INVESTMENT

Age of uncertainty

What are the prospects for merger and acquisitions investment on the UKCS, given the recent oil price crash and the COVID-19 pandemic? *Brian Davis* gains insights from PwC.

'Every few years there are those doomsayers who prophesise the imminent demise of the UKCS. Despite this, the basin has remained resilient.' These were the brave words of a report by PwC and OGUK last November called *Turning the tide – the transformation of the North Sea*. The authors insisted that through a combination of financial discipline and innovation, the sector has successfully navigated periods of economic turbulence and uncertainty, 'but more is to be done'.

However, this year has seen a double whammy as the oil price crashed to $19/b at one point (currently ~$40 /b) and the global pandemic hit, destroying oil demand; locking down thousands onshore and offshore; forcing equity investors to halt, rethink or renegotiate potential merger and acquisition (M&A) deals; and pushing some oilfield service providers towards bankruptcy. While the move towards being the world's first net zero basin may decelerate or accelerate depending which scenario you favour.

Petroleum Review invited a couple of the report authors, Adrian Del Maestro, Director of Research at Strategy&, and Alan Barr, Head of Deals (Aberdeen) at PwC, to explain how they see the M&A deal scene shaping up this year and next, and prospects for the energy transition in the face of the pandemic.

'The oil price goes hand in hand with the impact of COVID-19,' remarks Barr. 'The oil price fell a couple of weeks before the UK went into lockdown. Up to that point we had been seeing quite high levels of deal activity – though not reaching completion. We expected 2020 to be a busy M&A year – particularly in oilfield services. One transaction was completed in February, with Hunting acquiring Enpro Subsea. Then the oil price crash and COVID-19 in March put all transactions on pause.'

After an initial flurry of businesses trying to figure out what COVID-19 meant in terms of staff repatriation, physical restrictions and facilities' shutdown, significant cuts were made to capital expenditure (capex) and operating expenditure (opex) of around 25% or more. In fact, Hunting has just cut 25% of its global workforce and Chief Executive Jim Johnson announced plans for a 50% cut in its $22mn budgeted annual capex. 'Across the board, global cuts have been close to 30% capex cuts,' Del Maestro notes.

Renegotiated deals

In June 2020, Energean amended its agreement for the acquisition of Edison E&P for $284mn, compared to the original consideration of $750mn. On 5 June 2020, Premier Oil announced an amended agreement in principle to acquire interests in the North Sea for the Andrew and Shearwater fields from BP for a proposed $210mn in cash plus contingent payments, instead of $625mn under the original deal. On May 2020, Total and Hitec Vision agreed to restructure the financial terms of the $635mn acquisition by HitecVision and its affiliate NEO Energy of Total's UK North Sea portfolio.

'2020 hasn't been a bumper year for oil and gas deals,' says Barr. 'Generally, upstream businesses have gained the benefit of capex cuts and oil price hedges that prior to the lockdown were at very favourable prices. Both these factors will support the upstream business through 2020, and significant capex cuts will probably continue into 2021.'

The oilfield services sector has been hard hit – suffering everything COVID-related and fundamentally operating at a much lower activity level because of upstream cuts. 'This is going to lead to a lot of stress, as this part of the sector is highly geared from a debt perspective,' Barr remarks. Admittedly, there's been a recession in the oilfield services sector for several years. 'The sector knows how to act when the oil price falls and pressure comes on their businesses. But this time, they are starting from a

Chrysaor is committed to playing a leading role in the energy transition, setting a target of 30% reduction of Scope 1 and Scope 2 carbon emissions by 2025 and 50% by 2028

Source: Chrysaor

Date	Buyers	Sellers	Deal (in $mn)	Deal summary
06/07/2020	Viaro Energy	RockRose Energy	306	Rockrose acquired Viaro Energy's North Sea portfolio, including stakes in the Brae complex
29/06/2020	Energean	Edison	284	Energean acquired Edison E&P for $284mn; compared to original offer of $750mn July 2019
05/06/2020	Premier Oil	BP	210	Premier Oil amended its agreement to acquire interests in the Andrew and Shearwater areas from BP
21/02/2020	Hunting	Energy Ven, Enpro	33	Hunting acquired Enpro Subsea
20/12/2019	SCF Partners	Score Group	151	Score Group acquired energy services company SCF Partners
27/11/2019	Sval Energy	Cairn Energy	100	Cairn Energy sold Norwegian subsidiary Capricorn Norge to Solveig Gas Norway
01/11/2019	North Star	SEACOR	25	SEACOR sold North Sea standby safety business to North Star Holdco
26/09/2019	Eni, HitecVision, Vär Energi	ExxonMobil	4,500	Vär Energi, owned by Eni and HitecVision, acquired ExxonMobil's Norway upstream assets
06/08/2019	ONE-Dyas	Cairn Energy	59	ONE-Dyas Norge aquired 10% in offshore Norway Nova development from Cairn Energy
26/07/2019	CalEnergy	Independent	205	CalEnergy Resources farmed into 50% of Independent Oil and Gas' southern North Sea assets
10/07/2019	HitecVision, Neo	Total	635	HitecVision and affiliate NEO Energy renegotiated the acquisition of Total's UK North Sea portfolio
07/07/2019	Equinor	Lundin Energy	910	Equinor acquired a 2.6% interest in the Norway Johan Sverdrup field from Lundin Petroleum
30/05/2019	Delek; Ithaca	Chevron	2,000	Delek Group's Ithaca Energy acquired the majority of Chevron's UK North Sea assets
18/04/2019	Chrysaor	ConocoPhillips	2,675	Chrysaor Holdings acquired ConocoPhillips' (COP) UK upstream operations
25/02/2019	RockRose Energy	Marathon Oil	140	RockRose Energy acquired Marathon Oil's UK upstream operations

Table 1: Upstream mergers and acquisitions in the North Sea, February 2019 – July 2020 *Source: Transaction database from IHSConnect*

weaker financial health perspective than they did in 2014–2015,' he notes.

Most oilfield service companies are contracting in size. According to *Scottish Energy News*, over 400 jobs are at risk of being made redundant at Petrofac, Wood and Amec Foster Wheeler following the coronavirus pandemic, as the service sector struggles with lower margins, over supply and weak investor sentiment.

The North Sea is a mature basin and in recent years the Oil and Gas Authority (OGA) has emphasised the importance of 'maximising economic recovery'. So, what has happened to that objective? Del Maestro maintains the North Sea will have a role to play for many years to come. 'Clearly it is a mature basin with quite high levels of operating costs per barrel. But in the last few years significant efficiencies have been made, with operating costs per barrel roughly halved between 2014 and 2018. The challenge is that other parts of the oil and gas sector globally, like shale in the US, can switch back up quicker than North Sea operations.'

Del Maestro suggests the UK government needs to make sure it can maintain an attractive regime for UKCS investment. What's more, he maintains: 'Technology is going to play a key part in keeping the basin competitive, with deployment of digital solutions to produce more efficiently. COVID-19 has emphasised that operators are going to be under pressure to produce more efficiently, and that's a driver for digitalisation. There are normally about 11,000 offshore workers in the UKCS. Today that is down to 7,000, with a skeleton staff who are social distanced. So digital initiatives and improved automation will be an important factor, particularly for oilfield services.'

Energy transition and investment

'The push for energy transition and impact of the pandemic is likely to make companies think much harder about how to diversify revenue streams, not just from oil and gas but *non-oil and gas*,' Barr comments. He highlights a significant shift in the investment community towards 'green investment', with a move away from oil and gas. 'The Green Investment Strategy has definitely gained traction over the last year. However, within the UK we now have a very low number of specialist investors in oil and gas. And even those investors will be looking for businesses that are part of the energy transition story.'

'A handful of European-based supermajors are leading the charge,' notes Del Maestro. 'They understand they have to evolve their business models to have a sustainable business going forward. Some oilfield service companies are on the journey, but many have yet to take the plunge into servicing renewables. The independents often have less resources in terms of headcount, R&D spend and available capital, and tend to insist "our core business is hydrocarbons". These companies are going to be under much more pressure for two reasons. First, they have to reduce their emissions footprint, both Scope 1 and Scope 2 emissions produced directly and indirectly from operations. Second, some may need to start diversifying into low carbon.'

Some are already taking the initiative. Chrysaor is branching into new energy transition initiatives (see **Box**) in partnership with Shell and Pale Blue Dot in the Acorn project. Neptune Energy is piloting an electrolyser on an offshore platform in the Dutch sector with Eneco in the PosHYdon project, the world's first offshore green hydrogen project. Wood Group is also delivering engineering and construction services across a range of renewable projects. While Danish oil and gas company

Leading by example

Chrysaor became one of Europe's leading independent exploration and production companies with the $2.675bn acquisition of ConocoPhillips' UK oil and gas business in September 2019. The company produces about 200mn boe/d and operates 14 fields across several hubs in the UKCS, as well as non-operated interests in nine fields. But, like all oil companies, it has been facing challenging times due to the oil price crash and impact of COVID-19. *Petroleum Review* invited Phil Kirk, CEO of Chrysaor, to give an eagle's eye view of the latest developments and moves towards net zero in the energy transition.

'We continue to grow in the North Sea and are exploring new options in the Norwegian Continental Shelf (NCS). We currently participate in 11 licences in Norway, of which four are operated. We are are planning our first exploration drilling campaign as operator on the NCS during the 1H2021, which if successful could lead to our first operated field development there,' he says.

Chrysaor is committed to playing a leading role in the energy transition. 'We are taking steps to reduce emissions, efficiently manage decommissioning and align with targets set by the Scottish and UK governments to reach net zero. As part of this, we have set an energy carbon reduction strategy where our target is 30% reduction of Scope 1 and Scope 2 emissions by 2025 and 50% by 2028,' says Kirk.

The company's commitment to the energy transition is also reflected in its investment in the Acorn project, a carbon capture and storage (CCS) project based in the North Sea. Chrysaor is partnering with Shell and Pale Blue Dot in the Acorn CCS project at the St Fergus gas plant near Peterhead, with plans to store CO_2 in the Goldeneye field.

Finally, there is the pandemic. People come first, remarks Kirk. 'Chrysaor's response to COVID-19 was to focus primarily on the health and wellbeing of our people, whilst maintaining crucial UK energy demands. We responded quickly by mobilising our Crisis Management and Business Continuity teams to oversee operations and manage the response. Onshore staff continue to work from home and offshore staff have support from a range of testing, tracking and assistance initiatives. While operated drilling activities have been temporarily suspended for up to six months to ensure the safety and wellbeing of our workforce.'

Neptune Energy is piloting an electrolyser on the Q13a offshore platform in the Dutch sector as part of the PosHYdon project, the world's first offshore green hydrogen project

Source: Neptune Energy

DONG Energy transformed totally to renewables as Ørsted, a global leader in offshore wind supplying green power to over 15mn people.

Tentative investors

'There's actually very few specialist energy investors pointed at oil and gas at the moment,' notes Barr. 'Though banks lend across all sectors. PE [private equity] generalist funds who have invested in the sector already have typically made some investments that have proven to be difficult along the way. So there's less appetite from generalist investors today. The second issue is the energy transition, as the investment strategy of many equity houses is being directed away from hydrocarbons.'

So is there a question mark over future UKCS developments? 'We'll be seeing a focus on fields that are producing or are close to production,' says Barr.

At a global level, Del Maestro asserts: 'Pre-COVID, the main trend since the 2014 oil price crash was operators were interested in investing in projects that were relatively low risk – low risk in terms of sub-surface, low risk in terms of financial risk and low risk in terms of operational geopolitical – quick turnaround; and relatively low returns but short cycle times. Which is why there has been so much focus on US onshore and shale. But now US onshore is going through a very difficult time.'

'In a period of capex and opex constraint we are unlikely to have lots of greenfield developments. Forecasts for well exploration capex fell about 20% between 2019 and 2020. Therefore, there will be more focus on brownfield developments that are fairly advanced and more efficient, producing less. There will still be some major new projects. But it is difficult to see a plethora of frontier regions, like west of Shetland, that will still proliferate. You might not have so many higher risk projects in this capital-constrained world.'

Rate of energy transition

One of the big debates is whether COVID-19 will accelerate or slowdown the energy transition? Del Maestro says there is a compelling argument for either option. 'On one hand, there is an argument that the pandemic will accelerate the energy transition, as people can also see the benefits of improved air quality and reduced noise pollution – you could hear the birds!'

However, on the other side, in an era of low commodity prices, there will be a temptation to leverage low fossil fuel prices, with a focus primarily on stimulating economic growth at the cost of sustainability. Some regions might go down that path. While Europe favours a green economic recovery and sustainability packages.

So, how do they anticipate the M&A scene will shape up in the next 12–18 months?

Barr suggests: 'Investments will be slightly more opportunistic, taking into account that certain companies are in a weaker financial position and see added value in them. So, there's scope for a deals-led recovery across all sectors. I think there will be opportunity investment and opportunity activity if there's a more stable oil price. Right now, we are certainly seeing a pick-up in deal conversations again.'

Del Maestro points out: 'It's always difficult for M&A when you don't have a clear floor price for oil, for valuations that buyers and sellers can agree on. We are getting closer to finding some kind of floor price, but I don't think we're there yet. Looking historically, we had that oil crash in 2014 and people talked about a wave of M&A coming as industry consolidates and restructures. It took about two years before we had that wave of M&A and it was asset based. So, I think we need to be cautious about whether there will be a wave of consolidation. Certain segments are going to find it increasingly challenging from a financial perspective.'

'Unlike the 2014 price crash, which saw significant strides made in efficiency and price deflation in the operators and service companies, that wriggle room doesn't exist now. The industry is much leaner and more efficient, so the scope for efficiency improvement is more constrained. You might see some M&A come back opportunistically or some defensive M&A. Players may decide to merge to deliver cost savings, to get scale and capability in a particular area. But it's hard to see a wave of change sweeping through the sector for the foreseeable future because there's so much uncertainty.'