Gas Strategies
Information Services

25 April 2024

Contents

Gas Strategies Group

10 Saint Bride Street
London UK
EC4A 4AD

ISSN: 0964-8496

T: +44(0) 20 7332 9900
W: www.gasstrategies.com
Twitter @GasStrategies

Editorials

+44(0) 20 7332 9957
editor@gasstrategies.com

Subscriptions

+44(0) 20 7332 9976
subscriptions@gasstrategies.com

Post-crash consolidation: Hazy outlook or a fait accompli?

It takes courage to challenge conventional wisdom. Conventional wisdom would say that as soon as we have shoots of recovery in the oil market, M&A will be back on the agendas of management committees. We only need look at the previous oil price crises for evidence. In the crash of 1997-1998 mega mergers created the oil majors as we know them today and in 2015-2017, private equity firms launched a buying spree of companies and assets. Once the worst of the current storm battering oil and financial markets passes, conditions should be ripe:

- ***Funds overflowing with capital:*** Blackrock's recent announcement of its closure of a $5.1B energy-focused fund supported IJGlobal's[1] earlier reports that a number of funds are full and on the verge of over-subscription. At Gas Strategies, our conversations with funds over the last two months have confirmed that major institutional investors are primed and ready to commit capital targeting the sector.
- ***Distress caused by the low commodity price cycle:*** those pressured from low operating revenues will be seeking to shore up balance sheets and find a way through the chaos, potentially through aggressive divestment processes.

However, if there has ever been a time to challenge conventional wisdom, that time is surely now.

Lenders cooling on the sector

The growing wave of bankruptcies of US shale companies that were running on high yield debt is likely the thin end of a wedge of defaults across the spectrum of creditworthiness. The combination of supply side shock and recessionary demand reduction is already filtering through to debt pricing as lenders evaluate the possibility of increased defaults and of low prices persisting for some time. For those pushing through deals that began before the meltdown, financing terms have changed. In a world of presumed 70% leverage on transactions, this has a real impact on returns and valuations. Without a change in the conditions, this will likely continue and with it a partial freeze on deal flow as valuation gaps between sellers and buyers remain too wide.

Another barrier to financing is the accessing of liquidity by "blue chip" oil companies tapping into credit facilities such as revolvers, limiting funds available to others in a credit constrained world. Our conversations with a number of clients and industry stakeholders have raised concerns over timely access to debt being a constraint on transaction activity in the near-term.

The end of accepted wisdom on price decks

Secondly, how will the stakeholders across the transaction space – lenders, sellers. acquirers and advisors - account for the uncertainty generated by the current three-headed (interdependent) monster of Covid-19, the collapse in oil and gas prices and a likely global recession? Previous oil price crashes have shown that transaction activity increases 9-12 months following the crash owing to improvement in prices and increased stability in the forward view. However, we are not entering a "normal" world and trying to map out recovery pathways for price and demand at the moment is like trying to catch a falling knife.

In the project finance market, we have been seen first-hand the negotiations between projects and lenders on oil prices. Where there has previously been a general consensus on long-term oil prices for financing cases, this accepted wisdom is now really challenged. On the M&A side, historically low prices for oil and gas will also force a rethink on price decks and could keep sellers out of the market while they wait for an improvement, at least for as long as they can. Furthermore, the existential threat of the energy transition cannot be discounted – the range of possible outcomes on the transition, and therefore price and demand pathways, has now increased due to the diverse recovery pathways from Covid-19.

This increased uncertainty will indeed add to the risk profile for lenders and constrain the willingness to lend.

Mapping the impacts

Taking these above, we see a number of impacts as this plays out over the next 12 months.

- ***A delayed rush***: the repricing of debt and uncertainty over oil/gas prices and demand will cause a disconnect between sellers and buyers, which will take some time to permeate the market. Indeed, the current volatility is not conducive to transactions, as we wait to see the "bottom" and some green shoots. However, once this does happen, will this cause a rush that creates a "buyer's market"? How might sellers seek to time their assets sales, and factor in possible constraints in debt access into that decision?
- ***Searching for bankable scenarios:*** For those contemplating asset sales (or purchases) – what scenarios of the forward view will be factored into the valuation? And how robust will the views on asset value be within the context of these scenarios? Gas Strategies expects an increasing challenge to reach consensus and consider there is a real need to delve into a higher level of scenario thinking. Standing back from the conventional wisdom will be key!
- ***Premium deals only:*** There is no doubt that for sale signs will be hung over assets and companies as a result of this market distress. However, a shift to a "risk-off" market will mean many of these will be overlooked by buyers (and lenders) who can't see beyond a dense fog of market risk. Premium targets such as infrastructure with regulated returns or long-term contracted revenues or companies with world class reserves or project pipelines could still transact and some opportunist buyers will be preparing to make approaches.

Whilst there can't be many certainties in today's world, we are increasingly sure that this crisis won't be like last oil price crash, or like the last financial crash. For now, the market seems to share our view that we won't see a strong pipeline of deals – credit challenges and market turbulence are too high. Navigating through this requires a careful consideration of the above factors and a search to challenge that conventional wisdom.

[1] https://ijglobal.com/articles/146853/blackrock-closes-energy-fund-above-... [1]

***

If you would like more information about how Gas Strategies can help your business with Consulting [2] services across the value chain or provide industry insight with regular news, features and analysis through Information Services [3] or help with people development through Training Services, please contact us [4] directly.

Gas Strategies

Consulting

+44 (0) 20 7332 9900
consult@gasstrategies.com

Alphatania Training

+44 (0) 20 7332 9910
training@gasstrategies.com

Information Services

+44 (0) 20 7332 9976
subscriptions@gasstrategies.com