63rd CHEMICALS AND ENERGY TRANSACTIONS ROUNDTABLE

22 MARCH 2018 ▪ SINGAPORE

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SUMMARY

On Thursday, 22 March 2018, Pilko hosted its 63rd Chemicals and Energy Transactions Roundtable, together with co-hosts Bank of America Merrill Lynch, Clifford Chance, KPMG and Shell, continuing a tradition of bringing together the most senior chemical and energy transaction deal leaders and deal advisors, and facilitating a lively discussion amongst the industry's best. The Roundtable discussions were held under "The Chatham House Rule".

The discussion revolved around the following thematic guidelines:

Trends in Chemicals and Energy M&A in the next 6-9 months

- There will be more cross-border M&A and consolidation, with global majors selling non-core/performing assets and rebalancing their portfolio towards renewables.
- M&A will be driven by strong balance sheets in Southeast Asia, in addition to a likely correction in the public markets. This will be bolstered by the fact that there are good assets/portfolios in the market that require capital. [There is also greater access to key infrastructure and end-of-life assets.]
- In terms of pricing, the valuation gap between buyers and sellers appears to be closing. Deferred payment mechanisms are also becoming increasingly common to bridge the gap, with a variation of triggers for the deferred payment.
- With valuations on the rise, there is likely to be an increase in PE exits as PEs "take money off the table".
- An increased focus on investing in new energy (e.g. electric cars, batteries etc.) is expected.

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What is the future of crude demand?

- The general consensus was positive, largely due to the dislocation between crude supply (for which there is a lead time in E&P) and demand (which is continuing to grow at an exponential rate).
- OPEC will continue to exert a strong influence on oil prices, but it remains a question as to what extent OPEC will be driven by geopolitics, economics, and the need to secure placement for its crude. The Saudi Aramco IPO will be an interesting development that the market is watching closely.
- Shale is clearly a serious contender in the market. However, there were questions as to whether the shale success story has resulted in underinvestment in the upstream sector, thereby exacerbating the dislocation between supply and demand. In addition, despite the development of shale oil, to what extent is the world's refining today built around traditional crude, and can they handle the different types of shale?
- China continues to be a major source of demand for oil, both domestically and in its outbound investments, and this demand is only going to grow. India and China's policy and energy mix will be key factors in any future demand growth.

Is integration (downstream and upstream) sustainable?

- Some participants were of the opinion that there is a strong incentive for integration as a natural hedge – majors who are integrated are in a better financial position, given that today's downstream businesses have stronger balance sheets than upstream. In addition, with digitization and electrification, having a customer facing business will be important in the future of the energy supply chain.
- An alternative view was that dis-integration makes sense as there are likely to be different investors for different parts of the business. Also, some participants commented that the oil majors may not be as good as extracting value from certain assets in the value chain. While there was recognition that oversight of the supply chain is important, questions were raised about the ability of an integrated entity to actually translate this into business opportunities, and it was mooted that such business opportunities may not be exploited by one major player in the same way as it could be by different players.
- Another view was that integration in the form of partnership could be an attractive proposition. Partnerships may be useful to maintain brand, commodity input and retail reach. Some participants believed that the downstream market holds much opportunity, e.g. a gas station can be more than just an outlet for gas: it can be an e-commerce drop off point, retail outlet, etc. [However, some participants queried the extent one could expend capital on such a "de facto JV" before losing one's core strategy.]
- Ultimately, it was clear that there is no "one size fits all" approach - different models may be used for different businesses and at different times.

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Is renewable energy the new downstream for oil and gas companies?

- There was recognition of the progress that some of the oil majors have made in committing resources to move towards renewable energy. The consensus was that majors are well-placed to drive growth in the renewable sector, due to their excess to capital, technology and capabilities; their skillset and experience in operating complex projects; and the synergies between renewables and conventional oil & gas businesses.
- An alternative viewpoint was that the renewables market is still in its infancy. Instead of investing in technologies which are still being developed, why not keep the cash, and invest in the right energy source/technology at the right time?
- Ultimately, all participants agreed that renewables just aren't there yet in terms of scale, and until battery technology improves, are subject to supply fluctuation; and that the traditional oil & gas business will continue to be far more profitable. At the end of the day, renewable energy will not replace conventional energy, but will supplement it, as a way to meet growing energy demands.
- A lot of the discussion was focused on solar energy - it was recognised that certain geographies have the advantages of wind and hydro, while all that is required for solar is rooftops. A rising phenomenon is retail solar, although the use of retail solar vs big solar farms will ultimately vary from country to country.
- A clear driver towards renewables is the move away from pollutive resources to cleaner forms of energy. However, one of the key issues discussed was the extent to which renewables themselves attract environmental issues – e.g. the use of lithium and cobalt in battery technology has resulted in its own issues of technological/environmental waste.
- Another interesting theme of discussion was around the end-to-end supply chain. The end-customer interface is extremely important - this is an area where the integrated oil majors may have an advantage, in terms of brand recognition, loyalty programs, bundling of products, and retail management. On the other hand, IOCs may have a higher cost-base, which could make it more difficult for them to compete in a sector that plays by price.

What are the upcoming changes (and disruptions) for petrochemical portfolio?

- The petrochemicals industry has seen its landscape change in the last 15 years from chemicals, to a focus on commodities, which has resulted in an evolution of intermediates and specialty chemicals. Europe, Japan and America have been at the forefront of these developments.
- The sector is currently growing at 3-4% per year. There is a focus on petrochemical products as a replacement for traditional commodities – e.g. petrochemicals are replacing aluminum, because most electric cars are made of ultra-durable and lightweight plastic instead of aluminum. Indeed, petrochemical may also offer a solution for renewables – e.g. nanotechnology is now being used to build dust-free films for solar panels.

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- Large petrochemical companies are examining their portfolio - how do they grow from small niche products, should they move towards differentiated products, or should it be a combination of both?
- The biggest disruptor is the ever-changing regulatory landscape, particularly in relation to the environment. The banning of plastics could materially impact demand. In addition, environmental clean-up costs can be so excessive, making it no longer feasible to operate cost-effectively.

How successful has PE investment been in the energy sector?

- The success of PE in the energy sector has been varied: the upstream sector has been challenging for PE investors, who have done much better in the midstream and downstream sectors. There have been some spectacularly good investments in renewables, but some spectacularly bad ones too.
- It was observed that "PE is no longer strictly PE anymore" – financial sponsors are moving into different asset classes (e.g. real estate, infrastructure and debt); and there are different types of financial sponsors who are not necessarily PE (e.g. sovereign wealth funds, pension funds, etc.). These differing investor profiles has resulted in different investment objectives and structures – e.g.
  - there is a shift from traditional equity participation to innovative debt solutions;
  - control may not be the goal, with investors being happy to have contractual rights (largely around protecting cash flow); and
  - some of these investors may have a longer investment timelines and more moderate expectations on returns.

Is collaboration through co investing becoming more likely?

- Collaboration makes sense when scale is the objective.
- Drivers for co-investing include large deal sizes, a need for an alliance between parties bringing different propositions to the table (e.g. funding, skillset, technology, etc.). It is also a mechanism for investors to "dip their toes in the water" - venture funds can observe "within the circle" and then go full scale if they like the investment, or exit if they don't.
- One participant raised the point that co-investment may not only be effected through holding an interest in a JV, but can also be done by holding the business ecosystem.

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OUR APPRECIATION

We appreciate the participation of all of our participants.

Specifically, a world of thanks to our valued sponsors.

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FUTURE 2018 ROUNDTABLES

Upcoming Transactions Roundtables include London on 14 June,
New York on 13 September and Houston on 8 November.

Please contact Jenny Meyer at +1.713.357.0944 or jenny@pilko.com
if you are interested in joining us. We look forward to seeing you at our next Roundtable.

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