers seem to agree that the U.S. administration would face an uphill battle in trying thwart the acquisition. Over the last years, Joe Biden has blamed energy companies, and in particular ExxonMobil, for high energy prices taking their toll on consumers. The White House wrote to the Federal trade Commission (FTC) Chair in 2021 to ask her to scrutinize deals in the O&G sector for "anti-consumer behaviour", which caused the antitrust regulator to slow down the approval of many of them, to review them more thoroughly. Regardless, the FTC would struggle to forbid this merger, because oil and gas companies have been effective in arguing U.S. mergers alone cannot stifle competition, as commodity prices are dictated by supply and demand forces in a vast global market. Furthermore, an antitrust attorney with Doyle, Barlow and Mazard PLLC, said oil and gas deals such as this one, which involve production and exploration, are even easier to defend under antitrust law. Considering market movement, and antitrust lawyers' opinion, we can thus expect the deal to happen.

Advisors

Citi acted as lead financial advisor, Centerview Partners as financial advisor, and Davis Polk & Wardwell as legal advisor to ExxonMobil. Goldman Sachs, Morgan Stanley, Petrie Partners and Bank of America Securities acted as financial advisors to Pioneer. Gibson, Dunn & Crutcher LLP acted as legal advisor to Pioneer.

Conclusion

In conclusion, this strategic move positions ExxonMobil as the dominant player in the largest U.S. oilfield and secures a decade of cost-effective production. The FTC is expected to let the deal pass, meaning ExxonMobil should effectively acquire Pioneer Natural Resources in 2024.