81st Transactions Roundtable

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81st Transactions Roundtable Key Takeaways

Hosted by

Davis Polk pilko Morgan Stanley

1. **Biden Administration Policy Impacts**
   The Inflation Reduction Act (IRA) is intended to accelerate the transition to clean energy and reduce dependence on foreign suppliers. Additional permits are offered as a concession to encourage exploration both On and Offshore. The Act should spur investment in improving energy efficiency and penalize continuing Carbon emissions. Growth in Wind/Solar is being driven through JVs and Acquisitions although valuations are challenging. (**Click here** for Bipartisan Policy Blog Inflation Resuction Act Summary Energy Climate Provisions.)

2. **ESG support for Brown to Green Transition**
   Important to focus on industry and company initiatives that make sense. No simple/single answer. Renewables based on waste oils processed as a drop-in to the transport market are seen as positive although they still need carbon tax credit offsets to look economically attractive. Biofuels require blending and in the current political environment must address the dilemma of food versus fuel usage. Major fossil fuels players are also investing in Battery technologies. Carbon Capture, Utilization and Storage (CCUS) is being implemented using a range of different technologies with different regions adopting varying approaches to Capture. Still limited examples of Utilization. Many players are investing in Blue/Grey Hydrogen (to limit future mobile emitters) as a prelude to Green Hydrogen production. For the Chemicals Industry, the more pressing challenge is transitioning to the Circular Economy with Europe imposing taxes on virgin polymer usage. Critical to invest in innovation and technology to further molecular recycling and to improve mechanical recycling.

3. **Capturing Deal Value**
   Increasing bidder awareness of the value that can be protected and created by formulating a transition plan before signing an SPA and having detailed programs that can be triggered on or before Closing. Important to rank order initiatives and drive focus on the top 3 – 5 priorities to ensure rapid delivery. Assets may appear well maintained but performance can deteriorate quickly. The challenge is to integrate acquired assets into existing Operational Excellence programs to maintain and enhance integrity. Key metrics are critical to monitor progress and cold eyes benchmarking can be crucial to obtain an external perspective on improvement opportunities. Best practice is to go beyond incremental improvement and use acquisition to catalyse Transformation to a new level of sustained performance, which involves identifying and enabling the right people and processes. (**Click here** for Pilko's Deck on Transforming to Safest, Most Reliable and Sustainable Operations.)

   Click here for our Leadership Series Video on Post-Acquisition Value Creation.

4. **Impact of High Inflation and Interest rates.**
   Very difficult to characterize as there are many uncertainties in how the impact of these factors will influence demand and growth. Sanctions triggered by the conflict in Ukraine will lead to asymmetric and fluctuating regional shocks. In such a dynamic environment, there is a "flight to quality", windows of opportunity can open and close in weeks so timing is everything and anyone contemplating portfolio change should be ready to act at short notice. Deal Space does not have sharp boundaries with price settling very challenging. Some conservatism in agreeing EBITDA multiples. There may be opportunities for bespoke bilateral deals as well as contested auctions. Current M&A environment is more active than in mid-2020 but few players are financially forced to sell assets for now and so, barring geopolitical discontinuities, there are likely to be a select few opportunities still to be had in Fall 2022. The Northern Hemisphere winter could see escalating challenges – particularly in Northwest Europe.

5. **Build versus Buy**
   Long lead-time equipment is likely to see further cost escalation and delivery delay which could make attractive inorganic growth through acquisition of existing assets (especially if no imminent major turnaround) provided reliable and efficient operation can be demonstrated. Major strategic players are keeping an open mind on new builds as there are limited opportunities to acquire mature, well-maintained assets that have a good fit with existing feedstock models.

6. **Insurance Market reaction to current exceptional Uncertainty**
   Insurance supports the Energy and Petrochemicals industries in a variety of ways:
   i.) Underwriting the risks of assets currently held for use and helping to identify and mitigate operational risks.
   ii.) Acting as an enabler in the industry's energy transition by underpinning new technologies and their risks and helping smooth operational migration away from higher CO2 emitting fuels and feedstocks.
   iii.) Providing cover for the inflation and interest rate impact on asset values and operation. In particular, the impact on shutdowns or slowdowns either from lack of demand (during COVID), or lack of feedstock/utilities, or inability to compete economically.
   iv.) By providing W&I or Rep. & Warranty Insurance, Underwriters can facilitate transactions of assets held for sale – particularly when either counterparty has less financial security to underpin long-term indemnities, or the assets are in a Jurisdiction that may not be even-handed in its treatment of Buyer and Seller.

   Underwriters and Brokers are looking to collaborate much more closely with the industry by gaining wider access to Technologists and asset leadership teams and owners.

7. **De-globalisation and pivot to regional trading blocs.**
   The IRA bill may prompt more of an onshoring mindset in the US although, after 30 years of increasing globalisation, it will take time to disentangle complex global supply chains – especially those which involve raw materials controlled by different trading blocs. The NAFTA trade region is likely to strengthen as players based in other regions lightly affected by CFIUS concerns will still be attracted to acquire assets that allow domestic sales to NAFTA customers. In general, a preference for local production may increase if the world adjusts to regional blocs which may sustain interest in international deals. Peter Zeihan, a thought-provoking American author and geopolitical strategist, is a frequent speaker and writer on this trend. See his latest book "The End of the World is Just the Beginning: Mapping the Collapse of Globalization" and **click here** for his interview.