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M&A Quarterly: Lull in Asian Market Suggests the Boom is Yet to Come

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The global M&A landscape has been quiet in the first quarter of 2015. Overall, according to data from Evaluate Energy, the value of global upstream oil and gas merger and acquisition deals fell to US$7.1 billion during the quarter – a decline of 79% against the same period last year and a drop of 85% compared to the average value per quarter since the start of 2009.

The period's standout deal was the sale by Royal Dutch Shell of its stake in Nigeria's oil mining lease (OML) 29 and the Nembe Creek Trunk Line to local firm Aiteo Eastern E&P, for a reported US$2.5 billion.

The next highest transaction recorded – the purchase of Beaumont Energy for US$517 million in cash and stock by fellow Canadian firm Whitecap Resources – came in at just one fifth of this value.

In Asia, though, not a single deal came close to the top 10 positions. Given that that the final place on this list was taken by Swiss petrochemical firm INEOS' US$141 million deal to acquire UK shale gas acreage from iGas Energy, this is somewhat surprising.

Instead, the region's M&A activity, it seems, has ground to a halt.

Much of this is down to a lack of activity from the market's major players. During 2014, China's Big Three state-owned oil and gas firms, China National Petroleum Corp. (CNPC), Sinopec and China National Offshore Oil Corp. (CNOOC), spent almost US$3 billion on acquiring overseas assets. In 2012 and 2013, this figure stood at US$34 billion and US$22.2 billion respectively. Yet as of the start of 2015, the figure is close to zero.

"Most Asian state oil firms have been fairly quiet in 2015," SOLIC Capital senior managing director, Kim Brady, told NewsBase. "This is likely due to the fact that they have been the biggest buyers in recent years and now they seem to be more focused on developing the inventory of assets they have acquired when oil prices were at their peak."

At the same time, Beijing's widespread anti-corruption probe has taken up much of their attention. Combined with the collapse in oil prices and resulting asset write-downs, the appetite for new deals has been far from strong.

Sleeping NOCs

However, at the start of the year it was widely seen that this environment could kick-start a period of M&A activity, with assets owned by smaller E&P companies becoming available as they struggled to repay bank loans. Some Asian state oil companies – in particular India's Oil and Natural Gas Corp (ONGC) – were expected to be at the forefront of this period of consolidation.

“Debt-laden oil and gas companies that are not well-hedged could increasingly become takeover targets in 2015,” IHS director of energy M&A research, Christopher Sheehan, said in a January 5 report. ‘‘The volume of global assets for sale could surge if oil prices continue to remain depressed during the first half.’’

So far, though, this has not come to pass, despite prices remaining low. But while the first quarter was largely silent, the past few weeks have seen a flurry of activity focusing on Australia’s LNG market.

Early April brought the sale of Apache’s Australian subsidiary to a consortium of private equity funds managed by Brookfield Asset Management and Macquarie Capital Group for US$2.1 billion, along with the completion of its 50% interest in the Kitimat LNG project to Woodside Petroleum.

The headlines were instead taken up by the announcement of the US$70 billion merger between Shell and BG, a move driven in part by potential tie-ups between the firms’ Arrow and Queensland Curtis LNG developments.

Since then, the talk of resurgence in M&As has gathered pace here, with much discussion focusing on the long-term potential for LNG exports to Asia. But, says Brady, the agreement should be seen as “meaningful but not significant.”

“While other oil majors are looking to buy up cheap oil and gas reserves, we don’t think the BG/Shell deal is necessarily a catalyst for a flurry of M&A activity in Asia. Oil majors are attempting to strengthen their balance sheet, focusing on capital efficiency on projects as well as offloading non-core assets and cutting exploration and development budget.”

This view was echoed by Scott Cockerham, managing director at Houston-based consulting firm Conway MacKenzie.

“Much of the focus [that] Shell’s acquisition of BG has garnered has been based on the sheer size of the transaction. It’s prompted a lot of speculation about what the purchase means for the industry at large going forward,” he said, in an interview with NewsBase.

“But Shell’s acquisition was based on the very unique complement BG provided, turning a very strong LNG supplier into a behemoth in the industry.”

Wariness

Despite this diversion, it seems clear that the challenges facing M&A activity show no sign of abating.

“Potential acquirers don’t want to pay too much for assets against a backdrop of falling oil prices, industry balance sheets are in poor shape so there are few with the ability to fund deals, and uncertainty around the timing and extent of an oil price recovery is leaving its mark,” adds Tim Bednall, corporate partner at global law firm King & Wood Mallesons.

This is compounded by increasing levels of shareholder activism – making oil and gas companies wary of bold moves – and the growing recognition of the material risks involved in owning oil and gas assets, and the lull in M&A is understandable.

At the same time, many producers have remained protected against falls in oil prices by hedging large portions of their production to mitigate risk, as much as satisfy reserve-based lender agreements.

“Hedge protection and a modest bump in the price of oil have kept many companies from true distress,” says Cockerham. “Also, the ability to sell working interest positions in drilling programmes has allowed operators to allay risk without succumbing to a corporate transaction.”

Another mitigating factor has been the slowdown in the shale boom. Previously, numerous US firms had sought to offload their assets in Asia in order to focus on the North American shale market, an area perceived to provide much greater benefits closer to home.

With the sector now slowing down as prices make developments uneconomic at current Henry Hub and blended oil prices, the flight from east to west looks to have run its course.

Despite this, says Brady, it may be a mistake to think the trend has changed altogether, since companies still face the pressure to replace depleting oil and gas reserves, and the US market still is proving attractive. This week’s announcement that Noble Energy, the US oil and gas group, is to buy shale producer Rosetta Resources for about US$3.7 billion, including debt, shows that there is considerable life left in the industry.

“Partially,” he adds, “the bet on US shale hasn’t paid off and they likely have overpaid to buy the US assets. Many had to write down the value their US shale assets and this will likely to continue through 2015. And with the current oil price where it is, there is a pause and wait-and-see attitude.”

Watch and wait

With all this in mind, the forecast for the coming quarter seems clearer. “There could very well be a significant uptick in activity in the second half of 2015, with some already suggesting that the low oil prices will force smaller outfits into survival mode – giving an opportunity for the larger players to take advantage of distressed assets,” Bednall concludes.

Momentum has been building, but the predictions of strong M&A activity in 2015 have been premature. Instead, NewsBase anticipates a resurgence in deals taking place at the end of the current quarter, or as late as early 2016.

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