

SUPPORTING SUCCESSFUL DOWNSTREAM ACQUISITIONS

by Richard J. Marcogliese

In recent years, the downstream market has seen steady growth in Mergers & Acquisitions (M&A) transactions involving non-traditional buyers. It is not unusual, for example, to see private equity (PE) firms investing in the downstream business via the acquisition of a refinery or related assets; and independent refiners continue to be involved in purchasing stand-alone facilities that no longer fit the previous owner's geographic or strategic focus.

Downstream assets can be attractive acquisition targets for non-traditional buyers seeking steady returns and diversification. Both PE firms and small independents bring unique skill sets to these transactions, as well as to the ongoing management of the asset post-transaction.

At the same time, aside from a handful of integrated major oil companies and large independent refiners, acquiring companies may lack the internal resources to perform in-depth due diligence prior to the transaction. It can also be a challenge to fully support the transition planning process, as well as carry out post-closing activities designed to increase efficiency and improve margins.

PE firms, while strong in financial modeling, typically don't have in-house experts in refining and other downstream operations. That lack of expertise can result in overlooked plant reliability and operational integrity issues and missed profit improvement opportunities. It is critical that the due diligence process determine whether the targeted assets can perform and meet the expectations of the economic model.

Small independent refiners do have the operational know-how. They, however, sometimes lack sufficient staff size to dedicate knowledgeable people to in-depth due diligence activities and managing transition-related issues.

Even companies with sufficient resources can struggle without a proper organizational plan, falling into the classic "silo approach" where different individuals or functions are responsible for each step of the acquisition, transition and initial operating plans – and there is inadequate integration of effort between each step.

A specific example of this is the frequent assignment of an acquisition team whose goal is completing the transaction. The importance of delivering this goal is illustrated by the best-selling business how-to book by two Harvard professors titled "Getting to Yes." At Pilko, we realize that "Getting to Yes" only provides the opportunity to deliver a successful

transaction. "Getting to Yes" is only a milestone, not the end goal.

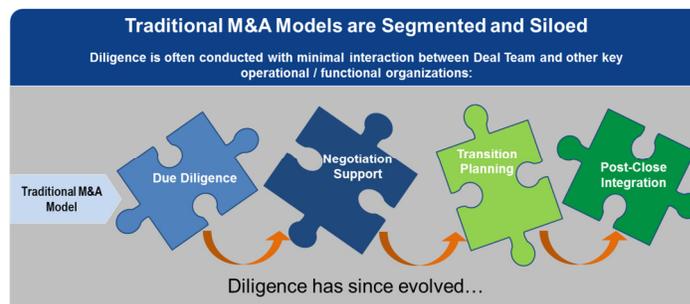


Figure 1: The Classic "Silo Approach"

The Pilko Integrated M&A Process includes a critical next step "Getting from Yes to Success," which involves a robust and collaborative approach among the functional and corporate groups to ensure post-closing success.

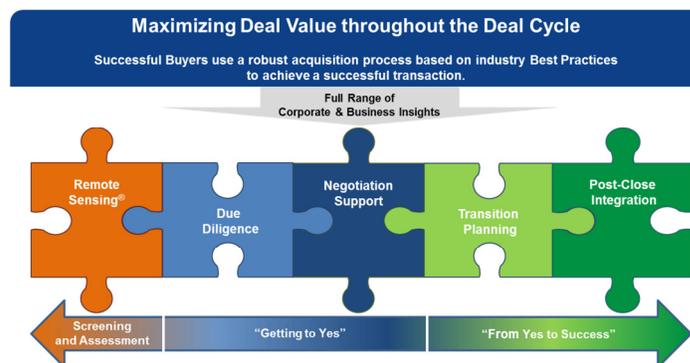


Figure 2: Pilko's Integrated M&A Process

Pilko & Associates provides a broad range of services to firms seeking assistance with M&A – from initial due diligence through the implementation of new processes and strategies designed to maximize the success of the acquisition. Our advisors have real-world, industry experience in health, safety and environmental (HSE) performance and plant operations with some of the world's leading energy and chemical companies. They have seen – and solved – the leadership, cultural and behavioral challenges that can undermine an acquisition and subsequent operation of a refinery or associated asset.

The following case study provides an overview of how Pilko & Associates was engaged in a major refinery transaction in support of a private equity firm that continues to benefit from our operational experience and executive-level support and guidance.



PILKO CASE STUDY

Pre-transaction activities

Pilko & Associates was retained by a private equity firm interested in the acquisition of a refinery complex. As part of the firm's due diligence, they wanted an advisory firm with refining executive background, with experience in the acquisition and assimilation process, to visit the facility and provide a written report centered on the plant's physical condition, potential operational integrity issues, and an unbiased assessment of the asset's ability to perform.

Pilko's initial visit to the refinery included a complete facility tour, interviews with key management staff and refinery leadership, as well as examination of historical files in the virtual data room to review operational results, competitive benchmarks, and any evidence of plant performance issues including health and safety and operating reliability. It was critical to get a sense of the overall culture at the facility and the attitudes and behavior of management and staff toward the asset and their jobs.

The goal for this two-day "early scouting" effort was to gain insight into the quality of the asset, the organizational capabilities and the plant's level of competitiveness. In other words, can this asset perform up to the potential buyer's expectations and meet or exceed the financial model for investment?

Pilko & Associates' deliverables included an immediate conference call debrief following the visit along with a detailed written report of our findings. The information gathered was folded into the firm's own due diligence, and helped executives feel more confident about their decision to move forward.

Over the next several months, I returned several times to provide additional transition support, including advice on the development of an improved labor agreement that was a key milestone toward the eventual transaction.

Once a deal was agreed upon in principle, Pilko was asked to send a full senior advisory team to the refinery for a more formal and detailed due diligence effort that focused on operational and HSE issues. Our team of experts conducted an assessment very similar to our proprietary **8IGHT DRIVERS®** review, which involved a deep dive in the facility's HSE performance and culture. The review enabled us to provide additional insight into the facility's strengths and weaknesses prior to closing.

Though timing on this particular acquisition did not permit, Pilko & Associates also offers an early due diligence methodology called **Remote Sensing®**, which can uncover a broad range of potential safety and operational issues without the need for a site visit. This can be very effective in determining early interest or disinterest in a target asset. The Remote Sensing process can gain critical and insightful information for a potential buyer without the identity of the buyer being divulged.

This can be a key consideration in the early stages of the assessment of a transaction.

Transition planning activities

As soon as the PE firm reached a purchase and sale agreement with the seller, we were asked to participate on the transition planning team, beginning with the design of a new organizational structure that would be implemented on Day 1.

Our active involvement in establishing a list of priorities for the first 100 days after the close, directly supporting the new company's CEO, included a broad range of activities, from HSE to operational and profit performance improvements.

Post-close activities

Following the close, I supported the roll out of the new organizational plan and implemented the priorities developed for the first 100 days. I also served as a key interface with other consultants working on the acquisition, and provided ongoing support to the CEO and local refinery managers.

During a time of change such as an asset acquisition, it often helps to have someone with direct experience provide an external perspective from prior executive management within the refining industry. It is important to establish a level of trust as an advisor with both executives and management as there are no goals other than helping the asset improve more quickly and effectively.

This effective working relationship also allowed the integration of other experienced Pilko & Associates advisors and resources for more specific improvement initiatives. This included an experienced corporate HSE director who helped rewrite a legacy operations excellence management system for more effective local use. We also integrated and continue to use one of the industry's best resources in safety culture assessment, competency development and supervisory leadership training.

Today, nearly three years after the acquisition's close, I continue to advise the plant's leadership team, and I have a strong working relationship with the CEO that enables me to provide onsite assistance with specific improvement projects as well as serve as a sounding board for new ideas and issues.

Lessons learned

In the days since the closing, the plant's personnel safety performance has been impressive. Leadership emphasis from the top along with targeted supervisory competency development have combined to make this possible. Continuing efforts are targeted to apply industry best practice to ensure sustainable industry-leading results.

Pilko & Associates' involvement has played a key role throughout the acquisition process and ongoing operations. And as an executive operations advisor to the CEO, I've been able to give support to his senior leaders in an efficient and unobtrusive manner.



Working Together

This case study is representative of the types of engagements that Pilko & Associates is known for since 1980. My Pilko colleagues average over 37 years of operational and executive experience in the energy and chemicals industries and provide support to clients with similarly complex challenges. This engagement model is also applicable to non-acquisition scenarios. In addition to this example, we have taken a similar approach to improving operations at a small independent refining company, which is benefitting from the broad industry exposure of our executive advisors.

Pilko & Associates can do the same for your company during transactions, whether it's Remote Sensing®, robust due diligence, in-depth acquisition assessment and planning, and post-close asset integration or ongoing operational improvement and operational risk mitigation.

If you would like more information on how Pilko & Associates' advisory services can assist in your M&A needs or your ongoing organizational guidance, please contact us:

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about Pilko

Pilko & Associates is the No.1 advisor to energy and chemical companies on Operational and Environmental, Health & Safety (EHS) Risks during ongoing operations as well as acquisitions, mergers, joint ventures and divestitures.

Since 1980, we have served energy and chemical clients in more than 59 countries, advising on over \$600 billion in transactions and ongoing operations. In addition, we have developed an excellent reputation advising companies on the integration of new or improvement of existing operations and the governance of Operational and Environmental Risks. Our global experience, combined with extensive knowledge and capabilities, is invaluable to firms in mitigating their most significant Operational and EHS risks and liabilities, thereby maximizing value and optimizing business performance.

For more information about our services and capabilities, please visit us at www.pilko.com.