# 5TH VIRTUAL TRANSACTIONS ROUNDTABLE

**June 15, 2021**

*Hosted By*

HSBC pilko Skadden

## 15 June 2021 Summary

### Relationships between Big Oil and Chemicals: Balancing growth and ESG agendas

- International Oil Companies (IOCs) under immense/increasing pressure to accelerate ESG initiatives. They are competing with each other and paying top multiples to acquire green renewables.
- Still no consensus on ESG Metrics. HSBC are monitoring corporate CO2 emissions vs. per Million USD revenues
- Impact on Chemicals more on helping the Circular Economy but also exploring new energy sources (e.g., electrification of crackers and renewable feedstocks)
    - License to operate now linked to becoming CO2 neutral within 20-25 years. National Oil & Chemicals companies (NOCs) increasingly encouraged to promote sustainable initiatives for example: Bioplastics and Biofuels.
- Deal economics now incorporate ESG variables with quantification of CO2 emissions impact.
- Activists leveraging small shareholdings to exert major influence on IOCs. For example: Engine I had 3 nominees voted onto the ExxonMobil Board including Greg Goff former CEO of Tesoro/Andeavor who has a track record of creating value and meeting expectations of wider stakeholders. Expect to see major changes at XOM.

### Energy Transition

- Energy transition and climate change -- a major theme for leading Chemicals players due to importance of feedstock sources (NGLs vs. Naphtha).
- Lots of focus on pace of transition. Recent bestseller, "Unsettled", Steven Koonin, and "New Map" by Dan Yergin useful in providing a perspective on how energy transition may play out.
- Significant media and political coverage amplifies/exaggerates what the science actually says.
- Expect increasing awareness of opportunity costs of fast-tracking transition in pursuit of new energies (H2, solar, wind) and carbon sequestration.

  - How to balance the shift to new energies while maintaining continuity and reliability of energy supply?
  - What are companies doing to strike balance between carbon-based and renewable energies?
  - Some companies reconditioning gases (e.g., from emissions to using for refrigerants) - not really circular, but directionally better.
  - Palm oil used for consumer products and energy; a substitute for petro-oil but not fully sustainable given the environmental impact.
- COVID has exacerbated nationalism which makes international cooperation on climate change more (not less) difficult. Europe will likely be at the front of this activity and not clear at what pace China/India (or even the US) will follow.
- Legal action on Oil & Gas operations is looking similar to what the tobacco industry experienced 30 years ago. We are beyond the tipping point for peak oil demand.
- Many reputational challenges for IOCs.
- In pursuit of sustainable monetisation of Hydrocarbons, IOCs have a renewed appetite for Chemicals assets and are actively reducing their refining footprint.
- Lots of efforts to explore alternative energies.
- Refineries are actively seeking more sustainable feedstocks.
- Private equity and Green Funds are trying to improve modelling of future profitability and growth prospects for renewable investments.
- Do not see integrated metrics on ESG being used in Due Diligence yet.

## Recent global developments in National Security/FDI

- National Security/CFIUS. Covid experience has emboldened regulators to apply CIFIUS in a much more direct way. All deals now need to consider National Security (UK as an example), seen the same in France (even food/Carrefour deal).
- Security laws are getting broader in their jurisdiction.
- National Security/FDI now as prominent an issue as anti-trust was 15 years ago.
- Many of the new laws have a 5-year look-back.

## Changes in deal dynamics and structure: (i.e., W&I insurance, Locked-box, Deferred Consideration, SPACs)

- Working capital close vs lockbox close.
- Preference depends on timing.
- Short interval between SPA signing and closing favors lockbox; longer duration favors working capital adjustment.
- Buyers starting to lose their patience with Locked box, especially carve-outs where the accounts have been artificially constructed so that buyers do not really know what they've bought.
- Reps and warranties claims are still quite rare.
- Seeing more and more of a hybrid of lockbox + working capital adjustments
- Bankers discourage deferred considerations as it weighs on seller confidence of what they'll get paid.
- Deal balance is "good price today and 'candy' at the back end".
- Challenge to assess future performance as companies are run differently 2-3 years post sale so hard to isolate what EBITDA improvements have been. Accounting rules can also change.
- One of the biggest deal concerns should be the risk of 'catastrophic incidents'. Which would negate any positive ESG narrative.
- During Covid, operating rates were reduced/ less stress on assets. Now during ramp-up seeing more and more incidents.
- During Covid, a lot of highly experienced operator employees were offered severance packages. Replaced by less experience people.
- W&I Insurance
  - 5-10% insurance pay-out levels from W&I are claimed but suggestion that actual levels are lower.
  - W&I growth is targeted at "Unknown risks" and is largely driven by Financial Sponsors to avoid giving enduring post-closing commitments to Buyers.
- The more interesting development is bespoke insurance for 'known' issues. More expensive but clearer value to mitigate risk.
- Earnouts/ Deferred Consideration.
- How do you know when the targets have been achieved?
- Depends on how keen the seller is to accommodate the buyer.

- SPACS -- less frothy today than 3 months ago. Where are they headed?
- SPAC boom has been US centric.  Less so Europe and little activity in Chemicals industry