US Oil and Gas

Chevron/Hess: the Stabroek ROFR from the perspective of XOM's merger restrictions

Merger Acquisition Divestiture

Under the terms of the PXD deal, XOM cannot bid on Hess

In light of the ongoing dispute whereby ExxonMobil (XOM) and CNOOC claim they have a Right of First Refusal (ROFR) over the Stabroek joint operating area in which Hess (HES) has a stake (which was disclosed in Chevron's recent S-4), we examine the ROFR from the perspective of restrictions that may appear to prevent XOM from another major acquisition until the Pioneer Natural Resources (PXD) deal has closed (see our recent report examining the specifics of the ROFR). Recall that the Chevron (CVX)/HES merger announcement occurred 12 days after XOM filed its own merger agreement with PXD, potentially putting both deals on an almost coincident path for FTC approval and close. But what was revealed under the "Covenants of Parent and the Company" in XOM's merger agreement are restrictions on XOM from entering into any acquisition that "would reasonably be expected to prevent, materially hinder or materially delay" the completion of the merger with PXD (see details inside).

CVX's timing is the only period when XOM cannot bid

CVX bid for Hess during a period when ExxonMobil, the operator of the Stabroek block, has restriction on its ability to make another major acquisition. In the event that any arbitration around the ROFR pushes the timeline of a HES shareholder vote beyond closure of the PXD acquisition, the restriction on XOM would arguably no longer be in effect. What is apparent from the Chevron S-4, is that it appears that Hess management did not engage in discussions with XOM as it considered the bid from Chevron. Per the Chevron S-4, "the Hess Board … discussed ….. considerations relating to contacting other potential … counterparties and preliminarily determined that any such outreach was subject to risks, particularly in terms of confidentiality and the possibility of losing the opportunity to transact with Chevron on attractive terms."

So why challenge the ROFR? Perhaps the answer is time

While Stabroek has been transformational for HES, the value created by the exploration, development, and production in Stabroek has been solely due to the efforts of the operator (XOM), with funding shared proportionately between XOM (45%), Hess (30%), and CNOOC (25%). All partners have independently expressed interest in increasing their respective interests in the block – but none was willing to sell to the other. The ROFR, embedded in the JOA, is intended to allow any of the partners to bid on the others' interest, in the event of a sale of its interest. However, as the applicability of the ROFR to a corporate change of control is what is in dispute and is a condition that would break the Chevron/Hess deal, there is a circular non-sequitur given that the ROFR could only be affected after the deal closed. The key question from investors then is why XOM would challenge the ROFR given the uncertainty of the outcome. Given the restrictions on XOM to make another acquisition, one answer may be time to close the Pioneer acquisition, at which point contractual restrictions on its ability to bid for any other company would no longer be in effect. An effective delay of the CVX merger with Hess through an extended ROFR arbitration process would at least allow shareholders to see whether there might be a counter offer from the most logical owner of the asset.

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FTC – Federal Trade Commission

JOA – Joint operating area
ROFR – Right of first refusal

XOM has contractual restrictions on M&A

…. until its pending acquisition of Pioneer has closed

In light of the ROFR dispute disclosed in the recent Chevron S-4, we highlight several nuances of the overlapping timing of both companies' (XOM/PXD and CVX/HES) pending acquisitions, in order to try to understand what the motivation might be for XOM to examine whether its right of first refusal under the Stabroek Joint Operating Agreement is triggered by the HES deal.

- Recall that Chevon's merger announcement with Hess was announced 12 days after XOM filed its agreement with PXD and essentially puts both deals on almost coincident paths for FTC approval and close.

- However, under the "Covenants of Parent and the Company" (section 8.01e of XOM's merger agreement), XOM appears restricted from "entering into any acquisition…" that "would reasonably be expected to prevent, materially hinder or materially delay" the completion of the PXD merger:

Quoting from the XOM / PXD S4:

"During the period starting on the date of this Agreement and ending upon the earlier of (i) termination of this Agreement in accordance with its terms and (ii) the Effective Time, and except for a confidentiality agreement permitted by Section 6.03, none of Parent, Merger Sub or the Company shall, and Parent, Merger Sub and the Company shall not permit any of their respective Subsidiaries to, enter into any acquisition, joint venture, exclusive arrangement or other similar arrangement, or any agreement to effect, or any letter of intent or similar document contemplating, any acquisition (including by merger, consolidation or acquisition), joint venture, exclusive arrangement or other similar arrangement, that would reasonably be expected to prevent, materially hinder or materially delay the ability of the parties to (y) obtain the expiration or termination of the waiting period under the HSR Act or any other applicable Antitrust Laws, or (z) obtain any authorizations, consents, orders, and approvals of any Governmental Authorities, in each case, necessary for the consummation of the transactions contemplated by this Agreement."

Put simply, the timing of CVX's bid for Hess has occurred during a period when XOM, the operator of the Stabroek block, appears unable to make a potential counter-offer.

ExxonMobil's ROFR dispute

At the root of the issue is whether a Right of First Refusal (ROFR) claimed by ExxonMobil (and CNOOC) under the terms of the Stabroek Block joint operating agreement is applicable to a corporate change of control. The dispute was disclosed in the S-4 filing by Chevron regarding the proposed acquisition of Hess Corporation.

Since the S-4 filing, our discussions with investors can broadly be characterized as confusion over ExxonMobil's possible motivations to dispute the applicability of the ROFR on Hess' interest in the Stabroek block, given that this would essentially break the pending deal. We note the following:

- The key issue is whether the ROFR should apply to a corporate change of control – which is a material condition that, per the S-4, would cancel the Chevron/Hess merger with an outcome whereby Hess would remain a public company.

- However, for the ROFR to effective, in the event that it was found to be applicable, the pending Chevron deal would have to close. But from the point above, the pending deal would not close if the ROFR was found to be applicable, creating a circular non-sequitur.

It may therefore be a moot point to consider that if XOM was to exercise the ROFR, the terms would also require XOM to pay a tax “gross up.” In our prior assessment, we suggested that this could reasonably be ~$12bn, based on our view of the value of Hess’ interest in Stabroek ($45bn); in our recent report examining the ROFR, we opined that this would not likely be something that XOM (and CNOOC) would be happy to do.

From CVX’s standpoint, the language between HES and XOM is described as “constructive” in the S-4, while we reiterate the statements from our discussions with Chevron management that it sees a “path forward for successful resolution” that would allow the transaction to close around mid-year. However, in light of the Chevron S-4, which also provided the background on the merger, we note one specific observation: Hess management did not engage in discussions with its JOA partners for a potential sale of the company itself while it was discussing its now-pending deal with CVX. As stated in the S-4:

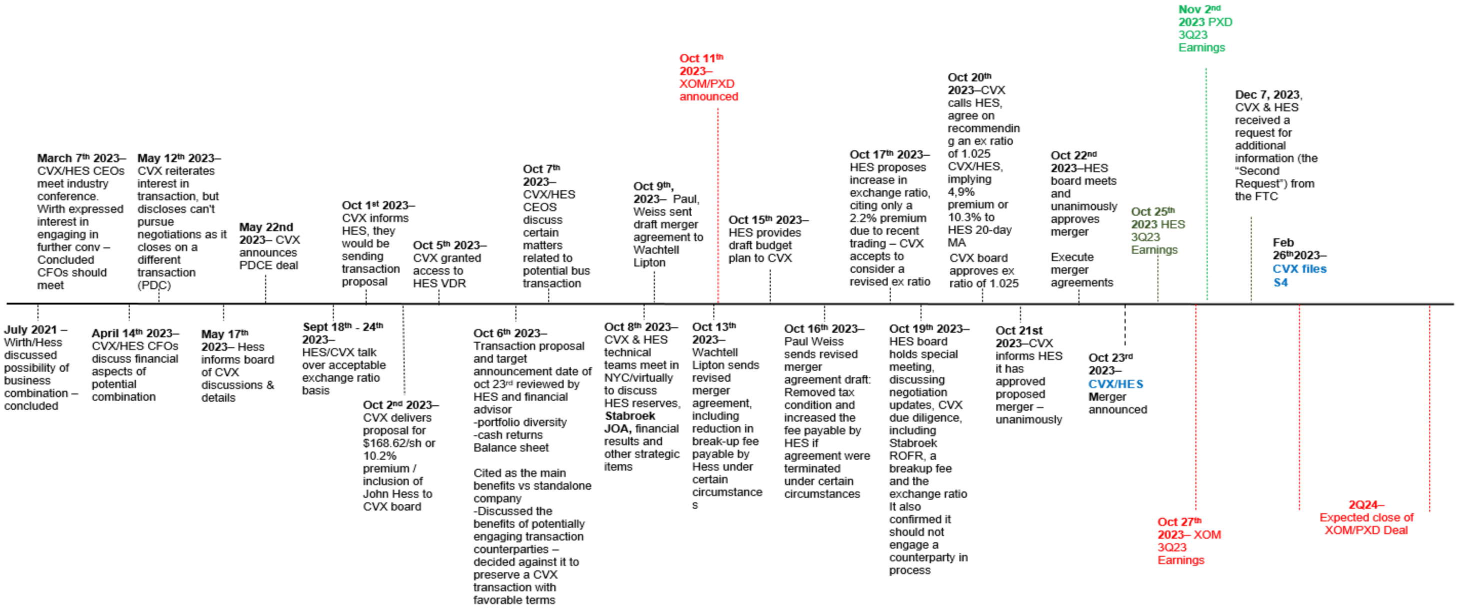
“….. the Hess Board … discussed ….. considerations relating to contacting other potential transaction counterparties and preliminarily determined that any such outreach was subject to risks, particularly in terms of confidentiality and the possibility of losing the opportunity to transact with Chevron on attractive terms, that would likely outweigh any potential benefits.”

While Guyana (where the Stabroek block is located offshore) has been transformational for Hess, creation of that value through exploration, execution, development, and ultimately production was by ExxonMobil as operator, which owns 45% of the block. XOM and other JOA partners have previously made it publicly known that they would be interested in a larger interest in what we view as one of the premier E&P assets in the industry – presumably the reason XOM may want explore the applicability of its rights to assert its ROFR.

An additional observation, which we discussed at the time, was why the deal was announced before HES and CVX had reported 3Q23 earnings. For CVX, in particular, earnings came with execution difficulties at Tengiz, which led to a 7% decline in the share price on the day. As the merger agreement had been announced four days earlier on October 23, Hess’ share price was trading with CVX, resulting in an 11% decline in Hess share price over the course of the week. The graphic below lays out the timeline.

Exhibit 1: CVX/HES potential merger timeline, per S-4, and other material dates

XOM/PXD and CVX/HES merger timelines are on similar paths



Source: BofA Global Research

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So why challenge the ROFR?

Perhaps one answer is time

Reverting back to the question what would ExxonMobil gain from challenging the ROFR, one answer, in our view, may be time – to close the Pioneer acquisition, at which point the contractual restrictions on its ability to bid for any other company would no longer in effect, leaving XOM open to consider strategic options.

One additional issue is the breakup fee payable by Hess in the event that a third-party bid results in a different merger agreement – in which case Hess would be contractually required to pay $1.75bn to Chevron. However, this is a fraction of the tax gross-up that would be theoretically payable under the ROFR.

Another motivation may be what XOM believes is the ultimate value of Guyana, given that the resource estimate of "more than 11bn boe" (barrels of oil equivalent) is dated. This estimate has been in place since the 22nd discovery in 2021, but the discovery count now stands at 37, so the associated value and development visibility is presumably greater.

The ultimate outcome, dependent on the timing of the Hess shareholder vote and Pioneer deal close, cannot be known at this time. For now, we see low risk that the CVX/HES merger does not close, not least given CVX's commentary about a "path to successful resolution" that would allow it to close the deal around mid-year, as planned. But an effective delay of the CVX merger with Hess through an extended ROFR arbitration process would at least allow shareholders to see whether there might be a counter offer from the most logical owner of the asset.

Price objective basis & risk

Chevron Corp. (CVX; B-1-7; $149.59)
Our price objective of $196/sh assumes $75 Brent and $70 WTI long-term. We assume long-term HH natural gas of $4.00. We apply a long-term (post-tax) weighted average cost of capital (WACC) of 7.7%, which is based on the BofA Strategy team's assumed risk premium and a five-year monthly beta.

The risks to our price objective are: (1) commodity price volatility, (2) operational execution particularly on new projects, and (3) inability to capture the price environment due to cost pressures (opex, capex and taxation), unseen integration issues with the recently announced acquisition. Upside risks to our price objective are higher oil prices and lower cap ex spending.

ExxonMobil Corp. (XOM; B-1-7; $105.64)
Our price objective of $140/sh assumes $75 Brent and $70 WTI long-term. We assume long-term HH natural gas of $4.00. We apply a long-term (post-tax) weighted average cost of capital (WACC) of 7.4%, which is based on the BofA strategy team's assumed risk premium and a five-year monthly beta.

The risks to our price objective are (1) the oil and gas price and margin environment, (2) significant delays to the new upstream projects critical to its growth targets, and (3) inability to capture the price environment due to cost pressures (opex, capex, and taxation). Upside risks to our price objective are higher oil & gas prices.

Hess Corp. (HES; -6-; $146.36)
We have removed the investment opinion on the company's stock. Investors should no longer rely on our previous opinion or price objective.

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RSTR				
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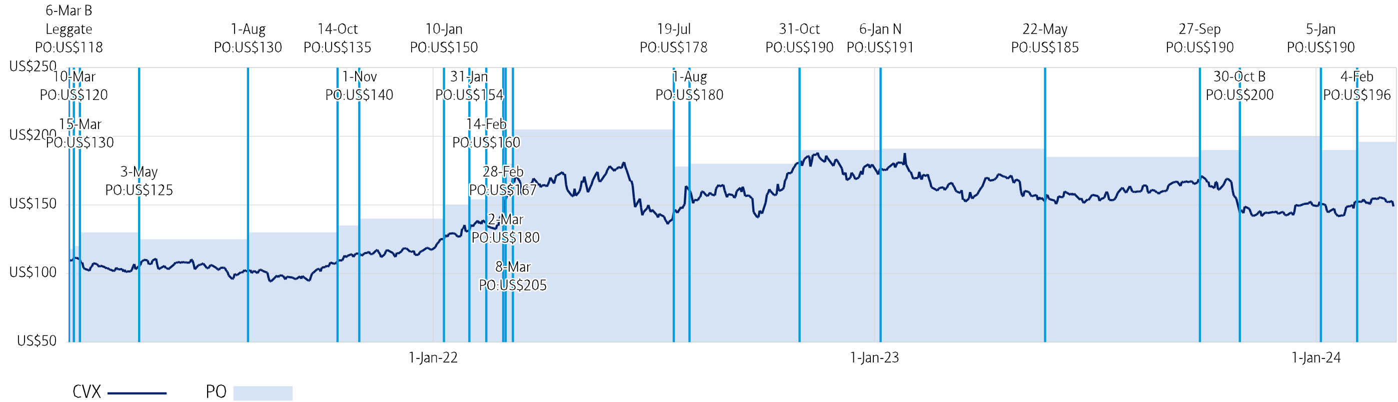
Disclosures

Important Disclosures

Chevron (CVX) Price Chart



B: Buy, N: Neutral, U: Underperform, PO: Price Objective, NA: No longer valid, NR: No Rating

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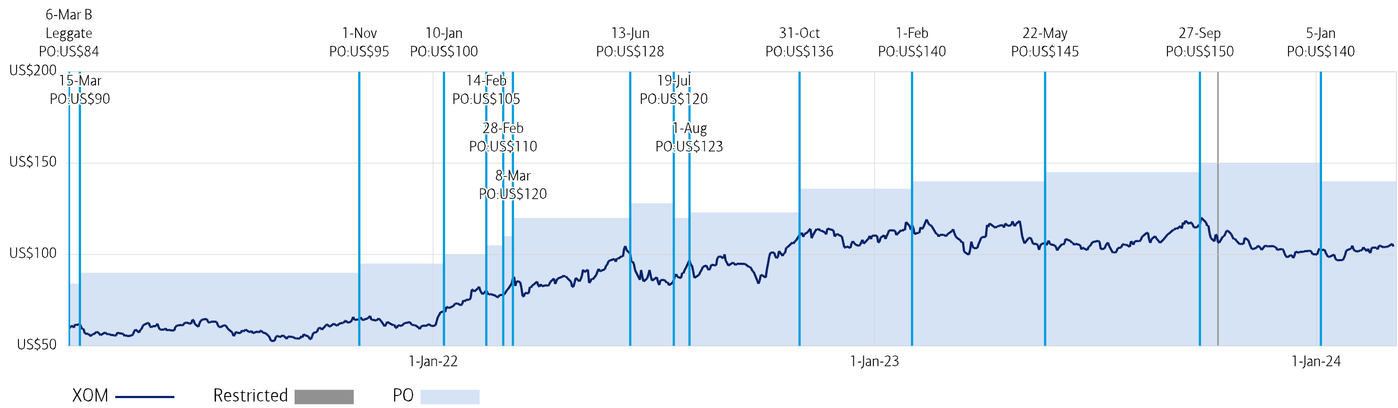
ExxonMobil (XOM) Price Chart



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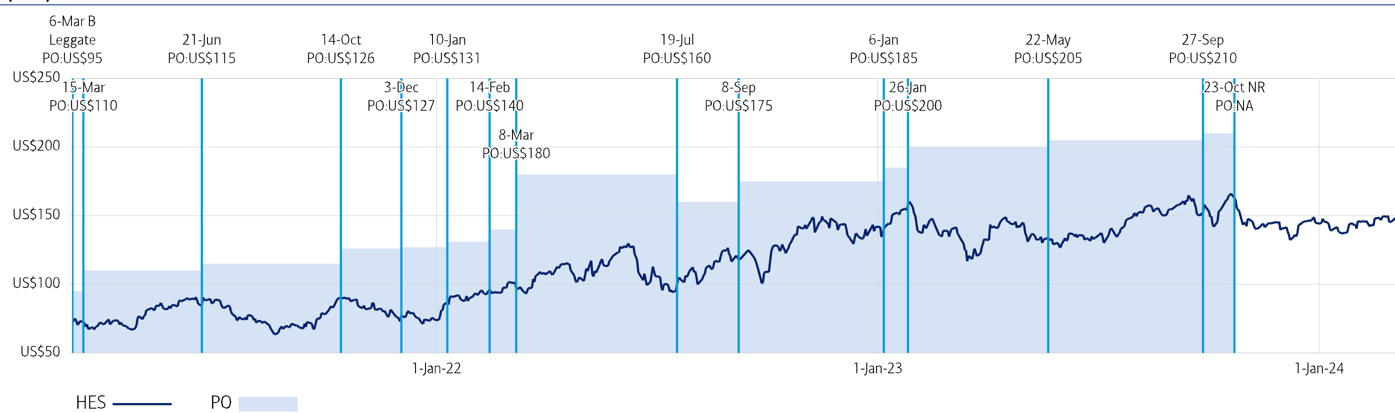
Hess (HES) Price Chart



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Coverage Universe	Count	Percent	Inv. Banking Relationships R1	Count	Percent
Buy	83	61.48%	Buy	64	77.11%
Hold	28	20.74%	Hold	21	75.00%
Sell	24	17.78%	Sell	18	75.00%

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Coverage Universe	Count	Percent	Inv. Banking Relationships R1	Count	Percent
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Hold	832	23.54%	Hold	454	54.57%
Sell	807	22.84%	Sell	383	47.46%

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