Energy Intelligence

REPRINT
VOL. 44, NO. 45
NOVEMBER 10, 2021
WWW.ENERGYINTEL.COM

ENERGY INTELLIGENCE **FINANCE**®

INDUSTRY TREND

Capital Markets Options Shift for Oil, Gas Producers

- *A move to self-funding and away from growth means oil companies are less reliant on capital markets now than they were in the past.*
- *Size and scale matters more than ever for oil companies looking to access debt and equity.*
- *Business models that spin units out of larger companies could improve access to capital markets, but these will also rely on receptive investors to be successful.*

The Issue

Oil and gas producers still need access to capital markets despite companies continuing to focus on equity appreciation and paying down debt. Major fund managers' declarations that they will align their portfolios with net-zero trajectories or divest from fossil fuels altogether would seem to spell bad news for oil companies' access to capital in the long term. But rising commodity prices, amid more disciplined strategies and continued low interest rates, have cracked open capital markets. Yet, access issues remain and there is a difference between the global haves and have nots. Further out, different types of companies — including transition and legacy businesses spun out from traditional oil and gas players — could attract different types of investors to both their debt and equity.

Equity Markets Favor Bigger Producers

Oil and gas equity markets are tearing higher, along with commodity prices. That outperformance is helping relations with their current investors but it does not always mean the market is clamoring for new shares. Those companies looking to sell equity into the current market need to make sure that they have the right assets and the strategy to win over Wall Street.

"On the company side there is pent-up demand for capital as other sources — such as traditional bank debt — have cut back their allocations for oil and gas," said energy specialist Alex Msimang, managing partner of law firm Vinson & Elkins' London office. "At the same time, on the IPO [initial public offering] investor side high commodity prices — and the prospect of high returns — are starting to look eye-catching again. So, there is inevitably some interest."

National oil companies have used public markets in their own countries to successfully monetize stakes in strategic assets. Abu Dhabi National Oil Co. (Adnoc) recently raised $1.1 billion on the Abu Dhabi Securities Exchange (ADX) and followed it by raising another $795 million with its Fertiglobe offering on the ADX.

But whether that momentum will spill over into enthusiasm for shares in independent E&P companies remains to be seen. Once the darling of Wall Street bankers, private exploration and production companies looking to go public have had a tough reception from investors. The IPO of private equity-backed Vine Energy earlier this year was considered a flop after the company priced its shares below the expected range and saw them fall further in early trading.

North Sea-focused Neptune Energy has also been reported to be exploring its options in public markets.

Debt Access Uneven

Access to debt markets across the energy space remains uneven. Those with supermajor-type size are finding bond markets wide open and rates low, as the central banks continue to stimulate the global economy.

In Europe, companies such as Repsol, Eni and TotalEnergies are increasingly turning to green or sustainability-linked bonds that offer even lower rates if proceeds are used for decarbonization or companies meet certain sustainability targets.

Italy's Eni floated a €1 billion bond with a seven-year term in June at a rate of just 0.375% but that rate will almost double

>> continued on page 2

to 0.625% if the company doesn't meet certain carbon reduction goals.

National oil companies often see their debt linked with the fortunes of their government shareholders, rather than those of their public company competitors.

But not all oil and gas companies are finding an open door when they go to visit their banking partners. E&P companies responding to the Federal Reserve Bank of Dallas' influential quarterly Energy Survey reported financing problems as one "headwind" they faced on the road to recovery from the pandemic-driven downturn.

"Initial conversations with regional energy banks show increasing interest in advancing incremental credit," said one respondent. "The 'money center banks' continue to seek to reduce their commitments to oil and gas borrowers."

Even the largest companies are not necessarily seeing the full benefits of higher prices. Ratings agency S&P Global increased its oil price deck by $10 to $75 for the remainder of this year but said higher prices "won't result in wholesale upgrades."

"We remain focused on issuers' financial policies and commitment to improving their balance sheets through debt reduction, particularly for investment-grade companies," the agency said.

Spinout Stratagem

With much of the industry transitioning away from growth it might appear that there will be less need in the future for additional debt and equity among established players. Large companies are reducing gearing and even the once-spendthrift US shale players know better than to try to fund growth through equity.

But as large oil companies chart a path through the energy transition, some are choosing to restructure their businesses to access both debt and equity markets. Investors are increasingly calling for large oil companies to spin off legacy hydrocarbon businesses, new energy transition activities or both in order to get a better cost of capital and attract a new investor base.

Eni hopes to entice investors back into independent shares as it eyes a potential IPO for its Var Energi joint venture that operates offshore Norway.

Eni CFO Francesco Gattei said the company's Angola joint venture could look to raise €2 billion-€2.5 billion once it becomes a separate entity later this year. He declined to speculate on the rates the joint venture could expect to pay but BP CFO Murray Auchincloss recently told investors that a similar joint venture it has in Norway, Aker BP, has had "absolutely no problem raising debt, both in Europe and the US" at "very attractive" rates.

Some are pitching more radical proposals, such as hedge fund Third Point's suggestion that Royal Dutch Shell split into two companies, with one focused on legacy oil and refining and the other on gas and renewables.

"We need to create these types of vehicles like we've done during [the] financial crisis with banks. We need to create new vehicles, new thought processes," BlackRock CEO Larry Fink has said.

While some would like to wait before looking at such options, energy companies should not take the current amenability of capital markets for granted.

"The markets are always cyclical yet hard to predict," Msimang said. "Consensus seems to be that any oil and gas companies wanting to tap the public markets should be acting soon and should be ready to move quickly."

Noah Brenner, London