EVERSHEDS

Volatility and opportunity

Energy M&A in Asia-Pacific

Issue 3 - April 2017

Increasing oil prices and government support for renewables bolstered M&A deal flow in Asia-Pacific's energy market in 2016.

Energy M&A in Asia-Pacific may not have had a record year in 2016, but it was still one for the record books. While dropping 33% in year-on-year value terms, overall announced deals maintained pace with 2015 (196 deals), closing the year with 198 transactions valued at US$77.6bn. Those amounts, despite the decline, were still the second highest annual totals, according to Mergermarket data spanning the past decade. Perhaps more importantly, M&A activity for the year points to the market's resilience, especially in the oil and gas space where price volatility has plagued national and international oil companies over the past 30 months.

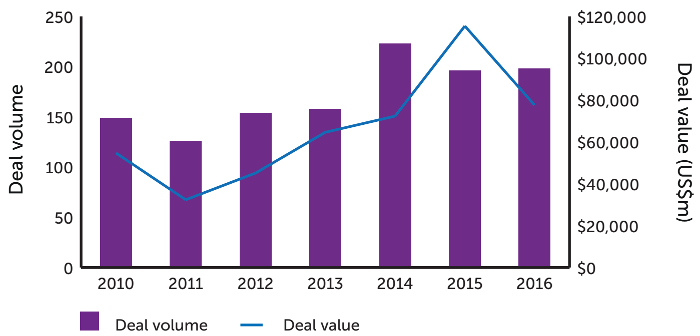
Oil and gas M&A drove deal values for the year, accounting for 34% of exchanged deal dollars. However, Asia-Pacific's alternative energy space is where the bulk of dealmaking occurred. Renewable energy transactions—those involving wind, solar, hydro, and geothermal power—accounted for more than half of energy transactions in 2016 (52%), increasing from a 44% volume share in 2015. Dealmaking in electrical power generation and transmission has begun to unfold as utility companies move from coal to gas and expand their renewable generation capacities.

China maintained its spot as the top market for energy M&A, driving deals as both a target market and buyer of assets abroad. In total, China accounted for 36% of deals and 31% of value. India had the second-largest year-end totals, accounting for 18% of deals and 22% of value, followed by Australia with 11% of deals and 20% of value.

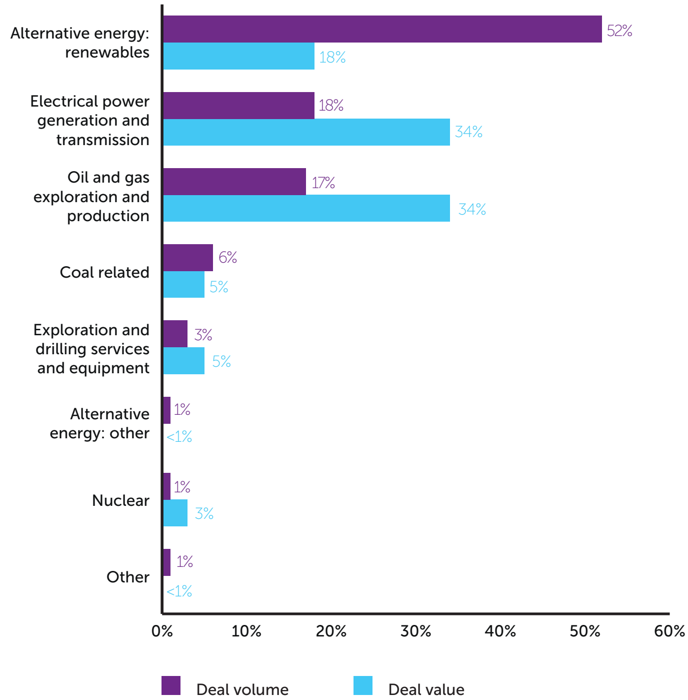
Cleaner and greener: Asia-Pacific's shifting power mix

Energy M&A in Asia-Pacific is increasingly turning green. China has made strategic choices favouring renewables over fossil fuels, with companies diversifying stakes in the context of China's continuing battle to scale back its use of coal as it transitions

Asia-Pacific energy M&A

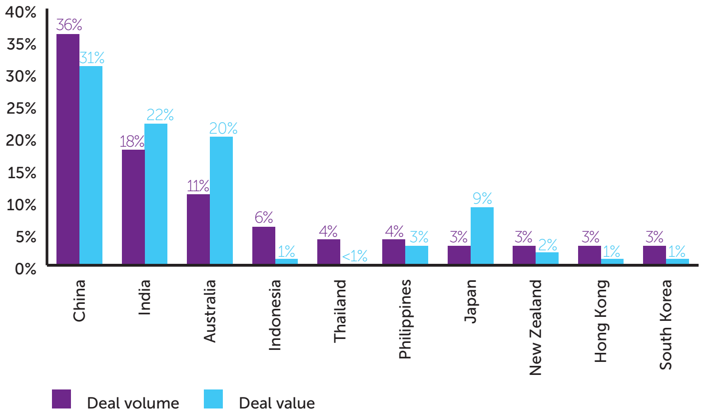


Asia-Pacific energy M&A: Subsector breakdown (2016)*

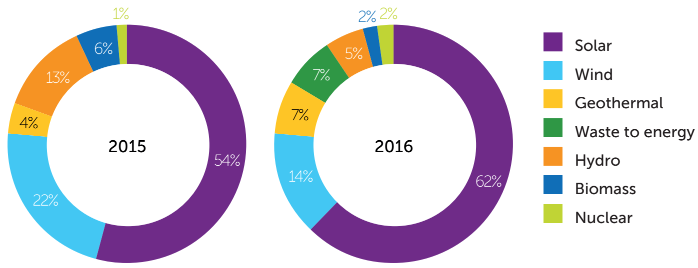


*Percentages may not sum to 100% due to rounding.

Top 10 Asia-Pacific target geographies: Energy M&A (2016)

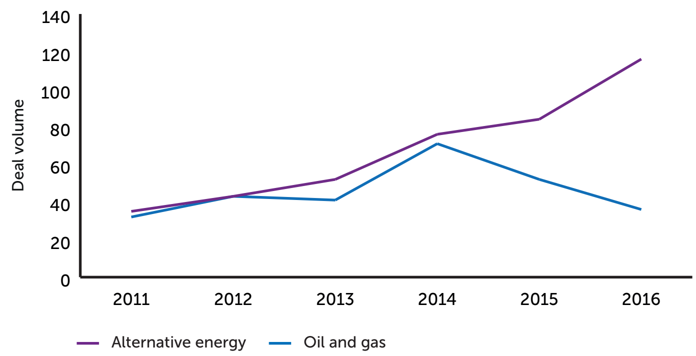


Asia-Pacific alternative energy M&A (deal volume)*

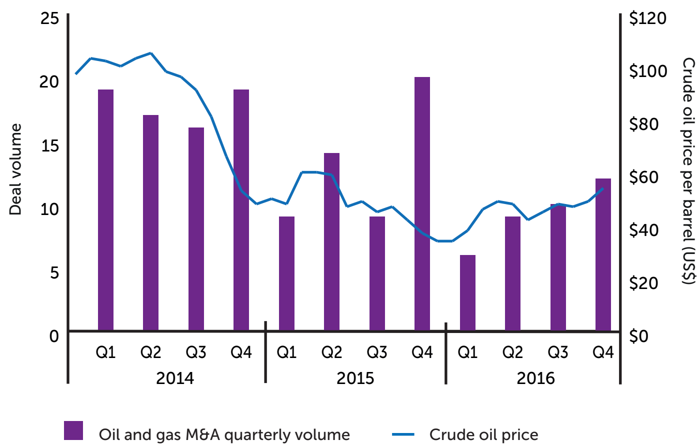


*Percentages may not sum to 100% due to rounding.

Asia-Pacific energy M&A



Asia-Pacific oil and gas M&A



to cleaner sources of energy. This falls into a trend whereby numerous Asian countries have set ambitious targets to curb CO2 emissions following the Paris Agreement in 2015.

The Indian government has likewise established clean energy targets such as 175GW of renewable energy, or 15% of total capacity by 2022, of which 100GW is expected to come from solar power. This has also helped to provide a focus for a strong flow of renewables deals, continuing a trend started in 2015 when the largest power sector deals were largely renewables deals. In 2016, one of the major players ReNew Power, an Indian renewable energy company backed by Goldman Sachs, raised over US$300m from prominent investors, including the Abu Dhabi Investment Authority, the Asian Development Bank and the Global Environment Fund.

Moreover, aside from major government commitments to transition to clean tech while managing carbon emissions, new insolvency and bankruptcy rules also facilitated the sale of distressed assets. This could contribute to a jump in M&A activity in the months and years ahead.

Oil and gas
National and international oil companies were able to breathe a sigh of relief as oil prices began a slow but steady ascent after bottoming out in January 2016. While still noticeably depressed from the highs of 2014 when oil was at more than US$100 per barrel, the 60% uptick in prices across 2016 has seen oil majors adjust their corporate agendas as they shift from forced divestment programs and asset sales to more strategic acquisitions.

Dealmaking for oil and gas assets in Asia-Pacific was more moderate than in past years, with only 37 deals valued at US$21.2bn in 2016. Comparatively, 2015 posted 52 deals worth US$58.1bn while 2014 had 71 worth US$39bn. While activity rose steadily across the quarters, oil executives hopeful of a more dramatic uptick in oil prices remained hesitant to sell at lower valuations. Those that did sell during the downturn focused on monetising assets to repair balance sheets and lower costs through improved efficiencies gained by focusing on their core assets.

Valuations remained mostly subdued in the first half of 2016, with only US$5.1bn through 15 deals. However, as the rebound in oil prices showed strength towards the half-year mark, values in the second half increased to US$16.1bn through 22 deals. Much of this momentum was created as Japanese trading houses, Chinese national oil companies, and international energy corporations returned to the market.

Cross-border deals
Cross-border M&A has been a key feature of energy deals in Asia-Pacific as intra-regional dealmaking and the participation of international oil companies add fervour to the market. Cross-border energy deals reached a record value of US$39.4bn (90 deals), an uptick from the 2015 total of US$34.3bn (91 deals).

2016 was marked by an increase in foreign inbound interest. Recording the highest deal value for inbound investment in the past five years, international acquirors completed US$16.3bn (16 deals) in transactions, increasing from US$12.5bn (26 deals) in 2015. These deals included stake sales in India-based Essar Oil to a Russian consortium led by Rosneft Oil and United Capital Partners. Russian deals accounted for 77% of

Expert Q&A: Asia-Pacific energy markets in winds of change

Eversheds partners Charles Butcher and Jae Lemin share insights on current geopolitical and economic trends shaping Asia-Pacific's traditional and alternative energy markets.

Oil prices hit a low of US$33/barrel in January 2016 and have since started a slow rebound. Has a bottom in oil prices been reached? What is the impact of this on M&A and corporate activity?

Charles: Although we always hesitate to call a "consensus", the widely prevailing view is that oil prices have hit a floor and plateaued. This should steady industry confidence in Asia, and will likely result in increased energy M&A activity more generally.

Small producers lacking financial resources have been hardest hit by the oil crisis. Smaller cap deals are likely to continue in the short term as smaller players engage in distressed sales, merge to survive, or deleverage through asset divestment. We expect that a number of energy majors will continue to exploit current assets, while maintaining their balance sheets. There is a cautious optimism that prices have stabilised but a real recovery, including significant new investment and exploration, is unlikely before 2018.

What are some of the reasons to be positive and to be cautious about energy M&A in 2017?

Jae: Wood Mackenzie, a global energy consultancy, predicts that Asia-Pacific deal flows will rise this year, and we tend to agree. We expect the Japanese trading houses to be particularly active, given the low cost of financing available from the Japanese banks and the country's continuing search for energy security and growth. We also think that, while stricter capital controls in China may restrict non-core and opportunistic purchases by Chinese conglomerates, the Chinese state-owned enterprises will continue with their strategy of securing energy resources.

In Southeast Asia, we expect that conditions will generally remain challenging for foreign investors. However, there should be opportunities for strategic investors with strong local partners and a long-term investment horizon.

What is the impact of the Trump presidency on energy activity in Asia-Pacific?

Charles: The Trump presidency is a positive outcome for the traditional US energy sector. The lifting of the Cardin-Lugar anti-corruption regulations under the Dodd-Frank Act will assist US majors who wish to acquire targets in emerging countries. It remains to be seen what impact this development will have on M&A in emerging countries, although we do expect that producers in the region will face greater competition and pricing pressure from their US peers.

The Trump presidency is less positive for clean and renewable energy. The withdrawal by the US from the Paris Agreement will likely hinder the development of the subsector in North America. In Asia-Pacific, we think a Trump presidency will have less impact on renewable energy projects because of the diversified investor base. We do expect Chinese developers to become more active and assert themselves as renewable energy leaders in the region.

How will Australia fare against emerging Asia in energy M&A?

Jae: In 2016, total M&A deal value in Australia's energy, mining and utilities sector was AU$25.3bn. This was Australia's top target sector and was more than double the 2015 value.

As one of the safest markets in the region from a regulatory perspective, Australia is a sizeable market with a strong legal framework. Because of the country's political and economic stability, Australian investments are generally susceptible to fewer business risks than those in emerging Asian markets and, for that reason, we expect Australia to continue to be a popular destination for foreign investors.

What have been the major points of progress for alternative energy sources in the past 12 months? Are foreign investors still active or have investment and development become largely an Asia-centric story? What are your expectations for the alternative/renewable energy space in 2017?

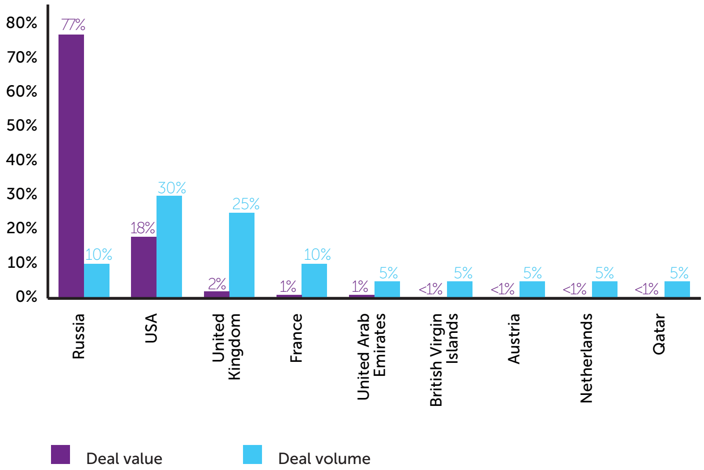
Charles: China has quickly become a world leader in alternative energy, more than doubling its solar power capacity in 2016, becoming the world's biggest producer of solar energy by capacity, according to China's National Energy Administration, and is increasing the proportion of non-fossil fuel generated power in its energy mix. Their current target is to increase non-fossil fuel generated power from 11% to 20% by 2030, and to invest US$364bn in renewable power generation by 2020.

Southeast Asia lags behind China in renewable energy development, though a number of countries are signatories to the Paris Agreement, have set ambitious renewables targets, and have passed feed-in tariffs and other incentive schemes to promote alternative energy.

Jae: Governments and their utilities are generally struggling to price renewables technologies at levels that are both attractive for foreign investors and acceptable to local constituencies, and until that balance is achieved, we suspect that headwinds will remain.

inbound energy value totals, while the largest volume of deals came from US-based energy companies, led by US giant ExxonMobil's acquisition of Singapore-based InterOil for US$2.4bn. China has likewise been a force in the energy market on both a regional and global scale. With the slowdown in its domestic economy and overcapacity in other sectors, Chinese companies continued to eye opportunities overseas. High-profile deals included State Grid Corporation's acquisition of Brazilian CPFL Energia for US$12bn, while Shanghai Electric Power bought a stake in K-Electric (Pakistan) for US$2.3bn. In the alternative energy field, China Three Gorges Corporation acquired a stake in WindMW GmbH (Germany) for US$1.9bn from US-based Blackstone Energy Partners.

Asia-Pacific energy M&A: Foreign inbound acquirors (2016)

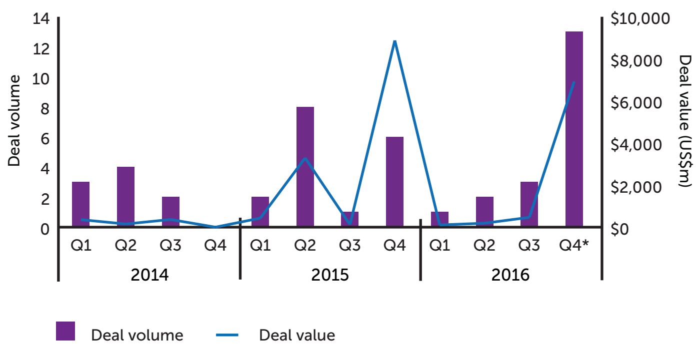


Private equity

Private equity participation in the energy market has shown increasing resilience over the past three years. Buyouts and take privates in 2016 totalled US$20.3bn (20 transactions), although this was largely due to the US$12.6bn privatisation of Ausgrid. Excluding that transaction, deal values were more balanced at US$7.7bn, a decrease from US$12.7bn in 2015 but more substantial than activity in 2014.

Amid the low oil price environment, private equity investors have shown interest in oil and gas plays across Asia-Pacific as they seek exposure to the region's growing energy consumption story. In a recent survey of private professionals in the oil and gas industry, participants unanimously agreed that this interest in Asia-Pacific would increase, compared to 99% for North America and 67% for Europe. For the time being, however, the challenges of timing and targeting have slowed such investments, according to analysis from the Asian Venture Capital Journal.

Asia-Pacific energy buyouts



*Q4 deal totals exclude the US$12.6bn privatisation of Ausgrid.

Private equity firms completed several investments into renewables, including acquisitions of solar and wind power assets in China, India, and across Southeast Asia. These deals accounted for 60% of energy buyouts, totalling US$672m as private capital secures its place in Asia-Pacific's uptake of clean energy solutions.

Outlook

Energy M&A in 2017 is likely to see some of its previous health return following the recent OPEC decision to cut global oil production, as decreased supply pushes up oil prices and, in turn, increases the value of assets. The year is already showing promise, with total deal value amounting to US$11.5bn (10 deals), 127% higher than Q1 2016. Much of that value came from the US$9.8bn sale of Australian infrastructure and utilities operator Duet Group to Cheung Kong Property Holdings (Hong Kong), suggesting that utility transactions will continue to hold favour among investors.

Divestments are also likely continue to play into overall energy M&A. In January 2017, Royal Dutch Shell completed the sale of several of its oil and gas assets in Thailand to Kuwait Foreign Petroleum Exploration Company. Oil and gas consultancy Wood Mackenzie anticipates that up to US$40bn in oil and gas assets across Asia-Pacific could come to market in the year ahead as major energy corporations reassess their portfolios.

China will continue to position itself as a leader in the clean energy space, a plan that is quickly gaining momentum as the US takes the opposite track following the election of Donald Trump. In the solar and wind sectors, China has pledged to spend more than US$360bn through 2020 as it struggles to curb greenhouse gas emissions, according to the country's National Energy Administration. Governments across Asia-Pacific are set to follow suit as many look to renewables to address increasing, and costly, energy demands to fuel economic growth.

MERGERMARKET

Charles Butcher
Partner, Corporate
+852 2186 3275
charlesbutcher@eversheds.com

Jae Lemin
Partner, Banking and Finance and a member of the Renewable Energy and Sustainability Group
+852 2186 3215
jaelemin@eversheds.com

Naveet McMahon
Publisher, Mergermarket
+852 2158 9750
naveet.mcmahon@mergermarket.com

eversheds.com