INTERESTING TIMES – M&A IN 2015

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Legal Briefings – By **Belinda Fan**

In these interesting times, challenges faced by the Australian resources industry are driving innovation in M&A strategies.

'Cost innovation' must be the phrase of 2015 for the Australian Energy and Resources industry. The industry continues to face challenges, including rising costs, sluggish finance availability and regulatory uncertainties. Plus, no one can dismiss the psychological and real impact of the fall in commodity prices on resources companies' shares and forward planning.

Beneath the gloomy surface, however, these changes are driving new opportunities in mergers and acquisition. Potential abounds for stakeholders who track the trends carefully in these interesting times.

INFRASTRUCTURE TAKES CENTRE STAGE

Energy infrastructure assets with predictable returns are highly attractive in the current volatile market, with the US$5 billion price tag for the Queensland Curtis Island LNG Project's pipeline presenting a compelling case study. The pipeline attracted enthusiastic bids from foreign and domestic financial investors as well as pipeline operators, and was finally won by APA at a price that reflects the asset's strategic significance to the pipeline operator.[1]

Similar energy projects have taken careful note of the favourable price signal and the evidently large pool of hungry infrastructure investors: the Gladstone LNG Project and the APLNG Projects have both announced plans for their pipelines' divestments in early 2015.

2015 could also see divestment of some mining infrastructure as miners continue to sharpen their pencils to focus on higher margin projects or commodities. However, the bearish commodity markets and their sustained impact on the miners' balance sheet may put a damper on valuation of mining infrastructure by investors and financiers.

SHIFTING SANDS OF 'NON-CORE' ASSETS

Explorers and developers continue to divest non-core assets or consolidate to strengthen their balance sheets. However, the definition of 'non-core' changes quickly in today’s industry vocabulary.

BHP Billiton has led the way by demerging all assets falling outside the 'four pillar' strategy. The demerged assets are far from the dregs – Macquarie Research indicated that South32, listed at NPV, would have the third-largest market capitalisation within the ASX resource sector. BHPB’s tighter focus on smaller pool of more profitable assets signals the end of the diversified mining model at the big end of town.

At the junior end, M&A activity will continue to be an important form of capital raising for junior miners as they struggle to raise equity. For this group, the mantra of ‘non-core divestment’ may be old news. Consolidation could be a necessity for survival.

In the energy sector, unconventional exploration projects are the early victims of cost pressures on energy companies. In 2013 and early 2014, energy majors PetroChina, Chevron, ExxonMobil and ConocoPhillips moved into Australian shale and other unconventional plays with unprecedented enthusiasm. All four companies have, in the last 6 months, indicated some reversal of that strategy. On 30 March 2015, Chevron elected not to proceed to stage two of its Cooper Basin exploration joint venture with Beach Energy, even after spending $190 million in the first stage. This decision was made notwithstanding the positive drilling results thus far.

The shift in the majors’ strategic focus away from long term or early stage projects could present opportunities for smaller or exploration focused players.

NEW MONEY, NEW PLAYERS

Insolvency and financial distress in mining and energy companies have attracted new entrants from unexpected quarters. The Seven Group’s first foray into the energy industry was undoubtedly opportunistic and innovative. By taking over Nexus’ $180million debt and funding commitment, Seven acquired (amongst other assets) Nexus’ 15% in the Crux gas field, which could be the feedstock for Shell’s Prelude Floating LNG project. The industry could expect to see more of Seven as it expands the new energy portfolio into a potential 'third arm' of the group[2].

New breeds of Asian investors are also entering the Australian resources industry. Chinese private conglomerate Fosun Group's recent $474 million cash bid for Roc Oil resulted in the group acquiring energy assets stretching from Australia and Malaysia. A few aspects of this transaction are worth highlighting. First, Fosun was sufficiently agile and aggressive to enter a takeover bid war as the second bidder (in an unfamiliar industry in a new jurisdiction, no less). This is a move which Chinese SOEs would rarely consider making. Second, unlike sector-focused Chinese SOEs such as China Minmetals and CNOOC, Fosun is a conglomerate of diverse interests. Roc Oil was only a small slice of Fosun's billion dollar global acquisition spree last year, which included North American insurance businesses and New York's 1 Chase Manhattan Plaza.

How a stakeholder re-gears to understand, engage or counter these new money and new players could prove to be a competitive edge in these interesting times.

This article was first published in National Resources Review, May 2015.

Endnotes

1. For APA's view on the acquisition, see APA Group, 'Open Briefing Interview with APA' (ASX Announcement, 22 December 2014).

2. Brian Robins, 'Seven in the hunt for more energy assets following Nexus buy', Sydney Morning Herald, 5 January 2015.

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