Having seen significant growth in oil and gas private M&A in 2017, we may see an increase this year in public M&A in the sector in London. In this article, we review public market activity in 2017 and preview corporate governance reforms in 2018.

Public M&A

2017 saw a 50% increase in private M&A in the oil and gas industry and a number of creative deal techniques being used (see our M&A Standpoint article Upstream oil and gas M&A: Co-operation for innovation).

Whilst public M&A activity levels generally picked up in London towards the end of 2017, this did not extend to the oil and gas sector. Since the takeover of BG by Shell in 2015, which took place near the bottom of the oil price cycle, we have seen limited public M&A in the sector. This can partly be attributed to the fact that there are fewer mid-cap exploration and production (E&P) companies in London than in previous years. Some mid-caps have also had specific issues (such as over-leverage and delayed developments) to address in recent years which are likely to have acted as a brake on consolidation. As E&P companies improve their balance sheets and the commodity cycle turns, they may be takeover targets for acquirers who are looking to replace reserves or diversify their portfolios.

In oil field services, we have seen more activity, with the most significant transaction in 2017 being the £2 billion offer for Foster Wheeler Amec by Wood Group. Whilst the Competition and Markets Authority was contemplating a detailed (and therefore protracted) investigation into the deal, Wood Group’s agreement to dispose of part of Amec Foster Wheeler’s business was accepted as an appropriate remedy and clearance was given.

There has also been a renaissance of the strategic joint venture in the sector, as seen for example with Centrica combining its E&P assets with Bayerngas Norge to create a new company, Spirit Energy, and the contribution by BP of assets into a new joint venture Aker BP for $140 million in cash plus a stake of 30% in the company.

The role of shareholders

Shareholders will continue to make their impact felt in the industry in 2018. In March 2017, Bowleven announced that it was considering all options, including a potential corporate transaction such as a merger or sale of the company. This strategic review was undertaken as a consequence of a significant
shareholder disagreeing with Bowleven’s strategy and requisitioning a general meeting at which most of Bowleven’s directors were removed. Although the review concluded without a sale, it is indicative of the greater influence that shareholders now have on a company’s strategy.

Shareholders will continue to make their impact felt in the industry in 2018...Shareholder activism is a growing trend.

Shareholder activism is a growing trend globally. Whilst it started in the US, shareholder activism has now taken a firm hold in London and Europe more generally. We have seen activist investors have an impact in the mining sector in London, and in the oil and gas sector outside London (for example Hess Corp. was the subject of a campaign by Elliott Management Corp in the US, leading to the company to divest a range of ex-US assets). Whilst shareholder activists have not to date taken a stand in E&P companies in the UK, it is likely to be only a matter of time before one does. On the back of the stance taken by activist shareholders, institutional investors are also becoming more vocal in expressing their views, both in the M&A context and more generally in relation to strategy and governance.

The role of shareholders is enhanced significantly where a transaction requires shareholder approval, whether it be public M&A or a significant private M&A transaction requiring shareholder approval (such as the combination of the Argentinian oil and gas assets of Mercuria Energy Group with Andes Energy (an African offshore E&P company with a market cap of £2.1 billion) obtain a standard listing in London, to supplement its existing NYSE listing, but without an associated offer.

In the secondary markets, London-listed Tullow carried out a rights issue to raise £607 million (before expenses) to reduce the group’s gearing and, through the reduction of its debt, to enable the group to, amongst other things, take advantage of opportunities that industry conditions offer.

We believe there is a good possibility of an increase in public M&A in the oil and gas sector in 2018.

If the markets are willing to accept buyers funding acquisitions by an issue of shares, as seen on the Wood Group / Amec Foster Wheeler deal, we may well see increased public M&A activity on the back of it.

UK capital markets

UK capital markets remain relatively challenging for new issuers, although the total number of Main Market IPOs across all sectors in 2017 was significantly up on 2016. In the oil and gas sector, 2017 saw Kosmos Energy (an African offshore E&P company with a market cap of £2.1 billion) obtain a standard listing in London, to supplement its existing NYSE listing, but without an associated offer.

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The year ahead

2018 is likely to remain high on the agenda for London-listed oil and gas companies. Investors continue to focus on executive remuneration and corporate social responsibility, including climate change and relationships with wider stakeholders. With a new Corporate Governance Code expected to contain enhanced provisions on stakeholder engagement and culture due later this year, as well as legislation requiring companies to report on how their directors have regard to employee interests and to fostering relationships with suppliers, customers and others, it is unlikely that focus on compliance in this area will diminish for some time to come.

Governance

Some mid-cap and smaller resources companies have significant shareholdings held by founder shareholders. For companies which have founding shareholders who have retained a large stake (30% or more), the rules for companies with or seeking a premium listing in London need careful consideration. On the back of some high profile governance controversies in recent years, the rules have been tightened to try to ensure that such companies have a business which is independent, in particular of any controlling shareholder. This remains an area of focus for the regulators, with a further tweaking of the rules in January this year. In addition, a shareholder with a stake of more than 50% of a premium listed company must achieve a higher approval threshold from the independent shareholders if they want to delist the company, for example following a takeover.

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The year ahead

We believe there is a good possibility of an increase in public M&A activity in the oil and gas sector in London in 2018. Companies will, however, have to be cognisant of the views of their shareholders and maintain focus on corporate governance issues such as remuneration, corporate culture and climate change.