

Spending made easy:

Russia's M&A market gets hotter

State-controlled companies increased their footprint in the Russian oil and gas industry in 2013, and an influx of cash in the private sector made an invigorating effect on prospects of mergers and acquisitions. Small and medium-sized companies look like attractive targets for private investors—unless the government makes their survival impossible.

Extra cash

The year 2013 witnessed large-scale deals that ended in de-privatization of some energy companies. Rosneft has managed to establish full control over TNK-BP, NGK Itera, Taas-Yuryakh Neftegazdobycha, Geotransgaz, Urengoi Gas Company, Irelyakhneft, and also acquired 99.9995% in Alrosa-Gas.

The bill of Rosneft's purchases during the year totaled \$52.713 bln plus 12.84% of own shares. The cash ended in private hands—and publicly traded companies (BP, Alrosa, Ashmore, and Enel) have received only \$20, or 38% of the sum. The largest portion of the proceeds went to individuals who have accumulated significant experience of managing oil and gas projects in Russia.

The list of the mavericks includes German Khan, Viktor Vekselberg, Mikhail Fridman, Igor Makarov, et al. Industry sources assume these beneficiaries of the deals with Rosneft may be eyeing investments in Russian projects. Even though no information exists about actual plans of this kind, the huge cash overhang is an encouraging factor for the M&A business.

New players have come to the are-

na, too, such as former Rosneft CEO Eduard Khudainatov; Yuri and Alexey Khotins from Belarus; and Arkady Abramovich, Roman Abramovich's son 'The owners of small assets who had remained in frustration and depression after the 2008 financial crisis, are suddenly feeling that a profitable deal can be possible,' a market player says. 'Companies are busily preparing for deals, and some have actually made them.'

Pre-crisis and post-crisis

The M&A market in the global and Russian oil and gas industry was growing prior to 2007 when the crisis dealt a blow to the upward trend. Ernst & Young reported a 29% downslide of this market worldwide in 2008 against 2007. According to PwC, the number of M&A deals in the oil and gas industry in Russia fell from 41 in 2007 to 33 in 2008, and the overall value shrank from \$35.7 bln to \$12.3 bln in one year.

Lenders had been eager to finance the owners of greenfield projects even if the licenses were for geological studies only: they were convinced that the assets could be sold with profit after discoveries. After the crisis the mood changed as such investments appeared too risky. License holders had to sell their possessions at great discounts and developed an aversion toward risky assets, impeding exploration of new reserves.

The market took first steps to recovery in late 2012 when Rosneft announced it was taking over TNK-BP for \$55 bln. The deal was finalized in March 2013 and was the largest contribution to the statistics of M&A in

the Russian economy. In the first ten months of the year the sum of such deals totaled \$101.3 bln, according to AK&M.

Even without 'the deal of the century', the volume of M&A deals in the industry in January-October totaled \$46.3 bln which is 14% larger than a year earlier. The investors, who survived the crisis with a cash hoard, are showing new appetite in investing although most of the sum was spent by managers of state companies. Rosneft alone invested almost \$9 bln in acquisition of smaller assets.

Hot deals

The most recent hot deal was the acquisition of OOO Diall Alliance by companies associated with Arkady Abramovich and his partner Valentin Bukhtoyarov. The Saratov-based company belonged to London-based Vostok Energy and became available on the market about a year ago. The initial price of \$800 mln was trimmed to \$500 mln and finally stopped around \$300 mln including \$160 mln of debts.

Another relatively large asset on the market was Exillon Energy, also registered in London by a Kazakh tycoon Maksat Arip. It holds ten small licenses in Western Siberia and Komi Republic: the fields are at early stages of production; and 2P reserves total 71 mln t. In early December Mikhail Gutseriyev bought 14.9% of the company and quickly resold it to another businessman from Kazakhstan, Igor Shkolnik (who had bought the Orsk refinery from Gutseriyev in 2011.)

Private companies' acquisitions in 2013

Buyer	Investors	Purchases	Fields, reserves	Date	Sum, \$ mln
CrownCity, Seneal International Agency Ltd.	Yuri and Alexey Khotin	100% of Dulisma	Dulisma field in Irkutsk (15 mln t of oil, 8 mln t of condensate, 77 bcm of gas)	December 2012	89
		29.99% of Exillon Energy plc	Licenses in Western Siberia and Komi (71 mln t)	December 2013	300
Lukoil	Lukoil shareholders	100% of Samara-Nafta	Over 60 plays in 23 blocks in Samara and Ulyanovsk (85 mln t)	April 2013	2,050
Independent Oil Co.	Eduard Khudainatov	100% of Paiyakha	Paiyakha and North Paiyakha blocks in Krasnoyarsk (58.9 mln t)	August 2013	500 (for both)
		100% of Geotex	South Mechetkinsky block in Saratov		
Zoltav Resources	Arkady Abramovich, Valentin Bukhtoyarov	100% of Siberian Geological Co. (CenGeo Holdings)	Koltogorskoye field in Western Siberia (10 mln t)	March 2013	26
		Diall Alliance (Vostok Energy)	Bortovoi block in Saratov (10 bcm of gas and 2.2 mln t of liquids)	November 2013	Less than 300 (incl 160 of debt)*
Avoca Trading	Igor Shkolnin	14.9% of Exillon Energy plc	Licenses in Western Siberia and Komi (71 mln t)	December 2013	111

*estimated

Source: RusEnergy research

The owner of this minority stake in Exillon Energy made offers to the other shareholders hoping to accumulate 100% of interest, but suddenly another stake (29.9%) was bought by companies of Yuri Khotin and Alexey Khotin. The father and son had bought Dulisma from Sberbank in December 2011 at a great discount, and now are reportedly willing to get 100% of Exillon.

After the sale of Exillon the Russian market of small and sale-ready oil and gas assets seems to be depleted. Nevertheless, there are still a few dozen companies that can theoretically be purchased by serious-minded investors. The list includes some majors (Bashneft and Alliance Group) and such small fry as producers with reserves in the

rage between 0.5 mln and 3 mln t.

Money at stake

Industry sources claim the market is vigorous. A company with 12 mln t of oil reserves (C1+C2) in the Orenburg was offered in November and sold in December. However, an asset with current production of 200,000 tpy and growth potential to 500,000 tpy is a rare event. Offers tend to be small fry and the owners keep looking for willing buyers for a long time.

There is solvent demand, but the buyers are mostly in the 'big spenders' category. One of the owners who has reaped a big sum for assets sold to Rosneft told RusEnergy that he and his partners would keep the salaries of the key managers intact

till the end of 2013 and then made a decision to go on paying them only if the cash could be invested in other large and attractive assets.

To date, none of the companies that received cash from Rosneft has reported any purchases. The shareholders of Alfa Group who collected \$13.86 bln for the sale of their interest in TNK-BP have established an investment vehicle in Luxembourg, LetterOne Holdings S.A., and poured \$15.36 into it. The new company has a special unit, L1 Energy, headed by former executive director of TNK-BP German Khan. RusEnergy has learned that the company is looking for assets priced in the range of \$1 bln to \$5 bln.

One of the alleged targets is RWE

Sellers of assets to Rosneft in 2013

Company	Beneficiaries	Sold assets	Date	Sum, \$ bln
AAR	Mikhail Fridman, Leonard Blavatnik, Viktor Veksberg, German Khan	50% of TNK-BP	March	27.73
BP plc	BP shareholders	50% of TNK-BP	March	16.65 (+ 12.84% of Rosneft)
MGK Itera	Igor Makarov	100% of NGK Itera	July	3.1
Alrosa	Alrosa shareholders	100% of Geotransgas, Uren- goi Gas Co., Irelyakhneft; 99.9995% of Alrosa gas	September	1.38
Ashmore Group, Finfund Ltd., Yakut Energy Ltd.	Ovneiko, Georgy Ramzaitsev, shareholders of Ashmore Group, Mosnarbank Eurofinance*	65% of Taas-Yuryakh Neft-egazdobycha	October	2.053
Enel SPA	Enel SPA shareholders	19.6% of SeverEnergia	November	1.8

*estimated

Source: RusEnergy research

Dea, an upstream unit of RWE with assets in Germany, Norway, Turkmenistan, UK and other countries. It produces annually about 31 mln boe and is estimated to be worth between €4 bln and €7 bln, which makes it less profitable than TNK-BP used to be. Another asset eyed by LetterOne is in Nigeria, but sources in the company admit that the negotiations are still at a very preliminary phase.

Fridman's advantage

Officials of Russian companies believe that after a while the owners of Alfa Group will return to this

country when they finish their global searches, and start investing in Russia, as Vladimir Putin had asked them to do when they sold their stakes to Rosneft. And Mikhail Fridman had promised to come back 'not before we are politically engaged but because Russia for us is a comprehensible country where we have got noticeable competitive advantages.'

It will hardly be possible to repeat the success of TNK-BP, but some under-priced assets wanting to get financed could really be available—especially when cash-loaded potential investors have emerged. If assets as large, Rosneft may get interested; but if

they are not good enough for Igor Sechin's company, they might be taken over by Eduard Khudainatov's Independent Oil Company (established, as some observers believe in the interests of Rosneft and/or its top managers.)

Both Sechin and Khudainatov can get relatively cheap funding and can be generous if an asset is attractive. It could mean an opportunity for small pioneering ventures, which would buy underexplored assets, upgrade them to a producing stage and sell with profit.