As oil prices tumbled to record lows, falling almost 60% over 2015, Asia-Pacific remained one of the world’s busiest markets for energy M&A.

Showing remarkable resilience, the rate of acquisitions among regional and international energy majors reached near-record levels in 2015, with 200 deals completed, marginally short of the 222 in 2014.

Driven by ongoing uncertainty toward global market conditions, energy corporates have been rationalizing their operations in the region. With markets unsure how long depressed prices will continue, producers are seeking to cut costs through restructuring and, in some cases, widespread divestment programs.

In the renewables space, many Asian countries, possibly with the exception of those in the truly ‘emerging’ countries, are gradually increasing their diversification away from hydrocarbon energy. This has included a general uptick in investment into natural gas, solar and wind-power assets.

**Demand dynamics**

Overall, countries in the Asia-Pacific region consumed around 32 million barrels of oil per day in 2015, according to the International Energy Agency (IEA). China accounted for more than one-third of this average, with its oil demand up 9% year-on-year as of August 2015. The resilience of this demand can be attributed largely to consumer-related consumption, as a result of ongoing urbanization and rising household income. As China’s middle class expands, demand for gasoline and aviation fuel saw strong growth over 2015.

In terms of M&A activity, of the 200 deals completed in the region, 85 (43%) involved Chinese companies, with a total value exceeding US$56bn. Australia and New Zealand, with 28 and five deals respectively, together ranked second with 17% of Asia’s overall deal count and total transaction value of US$20.5bn. While the deal count in Southeast Asia equalled Australasia’s transaction volume (33), the region’s aggregate deal value of US$5.5bn was well behind that of Australasia. Malaysia accounted for US$2.7bn of Southeast Asia’s total deal value, spread across just four transactions.

**Energy M&A in Asia-Pacific**

<table>
<thead>
<tr>
<th>Year</th>
<th>Deal count historical trends</th>
<th>Deal count 2015</th>
</tr>
</thead>
<tbody>
<tr>
<td>2010</td>
<td>148</td>
<td>37</td>
</tr>
<tr>
<td>2011</td>
<td>127</td>
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<tr>
<td>2012</td>
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<td>67</td>
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<tr>
<td>2014</td>
<td>222</td>
<td>200</td>
</tr>
<tr>
<td>2015</td>
<td>200</td>
<td></td>
</tr>
</tbody>
</table>

**Asia-Pacific energy M&A: Subsector investment breakdown (2015)**

<table>
<thead>
<tr>
<th>Subsector</th>
<th>Deal volume</th>
<th>Deal value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Oil and gas exploration and production</td>
<td>27%</td>
<td>19%</td>
</tr>
<tr>
<td>Alternative energy</td>
<td>48%</td>
<td>44%</td>
</tr>
<tr>
<td>Power</td>
<td>26%</td>
<td>23%</td>
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<tr>
<td>Drilling and exploration services</td>
<td>6%</td>
<td>5%</td>
</tr>
<tr>
<td>Coal</td>
<td>3%</td>
<td>1%</td>
</tr>
<tr>
<td>Energy conservation related</td>
<td>2%</td>
<td>1%</td>
</tr>
</tbody>
</table>
Chinese SOEs: Ambitious and acquisitive

While many Chinese oil majors, including PetroChina and China Petroleum & Chemical Corp. (Sinopec), remained on the sidelines of dealmaking for much of 2014 and into 2015, there are strong indications this activity will pick up in 2016. In a briefing in August 2015, PetroChina President Wang Dongjin said the company sees low crude prices as an opportunity for acquisitions, noting that “Timing is really important now. We have been tracking some assets for a while and are waiting for the time to come.”

Since then, PetroChina has targeted acquisitions across the region, including parts of Australia’s Browse Basin and other assets in Western Australia. State-owned offshore producer CNOOC has also not ruled out further asset acquisitions, though its focus remains the integration of Canada’s Nexen, which it bought for US$15bn in 2013.


Asian energy: Turning green?

Though China has long been criticized for its high CO2 emissions, due to an over-reliance on hydrocarbon fuel sources – particularly coal, 2015 saw further indications it is attempting to diversify its energy mix into renewables. At the United Nations Climate Change Conference in Paris last December, China announced a state-led commitment to generate 20% of its energy needs from non-fossil fuel sources by 2030. It also pledged to reduce carbon emission intensity by up to 65% over the same period.

The country was also the world’s largest clean energy investor in 2015, spending more than US$110bn on solar, wind power and other renewable energy projects – up 17% on 2014, according to Bloomberg figures.

In Southeast Asia, particularly those countries where access to electricity is expanding rapidly from a smaller base, the need for sustainable energy sources is crucial in balancing power consumption with environmental impacts. Countries in the sub-region have been slow to diversify away from oil and coal, with demand for these traditional resources expected to remain strong.

The International Energy Agency predicts the region’s overall energy demand will increase 80% over the next 25 years. This would see oil consumption grow by more than 2 million barrels per day, and coal consumption climb to 440 million tonnes of coal equivalent (Mtce) over the same period. The share of coal in power generation would rise from 32% to 50%, contrary to the trend seen in most other parts of the world.

While hydropower and geothermal resources are relatively well exploited in the region, other renewable sources including wind, solar and biomass are largely untapped. The renewable energy potential of the ASEAN-5 countries - Indonesia, Malaysia, the Philippines, Singapore and Thailand – could meet total electricity demand across Southeast Asia 1.8 times over, the OECD report estimates.
Expert Q&A: Trends shaping Asia-Pacific energy markets

Eversheds’ Charles Butcher and Jae Lemin talk trends shaping Asia’s energy markets for oil and gas corporations and those in the renewable energy space.

What trends from 2015 are having the greatest impact on M&A in Asia-Pacific’s energy sector today?

Charles: “Energy has been one of the main sectors driving M&A in Asia-Pacific recently, and the year ahead could be a very interesting one for energy deals given oil price volatility. The big question on everyone’s minds is: How low will these prices go, and what are the energy majors doing in terms of asset sales or expansions to maintain the balance sheet or even eke out growth?”

Another area of interest has been in renewables given the emergence of new technology and government policies to encourage investment. The question is, will renewables live up to the hype of their effectiveness and ability to make returns to investors?”

Jae: “This year could be very interesting in the clean energy sector in Asia, especially as renewables begin to replace fossil fuels’ share of the regional energy mix. Throughout Asia, government policies and energy regimes are being rolled out which are supportive of renewables tech – although the effectiveness and enforcement remain to be seen. We know that investors are concerned about how committed governments are to current feed-in-tariff levels, which will impact investment trends now and going forward.”

What does the pool of international investors using M&A to enter the market look like? Who are the main buyers?

Charles: “Aside from state-owned players, the pool of investors is a mixture of private equity and global energy majors. In the latter two categories, where the search for yield is critical, these investors are favouring projects toward the end of their construction period. In this way, they are avoiding participation in the initial stages of project development where the risks and obstacles surrounding concession rights and other early stage processes may be higher.

For PE firms, this is a natural part of their investment strategies. Generally, buy-side financial sponsors look for more developed assets where they can enhance performance, exploit synergies and consider business combinations, and then exit. For energy M&A, while the sector hasn’t always been a classic fit for PE, there are examples of PE firms completing buyouts and repackaging these assets with other projects for trade sale exits to global and regional energy companies. More advanced stage renewables projects, for instance, may present packaging opportunities where cash flows are supported by favourable and sustainable incentives.

On the corporate side of Asia-Pacific energy M&A, national oil corporations and international energy majors are also starting to broaden their expertise into renewables. In this way, energy corporations can diversify and strengthen their positions in the clean energy space while the renewable companies can leverage the financial and operational support of more established energy players.”

What is going to be one of the themes for renewable energy M&A and investment in the year ahead?

Jae: “Picking up on Charles’ earlier point regarding construction period risk, we think one of the key themes will be the extent to which international investors use acquisitions and JVs with local firms as a way of entering the sector. International investors do not only bring capital into the region, they also bring expertise and experience, which can be valuable in Asia where the use of renewables technologies is still at the relatively early stages.

There are tailwinds for the renewables sector generally. Storage solutions will begin to address intermittency risk, and large countries such as China and India are reaching grid parity and there is a general (although not blanket) opposition among international banks towards financing new-build coal-fired power stations. To what extent will those tailwinds translate into significant deal flow in the renewables sector in Asia remains to be seen, although I think a lot of participants are asking this question.”

What are Australia’s advantages as an investment destination?

Charles: “Australia occupies an interesting place in Asia. Given its high level of development, advanced regulatory regimes and mature financial systems, it is in many ways attractive to a wider pool of investors. The basic investment risk profile is very different to that of China and emerging markets in Southeast Asia. Save for the occasional regulatory jitters like the ill-fated MRRT, there is no real sovereign risk, the legal system is robust and transparent, and industry players are highly sophisticated.

That being said, Australia is not a cheap country to do business in. While Australia has an educated and skilled work force, high labour costs and a sometimes tricky industrial relations environment can be negative factors. Nevertheless, alone among developed countries, Australia managed to avoid the worst of the GFC and retained a reasonable pace of growth.”

Jae: “Another thing we have to consider is that Australia, compared to parts of emerging Asia, has historically seen strong government support for renewable energy, and this has translated into significant investment in Australia, particularly into the wind and solar sectors. I think there is a general view that the current Government (and the Opposition) is supportive of renewables, and so the future remains bright for the sector in Australia.”
Private equity
Private equity investment in the Asia-Pacific energy space totalled US$11.9bn in 2015, with 17 buyouts – the best year for Asian energy buyouts since 2007. Australia led the region by a considerable margin, with US$10.2bn spread across five buyouts. This was followed by India, with US$920m (four buyouts), and China, with US$379m (three buyouts).

While private equity interest in oil and gas assets is picking up slightly, opportunities in clean energy assets and infrastructure are attracting greater attention. Ahead of the 2015 COP21 climate talks in Paris last December, India’s energy minister Piyush Goyal announced plans for a US$1bn private equity fund for the renewable energy sector. A number of Indian clean energy companies were also the subject of private equity buyouts throughout the year, including a US$600m acquisition of Mumbai-based Continuum Wind Energy.

Southeast Asia has had less success establishing a platform for private equity investment in clean energy. This is largely due to both the public and private sectors failing to prioritize renewable energy. Fossil fuels continue to be heavily subsidized, and there is a persistent lack of regional cooperation on clean energy technology transfer. With just two private equity buyouts in Southeast Asia in 2015, this may represent an area of opportunity in 2016.

For the time being, it remains to be seen how long it will take for the smaller economies of the region to balance their energy mix away from hydrocarbons. Such processes take time and political will, and many of these countries are grappling with other domestic issues.

Broader trends and considerations
The ongoing impact of low commodity prices, with oil at its lowest ebb since the early 1990s, is the most obvious reason for a lack of private equity interest in traditional fuel sources. Brent crude was trading at less than US$30 per barrel at the end of 2015, with some commentators speculating prices may yet have further to fall, and a price recovery to mid-2014 levels is potentially years away.

In such a pricing environment, the commercial viability of exploration and production projects are questionable at best. A number of Asian NOCs and other government-controlled investment vehicles, such as sovereign wealth funds, are still moving into PE deals in this space. However, few of the region’s general partners are joining them.

Chinese energy policy will play a key role in boosting Asia’s clean energy investment in 2016, but in the shorter term, a continued oil price slump should mean 2016 is another strong year for oil and gas M&A, with a good chance of exceeding the record set in 2015. As prices seem to have begun settling, both buy- and sell-side participants will likely move off the fences. Smaller hydrocarbon producers will seek scale, while oil majors divest assets to focus on either up- or down-stream competencies.

In China, the bedding down of new Chinese government anti-corruption measures should also have a positive impact, as uncertainty among senior executives at SOEs had been stalling international deal activity in 2015. Further policy shifts allowing China’s private sector to participate in M&A deals should also improve governance. Though whether this means greater deal volumes or fewer, but better quality and higher value deals, remains to be seen.