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Note: This report presents EY’s analysis of transaction data largely compiled by Derrick Petroleum. Throughout this report, disclosed or reported transaction values are expressed in US dollars.
Introduction

Welcome to EY’s annual review of global oil and gas transaction activity. In this report, we look at some of the significant trends in oil and gas deal activity over 2014 and the outlook for transactions in the sector in 2015. We analyze the diverse dynamics in the upstream, downstream, midstream and oilfield services (OFS) segments, as well as the regional trends that underlie the macro environment.

Deal value up sharply in 2014, but deal volumes continue to slide amidst rising volatility

After more than three years of relatively strong and fairly stable oil prices, weakening market fundamentals in the second half of 2014 finally outweighed geopolitical uncertainty, causing oil prices to decline by more than 50% by year-end, compared to their mid-year highs. (See page 6 for more details of the oil price collapse.)

While oil and gas transaction activity slowed understandably in the fourth quarter, 2014 was a notable year. Total global reported deal value reached almost US$443 billion, up by more than 69% from 2013, and well above the most-recent peak in 2012. However, the total number of oil and gas transactions – the total deal volume – continued to decline in 2014, dropping more than 20% from 2013.

Upstream transactions continue to dominate the landscape, accounting for almost three-quarters of the total global deal volume. But notably, the upstream share of total reported deal value dropped below 50% for the first time in 2014, as non-upstream deal activity surged. Total reported deal value was up for the year for each segment of the industry: upstream increasing by 21%, downstream by 88%, midstream by 115%, and oilfield services by 242%. The number of deals, however, dropped in 2014 for each segment except downstream.

Global oil and gas transaction activity

Source: EY analysis of data from Derrick Petroleum

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Global oil and gas transaction activity

Source: EY analysis of data from Derrick Petroleum
Four notable trends characterized the transaction year for oil and gas: bigger deals, less acquisition spend by National Oil Companies (NOCs), continued high interest in US unconventional assets and continuing expansion of private equity (PE) interest in the sector. Firstly, in 2014, there were 82 deals with a reported value of US$1 billion or more, including four “megadeals” with reported values in excess of US$10 billion. In contrast, 2013 saw 67 deals greater than US$1 billion, with only one megadeal. With the larger deals, the average deal size for the year was more than US$447 million, up sharply from the average of the previous four years. While the activity over the previous four years had been trending toward smaller average deals, that trend seemed to be reversed in 2014.

NOC transaction activity, which had played a major role in recent years, was notably subdued in 2014, from a reported deal value and a deal volume perspective. Deals where NOCs were involved as buyers, either wholly or in partnership/consortium, accounted for less than US$21 billion of reported deal value in 2014, down from more than US$63 billion in 2013, and well below the record in 2012 of more than US$122 billion. Transaction activity by the three major Chinese NOCs was off sharply in 2014. After spending an average of more than US$27 billion per year over the previous four years, the three NOCs spent just over US$6 billion in 2014, as the companies focused on integrating earlier acquisitions and were somewhat distracted by the on-going government prompted management changes. Russian NOC activity, which had soared in 2012 with the big Rosneft deals, was also off sharply in 2014.

We would however, expect to see some resurgence in NOC activity in 2015, particularly from the Chinese and other Asian NOCs, as those organizations move to take advantage of more attractively-priced assets.

The impact that unconventional oil and gas development has had on the industry over the past 10 years or so has been nothing short of revolutionary, in every sense of the word. That revolution has so far been largely contained to North America, the US in particular. The US has long remained the most active region for oil and gas transaction activity. While the number of US upstream deals continued to decline in 2014, activity involving unconventional assets has been steadily increasing in the US, as a percent of all US upstream activity.
Looking forward in 2015 to a volatile, lower-price market, but also a strengthening transactions market

We believe that a shift is underway in the oil and gas business as the industry takes account of the changing balance of supply and demand to a fully supplied market. For the global oil and gas industry, four key implications result from this structural shift:

1. Costs matter. In a fully supplied world future commodity prices will not preserve or rescue high-cost projects as the industry grapples with structural cost pressures. Capital intensive unconventional resource development, increasing regulatory and environmental costs, and the growing technology and service costs of unlocking abundant, yet complex and costly plays will drive new business models and a renewed focus on operational excellence, which will result in the bifurcation of winners and losers – those able to adapt and those who fail to adjust.

2. Globalization. The global nature of the industry continues to change. Growing unconventional production has disrupted old market dynamics creating new competition at a global level. Capital continues to flow to projects with little regard for borders, while players continue to evolve strategies and structures in ways to best address and succeed in the global energy marketplace.

3. Innovation. Essential to realizing the resource potential of the industry, new innovation (technology, business processes, structures, operating and funding models) will be required to offset high structural costs/technically challenging plays (for example, the deep water, oil sands, unconventional plays). Innovation will be a key driver of success.

4. Resilience. The future market looks to be moving back to higher levels of volatility and uncertainty. In this context a renewed focus on building operational, financial and portfolio resilience is inevitable and will be a critical consideration in much of the transaction activity.

In the absence of substantial short-term changes to the expected global oil balance – e.g., stronger oil demand, unexpected reductions/outages in supply or a slowdown in the growth of non-OPEC supply – oil prices could weaken further in the first half of 2015. The fundamentals should start to improve in the second half of 2015, albeit slightly, as demand is expected to increase and non-OPEC supply increases are expected to be moderate. The level at which the market eventually stabilizes, however, is still subject to much uncertainty.

So for 2015, we see the scope for a strengthening oil and gas M&A market, primarily driven by the implications of and responses to the recent price collapse, as companies:

- Re-allocate capital to optimize their portfolio and focus on higher returns
- Remove underperforming and lower-yield businesses and assets (e.g., carve-outs and divestments)
- Pursue opportunistic acquisitions of challenged or under-valued businesses
- Look to joint ventures to share capital and risk
- Increase investments into growth markets

In short, particularly in the remainder of 2015, we expect to see more motivated sellers and more consensus on valuations. Consolidation will be driven by over-capacity, intense margin pressures, and generally weaker capital markets.
After holding above the US$100 per barrel mark for more than three years, since mid-June 2014 oil prices (using spot UK Brent) have declined by more than 50% (through mid-January 2015). OPEC’s decision at their late-November meeting to maintain the current production ceiling, rather than cut production to support prices, exacerbated the decline.

The global oil market balance in recent decades can be characterized by three components – demand, non-OPEC supply and the derived “call” on OPEC crude oil production and inventories. Historically, non-OPEC supply has satisfied as much of global oil demand as it could, with the remainder to be supplied by OPEC and/or from inventories. But since Q1 2014, OPEC has supplied more crude oil than the market has needed, and given current expectations for global oil demand growth and for non-OPEC production growth, the amount of crude oil needed from OPEC will decline sharply in the first half of 2015. With OPEC resolved (at least at this point in time) to maintain its current production ceiling of just over 30 million b/d, and oil demand declining seasonally starting in the first quarter, the market is likely to be over-supplied by as much as 1.5 to 2 million b/d in the first half of 2015.

The actions of OPEC in allowing a process of undisturbed price discovery to take place can be characterized as a reminder to higher-cost producers that there is no implicit price guarantee that OPEC (in effect Saudi Arabia) is prepared to underwrite when that primarily acts to support non-OPEC margins. Multiple explanations for OPEC’s motivations have been put forward. However, an explanation based on market fundamentals is compelling. A combination of ‘disturbances’ to the supply side after the global financial crisis masked the structural impact of growing unconventional (and other) non-OPEC supply leading to a fairly balanced market and stable price. As demand growth remained weak and supply ‘disturbances fell away,’ OPEC was placed in the position where price stabilization at recent levels would only be possible by continual market share erosion as higher prices motivated further high-cost production to be brought on stream. Given that market share losses would be more expensive to recover in the long term, OPEC is seeking to deter more high-cost production by providing a visible risk to economics and returns.

What does this mean for the industry in the short-term?

If the OPEC actions are motivated by the factors referred to above, then it is likely that they will look to see some hard evidence that the market is working to clear less economic barrels from supply before any decisive response is attempted. While there is a limit to the financial capacity of many OPEC players, Saudi Arabia as the swing producer has made it clear that it can and will withstand lower prices for some considerable time to come. In this context the following factors will drive the market finding a new price level:

- **Economic stimulus of the price reductions.** A US$50 reduction in the price of crude oil translates into a US$4.6 billion per day stimulus to the global economy, or more than US$1.7 trillion per year. In just the US, the stimulus would amount to almost US$950 million per day. An element of this could be offset in the form of less capital spending by some companies.

- **Contraction in upstream oil investment.** An immediate cut-back in upstream spending is happening as a direct result of the price decline. For conventional oil, cut-backs are most likely in exploration with some postponement or deferral of project sanctioning, particularly for the higher-cost, higher-risk projects, but little impact on short-term production. On the unconventional side, light tight oil (LTO) developers and producers are quickly reducing capital spending, “high-grading” their portfolios and increasingly concentrating on the “sweet spots.”

- Notably, LTO developers and producers are unlikely to shut-in existing production; rather, they will defer some new development drilling activity.
Cuts in LTO investment will not translate into a reduction in US oil production, but rather to a slowing of the growth in production. Investment reductions can be expected to be somewhat offset by the continued increasing drilling and completion efficiencies.

Estimates of US oil production growth in 2015 (generally made before the recent price declines) average around 1 million b/d. Those growth estimates could be cut in half by the end of 2015.

Increasing cost pressures. Pressures to reduce and control costs will escalate, with pressures on OFS providers to be particularly strong.

Tightened access to capital. Smaller, more-leveraged companies could struggle as lenders or investors tighten access to capital, limiting their ability to continue their exploration and development activities. Some LTO developers could be unable to fund the drilling required by the “unconventional treadmill.”

Increasing consolidation/transaction activity. Portfolio high-grading, cost pressures and capital market tightness should also spur increasing acquisition and divestment activity.

Rising political instability risks. Producing countries with fiscal break-even prices substantially above the market and with limited fiscal reserves (e.g., Venezuela, Libya, Iraq, Iran, and Nigeria) face rising risks of political/social instability, with consequently increasing risks to oil supply. Risk with regard to Russia remains very high, with the price declines adding to the difficulties that have resulted from the US/EU sanctions in the wake of the situation with Ukraine.

Iranian sanctions. A breakthrough in the Iranian nuclear negotiations, which would result in a ramp up of Iranian production/exports, would exert further downward pressure on prices should OPEC or Saudi Arabia not move to accommodate the increased supply into the market. Once OPEC feels that the market has reached a position where it is prepared to act then it is likely to do so as decisively as possible. The price recovery could therefore be rapid. The level at which medium term prices stabilize is currently the subject of much debate and it is the speed of the development of a new consensus on this which will drive the timing of much upstream M&A activity in 2015 and beyond.
Over the course of 2014, the key themes were:

1. US tight oil is attracting the majority of capital investment globally as US companies sold down or exited their positions internationally to fund ongoing development and consolidate locally.
2. NOC acquisitions dropped off materially as they focused on investing in the projects secured in previous years.
3. Megadeals are stealing the show as the available acquisition capital increasingly concentrated into the hands of the few.
4. Exploration and appraisal assets are still getting attention with nearly half of the total number of transactions globally.

Throughout 2014, transaction activity remained constant despite the sudden drop-off in commodity prices in Q4. The number of failed transactions (i.e., announced processes that didn’t complete in 2014) was at a low, with a mere 20% of deals announced not finding a buyer. Mirroring the theme of a preference to oil cited by most IOCs and NOCs, globally oil-weighted transactions took 70% of the acquisition capital with gas production garnering 30%; however, this varied regionally.

There was US$185 billion of reported upstream oil and gas transaction activity in 2014 representing a 21% increase on 2013. Capital appears to be concentrated, however, as US consolidation and global mega deals stole the show. The 1,376 upstream deals in 2014 were 22% lower than 2013. Indeed, 65% of the total value of global 2014 transactions (US$120 billion) is comprised of 50 deals greater than US$1 billion each.

Almost half of the upstream transactions by reported value in 2014 were in the US (46%), with Canada adding another 22%, leaving North America to dominate. The US had its biggest M&A year in over five years, with US$85 billion in announced values, an increase of almost 55% compared to 2013’s total.

The vast majority of this activity was consolidation and asset trading within US and Canadian companies. With over 70% of acquisitions by reported value, being made by US companies and less than 15% made by Canadian companies. However, 2014 began and finished with two notable exceptions to the local investment theme: China’s Goldleaf Jewelry’s surprise acquisition of a 95% stake in ERG Resources for US$684 million in February and, closing out the year, Repsol’s US$13 billion acquisition of Talisman Energy.

The rest of the regions delivered a relatively balanced contribution to the global M&A reported values, with between US$8 to US$13 billion to the total. India and perhaps more surprisingly, the Middle East continued to lag behind the rest of the world with negligible transaction values (or undisclosed) since 2011.
Companies are increasingly selective as they focus on value and portfolio optimization rather than purely buying reserves and/or production. Capital discipline was an on-going theme for 2014. Perhaps as a result, corporate M&A and acquisition of producing assets tied for first place by reported deal value with 38% each. Adding in acquisition of development projects, 95% of the acquisition capital in 2014 was focused on established assets.

On a transaction volume basis, however, almost 50% of transactions were exploration and appraisal assets, this highlights the importance of portfolio replenishment. North America continued to dominate with 40% of exploration-related transactions by volume. The exploration transaction volume in Africa was a modest 12% of global total volume; matching Australia and to a lesser extent Asia and the North Sea.
**IOCs dominate the list of sellers**

Over half (55% or US$101 billion) of global upstream divestments by reported value were concentrated into 20 sellers: with six (~38%) corporate transactions and the remainder asset rationalization by major oil and gas companies. The majority (65%) of transactions were assets or companies in the US and Canada.

For the top transactions by reported value outside of the US and Canada (i.e., about US$50 billion), over half of the sellers by reported value were by European companies, with US companies taking second place with almost 30% of transactions.

**Top sellers of assets, % of transaction value by region**

These statistics reflect the renewed focus on portfolio discipline of the industry.

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Source: EY analysis of data from Derrick Petroleum

*Top 20 sellers, by location of assets*

Source: EY analysis of data from Derrick Petroleum
Buyers are more globally diversified

The top 20 buyers in 2014 made a combined total of US$85 billion of acquisitions. Although the buyer mix is more diversified, the modest presence of many NOCs in the top 20 suggests acquisition capital may remain undeployed in certain previously active acquirers, such as NOCs in Korea, China and India.

There were 51 upstream transactions with reported deal value greater than US$1 billion. The major big buyers for 2014 were IOCs and PE, who both focused their acquisition capital on securing US companies and assets. NOCs and Sovereign Wealth Funds (SWF) were noticeably absent from the US. In contrast, all buyer groups invested in Canada. There were three large deals in Europe in 2014, including one by a Russian PE firm. Africa saw big investments from IOCs and SWFs. Asia’s three mega-deals were marked by US independents monetizing their international positions as they refocus their capital on their US domestic assets. The three big Australian acquisitions were a diverse group made by a SWF, NOC, IOC and Equity Capital Markets (ECM).

Global upstream transactions: buyer regions as a % of total value for deals over US$1 billion

Global upstream transactions: buyer types as a % of total value for deals over US$1 billion

Source: EY analysis of data from Derrick Petroleum
FSU: Lowest reported M&A transaction values in five years

The former Soviet Union (FSU) was the biggest loser for drawing investment and transaction activity in 2014 with a mere US$9.2 billion (a 72% drop in transaction value from 2013).

NOCs were less active

In contrast to 2013, the NOCs did not drive M&A activity in 2014. In fact, they had their lowest investment on record in five years; US$20 billion in contrast to 2013’s US$60 billion. They represented 12% of the acquisitions greater than US$1 billion.

NOCs are still digesting the material acquisitions made in the past few years. Many have met their objectives to secure resources, some are struggling with development project delays and/or cost overruns, and most are increasingly technically rigorous in their evaluations and investment decisions. Similar to IOCs, several NOCs are focusing increasingly on values and returns rather than strictly on securing resources and production. Some more mature NOCs are also entering the value chain earlier, securing exploration licenses.

As China continues to reorganize their NOCs in the wake of government investigations into improper business behaviour, 2014 marked the first year that Chinese NOCs represented one of the lowest reported values of global upstream M&A transactions with 75% less investment (based on reported value) than 2013, and an 80% decrease compared with their 2010-2013 average. Based on recent falls in valuation outlook, this looks like a timely pause from acquisitions.

Oil and gas transactions with NOC buyers

The drop in foreign investment in the FSU overall is likely to be the direct result of international sanctions placed on Russia in reaction to Russia’s annexation of Crimea. International sanctions have caused Total to suspend their shale oil exploration joint venture with Lukoil. The Ukraine crisis also stopped upstream exploration in Ukraine’s Black Sea and resulted in the cancellation of the South Stream pipeline.

CNPC’s acquisition of a 10% working interest in the Vankorskoye field from Rosneft for US$1 billion was the largest foreign investment into Russia’s upstream oil and gas sector in 2014. Total’s acquisition of a 1.28% stake in Novatek announced in June 2014 for US$434 million marked the only investment by an IOC. The remaining Russian transactions were a result of internal consolidation.

Outbound investments by Russian firms were similarly minimal. Luxembourg-based LetterOne, the international investment vehicle of the shareholders of Russia’s Alfa Group Consortium made headlines with their US$7.1 billion acquisition of RWE's Dea upstream business. The only other material outbound Russian investment in 2014 was Lukoil’s acquisition of a 37.5% stake in Bowleven Energy’s Etinde Project in Cameroon.
Outside of Russia, three >US$1 billion deals dominated with both Total and Statoil exiting the Shah Deniz and South Caucasus Pipeline for US$1.5 billion and US$2.25 billion respectively to NOCs Petronas and TPAO. In Kazakhstan, Sinopec bought up Lukoil’s assets for US$1.2 billion.

**Outlook for 2015**

In 2015, we expect M&A themes to be driven primarily by companies with strong balance sheets taking advantage of distressed sellers in light of depressed commodity prices. Providers of capital are likely to have a key role in choosing the winners and losers.

Companies that previously had a strict preference for oil-weighted production assets may broaden their acquisition parameters.

The biggest challenge to 2015 M&A will be buyers and sellers finding common ground on commodity prices, with projects that are marginal or uneconomic at US$60/bbl oil less likely to transact. Exploration assets will continue to languish as budgets are cut, and appetite to acquire high-risk opportunities continues to shrink regardless of the potential size of the prize. For cash-rich acquirers, however, the world in 2015, is their oyster.

The top ten upstream transactions in 2014, based on disclosed value:

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<th>Announced date</th>
<th>Buyers</th>
<th>Sellers</th>
<th>Nature of asset</th>
<th>Value (US$)</th>
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</thead>
<tbody>
<tr>
<td>15 Dec</td>
<td>Repsol</td>
<td>Talisman</td>
<td>Corporate acquisition of international assets</td>
<td>$13.0 billion</td>
</tr>
<tr>
<td>16 Mar</td>
<td>Letter One Group</td>
<td>RWE</td>
<td>European upstream businesses</td>
<td>$7.1 billion</td>
</tr>
<tr>
<td>27 Sep</td>
<td>EnCana</td>
<td>Athlon Energy</td>
<td>US unconventional assets</td>
<td>$7.0 billion</td>
</tr>
<tr>
<td>13 Jul</td>
<td>Whiting Petroleum</td>
<td>Kodiak Oil &amp; Gas</td>
<td>US corporate acquisition</td>
<td>$6.0 billion</td>
</tr>
<tr>
<td>14 Oct</td>
<td>Southwestern Energy</td>
<td>Chesapeake Energy</td>
<td>Unconventional US assets</td>
<td>$5.4 billion</td>
</tr>
<tr>
<td>15 Dec</td>
<td>Woodside Petroleum</td>
<td>Apache</td>
<td>Natural gas and LNG assets in Australia and Canada</td>
<td>$3.8 billion</td>
</tr>
<tr>
<td>7 May</td>
<td>EnCana</td>
<td>Freeport-McMoRan</td>
<td>US Eagle Ford assets</td>
<td>$3.1 billion</td>
</tr>
<tr>
<td>17 Jun</td>
<td>Public market</td>
<td>Royal Dutch Shell</td>
<td>9.5% stake in Woodside Petroleum</td>
<td>$3.0 billion</td>
</tr>
<tr>
<td>24 Jul</td>
<td>Breitburn Energy Partners</td>
<td>OR Energy</td>
<td>US corporate acquisition</td>
<td>$3.0 billion</td>
</tr>
<tr>
<td>4 Jun</td>
<td>Public market</td>
<td>Pemex</td>
<td>7.86% stake in Repsol</td>
<td>$2.8 billion</td>
</tr>
</tbody>
</table>

Source: EY analysis of data from Derrick Petroleum
Downstream transaction activity was up in 2014, recording its strongest deal volume and aggregate volume since 2012. Total disclosed deal value in the downstream segment was US$25.1 billion in 2014, up 88% compared to 2013. Deal volume in 2014 increased by almost 16%.

As usual, the US accounted for the largest number of downstream transactions – about 56% of the total – while Asia (including Australia) and Europe accounted for about 16% and 18% respectively. However, the decline in activity in European downstream was particularly notable, where activity was 30% lower than prior year, as companies continued to be cautious over growth in oil product demand, given the uncertainty surrounding the region’s economic recovery.

Historically, the largest downstream transactions tend to be those in the US or Europe. However in 2014, the two largest transactions (based on disclosed deal value) related to assets in Australia:

- Li Ka-shing’s Cheung Kong’s acquisition of the Australian gas pipeline firm Envestra in a cash deal worth US$3.4 billion.

- Royal Dutch Shell sold its downstream business in Australia to Vitol B.V. for US$2.6 billion. The sale includes the Geelong Refinery and 870-site retail business, along with Royal Dutch Shell’s bulk fuels, bitumen, chemicals and an exclusive distributor arrangement for Royal Dutch Shell Lubricants in Australia. It does not include the aviation business or the blending plant in Brisbane (which will be converted to a bulk storage and distribution facility).
There were 45 asset transactions and 42 corporate transactions in the downstream segment in 2014.

**Refining**

In the refining sub-segment, the two largest refining transactions during 2014 (based on disclosed deal value) were:

- Vitol B.V.’s acquisition of the Geelong Refinery as part of the overall acquisition of Royal Dutch Shell’s Australian downstream operations.
- Saudi Aramco’s acquisition of a further 28.4% stake in S-OIL from Hanjin for US$2.0 billion, increasing its ownership of S-OIL from 35% to 63.4%. According to Saudi Aramco’s chief executive, this transaction underscores the company’s confidence in the Korean economy and its strategy to enhance its presence in the growing Asian markets.

While there were also refining transactions in the US (including Bakken Energy’s acquisition of Green River Refinery in Utah and TrailStone’s acquisition of US Oil and Refining Co), it is worth noting that there was no outright refining transaction in Europe post the termination of the sale process of the Milford Haven Refinery in the UK as certain conditions precedent were not satisfied.

While refiners in the US are benefiting from higher crude runs and strong refining margins due to advantaged feedstock, overcapacity in Europe continues to impact utilization and the prospects of any real recovery in refining margins. More closures maybe needed to restore parity with demand.

Furthermore, the threat of exports from additional refining capacity coming online in the Middle East (with much of that capacity relatively complex) and the continuing upgrade of Russian refineries could further impact the attractiveness of the third and fourth quartile European refineries in particular.

Although Asian refining margins are also impacted by weak regional demand growth and surplus capacity, the region’s demand growth outlook is more positive than that of Europe’s.

As with previous years, there was no refining transaction in the Middle East given the high levels of state ownership. In Africa, pricing regulation and political instability have impacted the attractiveness of refineries in the region.

**Storage terminals**

In the storage/terminal sub-segment, the two largest transactions (based on disclosed deal value) in 2014 involved:

- Macquarie Infrastructure’s acquisition of the remaining 50% stake in International Matex Tank Terminals (IMTT), operator of one of the largest bulk storage terminal business in the United States for US$1.0 billion.
- DONG Energy’s divestment of its Stenlille Gas Storage Facility to state-owned entity Energinet.dk for US$386 million. The Stenlille Gas Storage Facility is the larger of two gas storage facilities in Denmark with a working gas volume of 575 mcm, corresponding to 57% of the total Danish gas storage capacity.

Demand for storage terminals is generally driven by:

- Increasing geographic imbalances between refining production and consumption
- Increasing products with different specifications in order to comply with regulations, leading to a greater need of segregated storage and blending capabilities
- Increasing activity from independent retailers/distributors and hypermarkets
- The requirement of oil traders and compliance with compulsory stock obligations

Over 70% of transactions in 2014 involved storage terminals in the US, driven by the difficulties in developing green-field sites in the country. Should the US start exporting crude oil, there is likely to be additional demand for storage terminals.

In Europe, investments during the early part of this decade have led to higher storage capacity in the region. However, combined with the decline in overall trade volumes, utilization and storage rates have eroded. Vopak recently announced its intention to divest 15 of its smaller, low-margin terminals to focus on its strategic markets.

Regardless, storage terminals remain a strategically important infrastructure asset and competition between oil and gas companies, independent storage operators, oil traders and infrastructure funds is intense for the right asset. The alternative is to build or acquire refineries and convert them to storage terminals. However this can often be more expensive than anticipated.
There was minimal storage terminal activity in Asia during the year. Infrastructure in Singapore, Malaysia and South Korea effectively acts as a trading hub for the region, similar to the role Amsterdam-Rotterdam-Antwerp plays for Europe. In Australia, its increasing reliance on imports of refined oil products has led to trading companies developing a significant regional downstream presence in the country, for example Vitol B.V.’s acquisition of Royal Dutch Shell Australia.

As with refining, there was limited activity in the Middle East and Africa during 2014 due to a combination of government and NOC ownership or the lack of salable assets.

**Retail**

In the retail/distribution sub-segment, the two largest deals (based on disclosed deal value) were:

- Hess’ divestment of its US retail business to Marathon’s Speedway for US$2.9 billion. The deal will add 1,256 Hess sites across 16 US states to Speedway’s 1,480 sites across 9 US states.

- Royal Dutch Shell’s divestment of its downstream business in Australia to Vitol B.V. for US$2.6 billion.

In the mature US and European markets, economies of scale (volume) is typically the key driver of profitability as competition naturally restricts fuel margin levels. However, this does not necessarily imply direct ownership of retail sites. As such, the strategy of major oil companies is based around optimizing the balance between value added and capital employed to minimize cost.

We expect that there will be further consolidation in these regions and continuing strong interest from various parties for retail marketing networks, particularly those with strategically advantaged throughputs, strategically located sites and strong non-fuel offerings (or an ability to develop one) from:

- Regional and national oil companies looking to expand within their supply envelope
- Independent retailers looking to improve their market share and economies of scale
- Financial investors looking to build competitive advantage through specialization and regional scale as opposed to control over the full supply chain

Given the level of competition, retail marketing networks of appropriate quality and scale in the right markets would likely command a premium.

There was limited transaction activity in Asia during 2014 as most of the market participants are focused on further developing their portfolio in this region, hence limiting transaction opportunities. As with other segments, there was not much activity in the Middle East and Africa during 2014.
### Trends and future prospects

Fundamentals driving transaction activity in the downstream sector remain robust. The strategic focus of oil majors continues to be on upstream with capital expenditure weighted towards E&P.

As such, oil majors will continue to review their downstream portfolio which often leads to divestments of non-core downstream operations to improve capital returns; while also continuing to invest in their key growth core regions. However, the return of oil price volatility may delay this process as companies re-discover the benefits of the integrated business model.

The top ten downstream transactions in 2014, based on disclosed value:

<table>
<thead>
<tr>
<th>Announced date</th>
<th>Buyers</th>
<th>Sellers</th>
<th>Nature of asset</th>
<th>Value (US$)</th>
</tr>
</thead>
<tbody>
<tr>
<td>7 May</td>
<td>Cheung Kong, Power Assets Holdings Ltd</td>
<td>Envestra Ltd</td>
<td>Gas pipelines in Australia</td>
<td>$4.3 billion</td>
</tr>
<tr>
<td>22 May</td>
<td>Marathon Petroleum</td>
<td>Hess</td>
<td>1,256 Hess sites across 16 US states</td>
<td>$2.9 billion</td>
</tr>
<tr>
<td>20 Feb</td>
<td>Vitol BV</td>
<td>Royal Dutch Shell</td>
<td>Downstream business in Australia</td>
<td>$2.6 billion</td>
</tr>
<tr>
<td>27 Apr</td>
<td>Energy Transfer Partners LP</td>
<td>Susser Holdings Corp</td>
<td>630 retail convenience stores in Texas</td>
<td>$2.1 billion</td>
</tr>
<tr>
<td>2 Jul</td>
<td>Aramco</td>
<td>Hanjin Energy</td>
<td>28.4% stake in S-OIL</td>
<td>$2.0 billion</td>
</tr>
<tr>
<td>7 Apr</td>
<td>Laclede Group</td>
<td>Energen</td>
<td>US natural gas utility operations</td>
<td>$1.6 billion</td>
</tr>
<tr>
<td>28 Feb</td>
<td>SIBUR Holding OJSC</td>
<td>Rosneft</td>
<td>49% stake in Yugravgaz, natural gas distributor</td>
<td>$1.6 billion</td>
</tr>
<tr>
<td>7 Jul</td>
<td>Macquarie Infrastructure Co LLC</td>
<td>International Matex Tank Terminals Inc</td>
<td>Remaining 50% stake in IMTT who operates one of the largest bulk storage terminal business in the United States</td>
<td>$1.0 billion</td>
</tr>
<tr>
<td>28 Feb</td>
<td>ONGC (India); Oil India</td>
<td>Government</td>
<td>5% stake each in the Indian Oil Corporation</td>
<td>$0.9 billion</td>
</tr>
<tr>
<td>14 Mar</td>
<td>Essar Global Fund, Ltd</td>
<td>Essar</td>
<td>Remaining stake in company</td>
<td>$0.8 billion</td>
</tr>
</tbody>
</table>

Source: EY analysis of data from Derrick Petroleum
Midstream transaction volumes dropped off in 2014, but disclosed value was up sharply, impacted by several large transactions. With 102 announced deals, activity was down by more than 23% in 2014. However, reported or disclosed deal value more than doubled to US$161 billion.

Midstream transaction activity, both in volume and value, is dominated by the US and Canada. Together, the two countries accounted for more than 78% of all midstream deals and about 94% of the global midstream disclosed value. Deal activity involving pipelines accounted for the largest portion of midstream activity (~46 deals (40%) and about US$17.6 billion in disclosed value (about 11% of total value). There were 30 diversified deals in 2014, accounting for about 29% of the total number of deals, but with more than US$131 billion in reported value, these diversified transactions accounted for more than 81% of the total reported value in the segment. There were 17 transactions involving gathering/processing assets in 2014 (17%), with total disclosed deal value of almost US$11 billion (about 7% of the total).
Asset transactions dominate the midstream landscape, accounting for 49% of all deals but only 10% of the disclosed transaction value in 2014. Corporate transactions accounted for 31% of the deals, but 83% of the total reported value. A further 20% of the deals and 7% of the reported value came from dropdowns of midstream assets from corporates into master limited partnerships (MLPs).

With the unconventional oil and gas boom in the US, attention to infrastructure investment has been at an all-time high, with substantial new pipeline, processing and storage capacity being built. We've also seen increasing consolidation, spurred on by significant tax advantages for MLP structures.

The midstream's largest deal in 2014, and by far the largest oil and gas transaction of the year, was the merger of Kinder Morgan Inc. and its three publicly traded subsidiaries – Kinder Morgan Management, LLC (KMR), Kinder Morgan Energy Partners, LP (KMP) and El Paso Pipeline Partners (EPB) – in a deal valued at an estimated US$71 billion (including debt assumed of US$27 billion). With Kinder Morgan as one of the pioneers of the MLP industry, the merger has drawn the attention of current and prospective MLPs, as well as various analysts and investor groups. Based on public statements, the merger was motivated by Kinder Morgan’s desire to accelerate its growth in North America by eliminating the parent company’s rights to cash distributions (resulting from its interest as the general partner) from the two MLPs. In particular, the concern was that the required distributions by the MLPs to their general partner had grown so large that the parent company’s ability to make acquisitions may have been hindered by a higher cost of capital. By eliminating the general partner distributions (i.e., the incentive distribution rights) from the MLPs, one of the goals of the merger was to significantly reduce KM’s overall cost of capital.

Although the merger represents a transformative transaction in the MLP space, attracting significant attention, the MLP as an investment vehicle and company structure continues to have a unique role in today's marketplace. MLPs offer a wealth of benefits to both sponsor companies and individual investors while providing a low-cost, alternative form of capital for expansion and growth. The merger does, however, provide a glimpse as to a potential ultimate exit scenario for current or prospective MLPs, depending on growth and relative economic environment, and, as such, should be part of the broader conversation with respect to strategic alternatives to certain mature MLPs.

The top ten midstream transactions in 2014, based on disclosed value:

<table>
<thead>
<tr>
<th>Announced date</th>
<th>Buyers</th>
<th>Sellers</th>
<th>Nature of asset</th>
<th>Value (US$m)</th>
</tr>
</thead>
<tbody>
<tr>
<td>10 Aug</td>
<td>Kinder Morgan Inc</td>
<td>Kinder Morgan Energy Partners</td>
<td>Multiple US midstream companies</td>
<td>$71.0 billion</td>
</tr>
<tr>
<td>24 Oct</td>
<td>Access Midstream Partners</td>
<td>Williams Partners</td>
<td>Merger of US companies</td>
<td>$34.4 billion</td>
</tr>
<tr>
<td>13 Oct</td>
<td>Targa Resource Partners</td>
<td>Atlas Pipeline Partners</td>
<td>US corporate acquisition</td>
<td>$7.7 billion</td>
</tr>
<tr>
<td>15 Jun</td>
<td>Williams Partners</td>
<td>Global Infrastructure Partners</td>
<td>Additional stake in Access Midstream Partners</td>
<td>$6.0 billion</td>
</tr>
<tr>
<td>10 Dec</td>
<td>APA Group</td>
<td>BG Group</td>
<td>QCLNG (Australia) gas pipeline</td>
<td>$5.0 billion</td>
</tr>
<tr>
<td>1 Oct</td>
<td>Enterprise Products Partners</td>
<td>Oiltaking Holding America</td>
<td>Corporate US acquisition of GP and LP interests</td>
<td>$4.6 billion</td>
</tr>
<tr>
<td>19 Oct</td>
<td>Tesoro Logistics</td>
<td>QEP Resources</td>
<td>US midstream assets</td>
<td>$2.5 billion</td>
</tr>
<tr>
<td>28 Apr</td>
<td>El Paso Pipeline Partners</td>
<td>Kinder Morgan Inc</td>
<td>Dropdown of US gas assets</td>
<td>$2.0 billion</td>
</tr>
<tr>
<td>22 Sep</td>
<td>Enbridge Income Fund</td>
<td>Enbridge Inc</td>
<td>Dropdown of US gas and pipeline interests</td>
<td>$1.6 billion</td>
</tr>
<tr>
<td>28 Oct</td>
<td>Western Gas Partners</td>
<td>Nuevo Midstream LLC</td>
<td>US corporate midstream acquisition</td>
<td>$1.5 billion</td>
</tr>
</tbody>
</table>

Source: EY analysis of data from Derrick Petroleum
Transaction activity in the oilfield services (OFS) sector declined in 2014, with 320 deals announced compared with 406 in 2013. However, this was still a substantial increase from 2012, where only 222 deals were announced. Furthermore, aggregate deal value in 2014 was up 242% year-on-year to US$72.0 billion, reflecting the impact of several large transactions.

The average disclosed deal value increased from US$126 million to US$600 million, dominated by the mega deal announced by Halliburton, the second-largest OFS firm, in November 2014. Their cash and shares offer for the third-largest OFS firm, Baker Hughes, was valued at US$38 billion. Excluding the Halliburton/Baker deal, the year-on-year growth would have been 62%, while the average reported deal value would have been US$283 million. The deal activity was relatively evenly spread over the first three quarters in 2014, with a sharp drop to just 46 deals announced in 4Q14.
2014 saw OFS customers focusing on industry cost inflation, corresponding to E&P operator’s operational cash flows coming under increasing pressure. With offshore E&P activities tending to have a higher cost base, the effect of the increasing cost focus was first observed by oil service companies who focused on offshore services. With the significant drop in oil prices over the second half of 2014, the cost focus further increased and also expanded noticeably into the US land unconventional oil production segment. Based on the disclosed value of OFS M&A deals in 2014, 51% were completed by OFS companies who focused on land based operations, 40% were by companies with a clear offshore focus and 9% involved companies focusing on both of these service segments. As expected, the 2014 OFS M&A landscape was dominated by North America, with 66% of the disclosed value deals having a Canadian- or US-based buyer, and 60% having a North American-based seller. Moreover, 55% had both a registered North American seller and buyer – supporting the view of considerable, ongoing focus on domestic equipment and service supply optimization to the US unconventional land industry. Seventeen percent of acquirers and 24% of sellers were European-based companies. Asia and the Pacific oriented transactions had 15% and 12% of the buyer and seller universe respectively. Within the various segments of the OFS value chain, the support services sub-segment accounted for 42% of 2014 M&A transactions, while the drilling sub-segment accounted for 21% of all transactions, and the well servicing sub-segment another 11%.

The top five transactions measured by reported value, were made by large corporations delivering equipment and services across multiple OFS segments, accounting for more than 11% of all transactions in 2014. The most notable deal was Halliburton’s US$38 billion acquisition of Baker Hughes, implying a LTM EBITDA multiple of 8.8x. The transformational deal will close the gap with main rival Schlumberger, as well as reduce Halliburton’s dependence on the North American market. Moreover, the strategic cooperation agreement between Baker Hughes and Aker Solutions will plug the Halliburton gap relative to the Schlumberger and Cameron One Subsea joint venture.

Another large deal was announced in September, when Siemens AG offered US$7.6 billion for the US-based and NYSE-listed rotating equipment manufacturer Dresser Rand Group Inc. The Siemens’ offer valued Dresser Rand Group at 17.4x LTM EBITDA. In a statement, Siemens highlighted their plans to concentrate their entire oil and gas products and services portfolio around the Dresser Rand Group platform and brand.

Next on the list came C&J Energy Services US$2.9 billion merger with twice its size Nabors Industries’ completion and production services business in Canada and North America. The combination creates the fifth largest pumping and fracking supplier in North America, measured on approximately 1.1 million hydraulic fracturing horsepower capacity. The transaction is viewed as a classic consolidation case, motivated on growth by means of greater scale, geographic reach, service capabilities and operating efficiencies.

Early in the year, AMEC acquired rival EPC firm, Foster Wheeler for US$3.2 billion. Another slightly smaller deal was the Canada-based engineering and construction company SNC Lavalin Group’s US$2.8 billion acquisition of London Stock Exchange-listed oil and gas specialist engineering and construction company Kentz.
The transaction added strength to SNC Lavalin Group in core markets like the Middle East, North America and Asia Pacific – as well as substantially increasing the SNC Lavalin group exposure to the oil and gas industry from 7% of annual revenue up to 24%.

From a valuation perspective, the longer-term trading history of large OFS players shows that the industry has not been able to recover fully after the financial crisis inflicted an oil price drop from US$147 per Brent barrel in July 2008 down to US$37 in February 2009. The corresponding average EV/EBITDA valuation (pre-2002-2008) and post (2009-2013) are for the large oilfield service companies 9.8x and 7.4x respectively. The same analysis for the large oilfield equipment manufacturers shows an average EV/EBIDTA valuation of 9.0x prior to the oil price drop, and 8.7x thereafter. In some respects, the second half of 2008 oil price trend can be compared to the oil price movement in second half of 2014. However, the oil price recovered rather quickly during 2009, moving into the US$60-80 Brent band, before crossing the US$100 per barrel mark in early 2011. For 2014, the OFS industry had started to come under market pressure towards the end of 2013, in a relatively healthy oil price environment, on the basis of cost inflation arguments from the E&P operators.

Thus, we expect that a considerable supply chain restructuring and efficiency program will be required, which will take time to plan and implement. Further pressure was added by the oil price drop, which is likely to strengthen the market effect in the short-term, while a potential oil price recovery is not necessarily going to increase E&P spending in the short-term.

### Outlook for 2015

We expect that the oilfield services transaction trend of consolidation will continue in 2015, as companies try to capitalize on scale, improve operational efficiency and cost bases. PE funds are well capitalized, and will likely use the opportunity to exploit short term valuation pressure to invest in quality companies with technologies and business models which are in tune with the E&P cost reduction focus. Leveraged companies will have to divest non-core business, and the expected decline in E&P spending will very likely facilitate a backdrop that can create a few surprises in the form of nontraditional mergers across the OFS value chain.

### The top ten OFS transactions in 2014, based on disclosed value:

<table>
<thead>
<tr>
<th>Announced date</th>
<th>Buyers</th>
<th>Sellers</th>
<th>Nature of asset</th>
<th>Value (US$)</th>
</tr>
</thead>
<tbody>
<tr>
<td>17 Nov</td>
<td>Halliburton</td>
<td>Baker Hughes</td>
<td>Corporate acquisition – diversified OFS</td>
<td>$38.0 billion</td>
</tr>
<tr>
<td>22 Sep</td>
<td>Siemens AG</td>
<td>Dresser-Rand group</td>
<td>Corporate acquisition - OFS equipment manufacturer</td>
<td>$7.6 billion</td>
</tr>
<tr>
<td>13 Jan</td>
<td>AMEC</td>
<td>Foster Wheeler</td>
<td>Corporate EPC acquisition</td>
<td>$3.2 billion</td>
</tr>
<tr>
<td>25 Jun</td>
<td>C&amp;J Energy Services</td>
<td>Nabors Industries</td>
<td>Acquisition of completion and production businesses</td>
<td>$2.9 billion</td>
</tr>
<tr>
<td>23 Jun</td>
<td>SNC-Lavalin</td>
<td>Kentz</td>
<td>Corporate acquisition - OFS engineering and construction</td>
<td>$2.8 billion</td>
</tr>
<tr>
<td>7 Apr</td>
<td>Alpha Laval</td>
<td>Frank Mohn</td>
<td>Corporate offshore services acquisition</td>
<td>$2.1 billion</td>
</tr>
<tr>
<td>17 Mar</td>
<td>JACCAR Holdings</td>
<td>Bourbon</td>
<td>Stake in offshore service company</td>
<td>$1.4 billion</td>
</tr>
<tr>
<td>4 Nov</td>
<td>Seadrill Partners LLC</td>
<td>Seadrill Limited</td>
<td>Offshore drilling assets</td>
<td>$0.9 billion</td>
</tr>
<tr>
<td>20 Jul</td>
<td>Compressco Partners LP</td>
<td>Warren Equipment Co.</td>
<td>Acquisition of Compressor Systems business</td>
<td>$0.8 billion</td>
</tr>
<tr>
<td>1 Dec</td>
<td>Lubrizol Group</td>
<td>Weatherford International</td>
<td>Chemicals and drilling fluids businesses</td>
<td>$0.8 billion</td>
</tr>
</tbody>
</table>

Source: EY analysis of data from Derrick Petroleum
Regional perspectives

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- Canada 31
- Europe 34
- India 36
- Latin America/Caribbean 38
- Middle East 39
- Russia/CIS 40
- United States 41
In 2014, the African continent continued to see regional transaction themes driven by operating plays in East, West, South and North Africa. The transactions market saw a large number of sellers looking for JV partners, outright buyers or funders of assets. However, due to the large number of investment opportunities available to potential buyers, the most significant challenge for sellers has been to successfully complete deals. The steep drop in the oil price in the second half of 2014 has also adversely impacted investment decisions. Deal volumes and values fell significantly in 2014, in comparison to the bumper year of transaction activity in 2013. Including license awards and relinquishments, there were 95 deals in 2014 (2013: 146 deals) with US$8.7 billion of reported value (2013: US$22.2 billion).

### East Africa

As anticipated in our outlook for 2014, deal volumes in East Africa were low. The region witnessed several sales processes, not all of which have succeeded. There has been a noticeable trend of companies declining opportunities to invest in gas assets, which in 2013 received significant interest from non-African NOCs.

The largest transactions with reported deal values during the year were Marathon Oil’s acquisition of a 50% working interest in Ethiopia Rift basin area from Africa Oil Corp for US$18 million, FAR and Pancontinental’s farm-out in Kenyan Block L6 to Milio International for US$10.5 million and Ophir Energy’s acquisition of a 75% working interest in an offshore Seychelles Block for US$8.3 million from WHL Energy Ltd. These modest deal sizes are in stark contrast to the largest transactions in the continent during 2013 involving assets in East Africa.

As companies have secured their equity positions in gas assets, unless there is material oil play in the region, we anticipate 2015 deal activity to remain low with relatively low deal values. A positive development has been the acquisition of licenses in less traditional geographies previously ignored, such as Ethiopia, Seychelles, Comoros Islands and Madagascar. We anticipate that companies will continue to build equity positions in these geographies, which is likely to fuel exploration and future transaction activity.

### West Africa

As anticipated in our Outlook for 2014, West Africa witnessed a relatively robust year of transaction activity, including four corporate M&A transactions. Nigeria attracted a large number of deal-makers interested in participating in onshore divestments by IOCs, corporate M&A opportunities, or in partnering with indigenous Nigerian companies in the marginal field licensing round. Angola, Cameroon and Ivory Coast notably attracted investors in producing/discovered assets as well as exploration licenses. Elsewhere in West Africa, transactions involving exploration licenses were also seen in Gabon, Senegal, Ghana, Guinea and Liberia.

While non-African NOCs dominated the deal space in 2013, especially in East and West Africa, there were a very small number of transactions in 2014 involving such NOCs. There were eight corporate transactions in 2014 compared to ten in 2013 and the reported deal value of US$3 billion in 2014 was significantly higher than the US$0.4 billion in 2013 due to two separate large acquisitions by Glencore and Al Mirqab Capital in Chad and a pan-African asset portfolio company.
The three largest transactions with reported deal values in West Africa were:

- Aiteo Group, Tempo Energy Nigeria Ltd and Taleveras Energy Resources’ acquisition of a 45% working interest in OML 29 in Nigeria for US$2.7 billion from Royal Dutch Shell, Total and ENI
- Al Mirqab Capital’s acquisition of an 80% stake in Heritage (pan-Africa portfolio with significant Nigerian asset weighting) for US$1.64 billion
- Total’s sale of a 15% interest in offshore Angola Block 15/06 to Sonangol for US$750 million

We note that the Royal Dutch Shell, Total and ENI consortium also sold interests in OMLs 18, 24 and 25 to Mart Resources and other undisclosed buyers, but the deal values of these transactions were not publically disclosed.

Despite lower commodity prices we anticipate 2015 deal activity to remain robust in West Africa as investors look for oil assets and exploration assets in the West Transform Margin to continue to attract explorers. The marginal field licensing round in Nigeria is likely to be concluded after the Nigerian elections, while selected onshore divestments by IOCs are rumored to continue in 2015.

**North Africa**

North Africa saw a healthy number of deals, as investment appetite returned to the Egyptian market and Morocco continued, as in 2013, to attract explorers. License awards exceeded relinquishments across the region and while deal values reported in 2014 were lower than 2013, there were three noticeable corporate M&A transactions in Chad, Egypt and Sudan.

The largest transactions in North Africa included Chevron’s sale of its Chad assets for US$1.3 billion to the Government of Chad, Glencore Xstrata’s acquisition of Caracal Energy for US$1.25 billion in Chad and Chinook Energy’s divestment of its Tunisian assets to PT Medco Energi for US$114 million. Both Sudan and Somalia also registered deal activity as Panorama Petroleum acquired State Petroleum in Sudan and Jacka Resources divested its interest in a Somali Block to Sterling Energy.

With numerous production and development assets in the region, we anticipate 2015 deal activity to remain at similar levels, subject to political and social stability. Deals may also be deferred by ongoing price volatility.

**South Africa**

Namibia continued to dominate the deal activity in the region, while South Africa saw a very small number of deals. Interestingly, Zimbabwe, Botswana and South Africa saw one deal each in unconventional assets and such deals are likely to continue. The only corporate M&A in the region was Tower Resources’ acquisition of Rift Petroleum for US$43 million. Other noticeable deals in the region without reported deal values were OMV and Murphy Petroleum’s acquisition of interests in two Namibian Blocks, ENI’s acquisition of an exploration Block from Sasol in South Africa and Tullow’s farm in into a Namibian Block.

We anticipate 2015 deal activity in the region to remain at low levels, as exploration activity is likely to be delayed due to the falling commodity prices.
Overall oil and gas transaction activities in the Asia region (excluding Oceania and India) were slightly down in 2014. Reported deal value for the combined upstream, downstream and midstream segments totaled US$10.4 billion, a decrease from US$11.1 billion in 2013. Transaction volumes were also down for the year, totaling 92 deals, compared to 101 in 2013.

North American midsize players re-balance portfolios and exit Asian upstream

Midsize North American companies are seeking capital to redeploy unconventional developments in their home countries, such as Murphy Oil and Newfield Exploration and some have also been looking into options to exit. Divestitures constituted the four top deals in the region:

- September 2014 – Murphy Oil sold assets in Malaysia to Pertamina for US$2 billion
- February 2014 – Anadarko divested offshore China assets to Brightoil for US$1.08 billion
- April 2014 – Hess divested Thailand assets to PTTEP for US$1 billion
- January 2014 – PGN pre-empted 75% interest in Hess’ offshore Indonesia block for US$650 million

Asian refiners being challenged by growing US product exports

Downstream deals contributed more than 25% of the total transaction value in the region this year, as weak refining margins forced some players to reshuffle their portfolios and divest non-core assets to strategic buyers. Significant refinery deals included:

- July 2014 – Aramco acquired 28.4% stake in S-OIL from Hanjin for US$2.0 billion
- December 2014 – Petronas acquired remaining 47% stake in Malaysian Refining Company from Phillips 66 for US$635 million

Upstream continues to be the most active sector in terms of both deal value and deal volume.
Southeast Asian NOCs reinforce regional operations and continue to build overseas presence

The dynamics of midsize North American players re-balancing their asset portfolios presented an opportunity for indigenous players. Regional NOCs such as Pertamina and PTTEP took over oil and gas assets to bolster reserves and production. Malaysia’s Petronas made the largest purchase among the three NOCs in the region, buying a 15.5% working interest in Shah Deniz and South Caucasus Pipeline, Azerbaijan, for US$2.3 billion from Statoil.

Besides asset acquisitions, Southeast Asian energy players have also entered LNG supply agreements with overseas counterparties. In July 2014, Pertamina completed their second LNG sale and purchase agreement with Cheniere Energy, covering 0.76 mtpa of LNG over a 20-year period. Keppel Infrastructure Holdings, the energy and engineering arm of Singapore’s Keppel Corp, signed Heads of Agreement in November to buy up to 1 mtpa of LNG from Petronas over 10 years.

Chinese NOCs slow down global expansion

Chinese state-owned oil companies notably slowed their overseas investment, with acquisitions by Chinese NOCs dropping by over 75% to US$6.1 billion in 2014. Despite the significant decline in M&A activities attributed to the various reasons such as integrating acquisitions and government investigations into improper business behavior, CNPC, Sinopec and CNOOC each still made billion dollar deals in 2014:

- February 2014 – Sinopec, Indian Oil and China Huadian bought Petronas’ Montney assets for US$2.3 billion
- April 2014 – CNPC acquired remaining 40% working interest in the Dover oilsands project from Athabasca Oil for US$1.2 billion
- September 2014 – Rosneft sold 10% working interest in Russia Vankorskoye field, Eastern Siberia to CNPC for US$1 billion
- March 2014 – CNPC acquired additional 7.7% WI in West Qurna-1 from ExxonMobil for US$442 million

Besides purchasing oil and gas assets, China signed two blockbuster gas supply deals with Russia in May and October in 2014. Under the first agreement, China will import 28 bcm of gas from Russia annually over three decades starting in 2018. The deal value is expected to be around US$400 billion. OAO Gazprom is also negotiating to supply as much as 30 bcm of gas annually to China over 30 years.

Outlook: opening of Myanmar upstream

In March 2014, Myanmar awarded 20 oil exploration blocks for its first offshore bid round. Oil majors and IOCs were big winners receiving acreage; companies such as Chevron, ConocoPhillips, Royal Dutch Shell, Statoil, ENI, Total and BG Group were leading the way. The licensing round could mark a new chapter in the region’s upstream sector.
Australia/Oceania

With the exception of a few large deals, transaction activity in Oceania was again relatively subdued in 2014. Tight conditions in equity markets meant Australia’s deal-hungry junior oil and gas companies continued to remain relatively starved of opportunity, resulting in volumes collectively for the upstream, downstream, and midstream segments being slightly down (4%) in 2014. However, the value of regional oil and gas transactions over the period increased dramatically from US$2.5 billion to almost US$23.3 billion, helped along by five significant transactions that contributed almost US$18 billion to the total. Three of these deals were divestments by Royal Dutch Shell, raising a total of US$6.8 billion for the global oil major.

Australia/Oceania oil and gas transaction activity (excludes oilfield services)

Consistent with prior years most of the transactions (93%) were in the upstream sector, although this year upstream only represented 49% of the reported deal value as the major ownership positions in Australia’s downstream/midstream landscape continued to change. One of the largest deals of the year was Cheung Kong and Power Assets Holdings’ acquisition of Envestra valued at US$3.4 billion. Cheung Kong’s all-cash offer eventually defeated an earlier scrip bid from rival APA Group in a hotly contested takeover battle. Envestra, now known as Australian Gas Networks Limited, is Australia’s largest pipeline owner/operator with approximately 24,000 km of regulated natural gas pipelines servicing some 1.2 million customers. The deal adds to Cheung Kong’s existing regulated assets in Australia, including 51% stakes in SA Power Networks in South Australia, CitiPower and Powercor in Victoria.

During the year, there was further activity in the evolving regional downstream sector. Vitol acquired Royal Dutch Shell’s downstream portfolio in Australia for US$2.6 billion as part of the oil major’s global divestment program. The deal included Royal Dutch Shell’s 870 site retail network, its Australian refineries, as well as its bulk fuels, bitumen, chemicals and most of its lubricants business. Puma Energy (Trafigura) continued to build its platform in the region following on from its US$1 billion entry into the Australian market last year with a US$26m acquisition of InterOil’s oil refinery and distribution business in Papua New Guinea (PNG), as well as InterOil’s Napa Napa refinery, the deal includes 52 service stations and 30 depots, terminals and aviation sites in country. Puma Energy has plans to grow the refinery and sees PNG as a strategic hub in its regional supply strategy. For InterOil it provides much needed capital to develop its large onshore gas resources in PNG.

In the upstream segment, Royal Dutch Shell took significant steps in its efforts to rationalize its portfolio selling its non-operated interest in the Chevron-led Wheatstone LNG project to Kufpec for US$1.1 billion and selling down a 9.5% stake in Woodside for US$3 billion. Plans to sell down a further 9.5% stake and reduce its Woodside holding to 4.5% were stymied by Woodside shareholders, when they voted down a buyback of the Royal Dutch Shell shares in August. Late in the year, Woodside also featured with the announcement that it was buying Apache’s interest in Wheatstone, as well as Apache’s interest in the Kitimat LNG project in Canada for a combined US$3.8 billion. Included in the deal were upstream gas assets associated with both the Wheatstone and Kitimat projects.

Further activity is expected in the downstream segment in 2015 with refined product suppliers looking to position themselves to take advantage of Australia’s transforming fuel supply market. As slated refinery closures start to come into effect, Asian refiners and global trading companies are expected to play a larger role in Australia’s fuel supply chain with many of them thought to be considering acquisition of storage and marketing assets to secure market access. In upstream, Australia will not be immune to the effects of the dramatic fall in oil prices and investment related transaction activity is likely to be weak as a result. While high-profile projects such as Browse LNG will likely be deferred, the weak pricing environment is also likely to put the brakes on the continued evaluation of vast shale opportunities in the Canning, Cooper and central Australian basins. Australia’s mid-cap companies featured prominently in Asian buying activity during 2014 and we expect that this theme will continue into 2015 as well-heeled suitors to the north look to take advantage of depressed market values and tighter operating conditions to acquire quality assets.

Source: EY analysis of data from Derrick Petroleum

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Transaction activity in 2014 in Canada or involving Canadian companies reflected in many ways the market participant reactions to the implications of the structural shift underway, with executives and investors trying to reposition their companies and capitalize on emerging opportunities.

Supported by a host of significant transformative business transactions, favorable commodity prices and strong capital markets support in early 2014, aggregate Canadian transaction levels (excluding oilfield services transactions) grew significantly in 2014 – more than three times the 2013 total (US$14.0 billion). Despite these robust transaction figures, total “publicly announced” transactions completed in Canada in 2014 continued a downward trend – declining 17% compared to 2013 (with 281 deals vs. 337 deals). Some of this decline in completed transactions is likely attributable to lingering sector uncertainties at the start of the year coupled with a pronounced decline in overall transaction activity in the final months of 2014 as the oil price collapse took hold.

Across the major components of the Canadian energy industry (namely oil, natural gas, LNG, oil sands, midstream and oilfield services), a number of business themes played out throughout 2014. Notable transactions in Canada in 2014 focused on a variety of rationales including: creative farm-outs to “share” exploration, development or project costs; carve-outs to monetize non-core assets; deals to strategically reposition a business (selling gas and buying oil); or as a response to activist investor threats; and all combined with increasing levels of new private capital intent on pursuing Canadian energy assets.

**Oil (conventional, tight and shale oil)**

2014 oil transactions represented a number of big bets on reshaped corporate strategies, ongoing play consolidation and continued asset rationalizations, with companies aggressively pursuing what were perceived to be “lucrative” oil assets. Some of the most significant oil-focused Canadian transactions in 2014 were:

- Spain-based Repsol SA agreed to acquire Canada-based, Talisman Energy Inc. for US$13 billion
- Crescent Point Energy Corp. acquired CanEra Energy Corp. for US$1.1 billion
- Encana Corporation completed the IPO and secondary sale of its royalty interests through the creation of PrairieSky Royalty Ltd. for combined proceeds of over US$4.0 billion
- Calgary-based Whitecap Resources Ltd. acquired certain Western Canadian oil and gas assets with 15,000 BOE/day of production from Imperial Oil Ltd. for approximately US$0.7 billion.
- Calgary-based Vermilion Energy Inc. acquired southeast Saskatchewan-focused Elkhorn Resources Inc. from a group of private equity-backers for approximately US$0.4 billion.
Natural gas

Similar to many Canadian oil assets, Canadian natural gas assets continued to attract international attention with notable transactions creating significant new players and reflecting the ongoing evolution of different production strategies and focuses. Some significant Canadian natural gas transactions in 2014 were:

- **Canadian Natural Resources Limited (CNRL)** acquired the Canadian conventional oil and gas assets (excluding certain Horn River and heavy oil assets) of Devon Energy Corp. for US$3.125 billion
- **Jupiter Resources Ltd.**, a newly formed portfolio company of Apollo Global Management, acquired the Bighorn gas assets (acreage, pipelines and facilities) of Encana Corporation for US$1.8 billion
- **Chevron Corporation** sold a 30% interest in its liquids-rich Duvernay shale assets to Kuwait Foreign Petroleum Exploration Company (KUFPEC) for approximately US$1.5 billion
- **Ember Resources Inc.**, a portfolio company of Brookfield Capital Partners, acquired the Clearwater CBM assets of Encana Corporation for US$542 million
- **Canadian Natural Resources Limited (CNRL)** agreed to acquire the Deep Basin assets of Apache Corporation for US$374 million

LNG

The “slow” advance of Canadian LNG projects continues to represent a significant opportunity and challenge for Canada, where a world-class asset base is at risk of becoming “stranded” without the export capacity represented by these projects. Multiple proponents (most of which are global LNG players) continue to advance projects but face a range of hurdles including global capital allocation choices, significant upfront capital commitments on long-term market calls, growing competition (especially from pending US LNG export projects) and continued “domestic” negotiations in Canada to set the right industry framework. Most notable Canadian LNG-related transaction activity in 2014 was focused on partnership building to share project development costs and portfolio rationalization to refocus on operations on “core” opportunities.

- **PETRONAS** sold a 10% interest in its Pacific NorthWest LNG project to Indian Oil Corporation Ltd. for approximately US$1.4 billion and a 1.2 million tonne annual offtake agreement.
- **Apache** agreed to sell its 13% interest in Wheatstone LNG (Australia) and 50% interest in Kitimat LNG (Canada), along with certain upstream oil and gas assets (including Horn River and Liard basin acreage) to Woodside Petroleum Limited for US$2.75 billion plus approximately US$1 billion in cost reimbursements. Associated upstream assets for the Wheatstone LNG project were also included in the Woodside/Apache deal.
- **Korea Gas Corp.** sold 5% of its 20% interest in the LNG Canada project to Royal Dutch Shell for an undisclosed amount, with additional efforts being made to sell-down its remaining interest in the project as part of a debt reduction plan.

Oil sands

The significant capital necessary to advance oil sands projects continues to pose an issue for many players. Junior oil sands players continue to be challenged to secure necessary project funding due to the broad range of energy investment alternatives and the restrictions on foreign investment in the oil sands imposed by the Investment Canada rules. Most oil sands projects now underway are SAGD projects, where no mining is involved and where the top projects have economics that rival the best plays elsewhere in North America, with the benefit of very long, minimal decline reserve lives. Capital will continue to flow to these projects.

Midstream

The dramatic growth in North American oil and natural gas production has been a boon to the midstream sector, with substantial infrastructure investments required in every basin. Significant project activity in Canada has mirrored this demand with much of the growth being organically driven by existing players. The Canadian midstream space has not been directly impacted by the MLP model that has recently been driving the US midstream space, but the yield and fee for services models of Canadian midstream players continues to provide more plentiful access to lower cost capital than for Canadian upstream players. Midstream transaction activity in 2014 highlighted creative transactions reflecting the larger repositioning occurring across the industry.
Oilfield services

The Canadian OFS segment is highly fragmented and consists of several hundred entities, many of which are private. The growth in service intensive, “unconnected” resource development has led to a ‘service renaissance’ in Canada. For example, some analysis suggests the average multi-stage fracked horizontal well drilled in North America is now seven times more service intensive and 2.5 times more expensive than the average well was less than 10 years ago.

Transaction activity in the Canadian OFS space was very robust during the first 9 months of 2014 – driven by aggressive consolidation efforts by some global and US-based strategic buyers and strong interest from PE groups. In many cases, know-how and access to innovative and proprietary technologies, tools or processes developed to address the operational challenges of the Canadian environment drove transaction activity – with consolidation, geographic entry and service expansion driving additional activity. A very entrepreneurial sector, transaction success in OFS has required buyers to be careful to align interests in order to retain the key people. A renewed focus on cost control and the pending threat of excess service capacity – due to lower activity levels driven by commodity price declines – are at risk of significantly (and negatively) impacting the broader oilfield services sector in 2015.

Looking forward

Since mid-2014, the transaction market has been stalled by a dramatic plunge in oil prices, with natural gas and all other natural gas liquids also being severely pressured. At current prices and with current market conditions, fewer new oil or gas projects globally appear economical and the Canadian industry is not immune. In addition, Canadian producers now have to face that their largest customer for oil and gas production (most of which is exported) – the US – is now also their greatest competitor. As low energy prices persist, transaction activity in early 2015 will stall until companies, investors and funders are able to develop a clearer sense that the global oil supply/demand balance comes into equilibrium - whether by way of demand growth; supply reductions (either achieved through reduced capital investment or cuts by Saudi Arabia); or by some combination of both - and therefore a clearer call on future prices can be made.

Once the current market “shock” has worn off, we expect that 2015 will see a continuation of 2014’s portfolio rationalization efforts. In Canada, we expect these transactions to be driven by a variety of factors including the need for incremental cash to fund other operations or shareholder requirements; to remove non-core assets to streamline operations and reduce costs; to continue repositioning the business; and (increasingly) to address balance sheet necessities (stress). Capital preservation will be a key theme in 2015, and we expect current market challenges to create unique opportunities for well positioned and well financed companies. Unlike during the financial crisis in 2008-2009 where transaction activity effectively ceased, we believe transactions will accelerate through the course of 2015. In the meantime, Canadian companies are focused on actions to enhance their resilience – from an operational, financial and portfolio perspective.
Following relatively stable activity levels in the period 2011-2013, European deal volumes, exclusive of OFS activity, declined sharply during 2014. Announced deal volumes of 146 were 40% lower than the 243 deals announced in 2013. While the large majority of activity continued to be in the upstream segment, the decline from 207 to 125 upstream deals in the year was substantial. The reported value of European oil and gas transaction activity remained slightly more robust during 2014, recording a more modest 15% decline from US$18.1 billion to US$15.3 billion. Although the US$7.3 billion of European midstream activity was not repeated in 2014, there was an almost corresponding US$6.9 billion increase in the value of upstream transactions.

The main driver of aggregate upstream deal value in Europe was Letter One Group’s US$7.1 billion acquisition of German-headquartered RWE Dea. RWE Dea was the upstream subsidiary of utility, RWE ag. Following a slightly different route, E.On, another large German utility, recently announced its plans to split its business into two by separating out businesses in E&P and conventional power generation. The other big deals for the region in 2014 were Norway Det Norske’s acquisition of Marathon Oil’s Norwegian production company for US$2.1 billion, announced in June 2014, and Wintershall’s acquisition of Norwegian assets from Statoil for US$1.3 billion.

The European downstream sector continued to remain relatively challenged, recording only 15 deals in 2014 at a total value of US$1.3 billion. While the totals in this segment are modest they mask a range of underlying trends. Refining assets without technical complexity, optimal configuration or advantaged logistical positions appear to be over-supplied, with several proposed transactions failing during 2014. Many storage assets, however, remain strategically attractive, particularly where increased imports of refined products are anticipated.

The OFS sector in Europe represents several thousand companies, many with proven capabilities in technically complex products and services, proven to operate in harsh environments, such as the North Sea. With this capability, the European industry has a strong export base and international dynamics have played a key part in many transactions in the sub-sector with companies either seeking capital partners for global growth or being acquired to expand overseas businesses’ product offerings. While not included in the European regional totals, SNC Lavalin’s US$2.8 billion acquisition of Kentz was the largest European OFS deal in 2014.
Beyond the established oil and gas industry, Europe is home to a range of capital markets which are important sources of funding for the oil and gas sector on a global scale. 2014 started on a positive note for both equity and debt markets, with optimism about returning IPO activity. The year ended, however, more bearishly with stock market indices following commodity prices downwards. EY’s Oil & Gas Eye index, which tracks the top 20 oil and gas companies listed on London’s AIM market fell 55% during the year. In debt markets, yield-hungry investors provided some support to the sector, but looming redeterminations on reserve-based facilities augurs for a difficult start to 2015.

Economic strengthening in Europe is a positive for 2015. However, a meaningful element of GDP growth in Europe is likely to be as a result of the recent significant declines in oil prices, which began in the last half of 2014. This depressed price environment will be the much more significant factor shaping Europe’s oil and gas transaction landscape in 2015. The North Sea is a relatively high-cost environment and falling commodity prices are likely to have an immediate impact on project economics, with postponements or divestments likely to follow in the upstream market. Volumes and margins will come under pressure for the supply chain. In contrast to prior years, well-managed downstream operations may prove to be the most resilient market segment.

We expect capital conditions for many operating in the sector to tighten as reduced operational cash flows combine with lower lending capacity and equity markets favoring other sectors. This is likely to lead to transactions born of necessity and opportunism, with consolidation progressing in the supply chain. Fiscal policy setters in North Sea regions, as well as the UK’s new industry regulator, will need to adapt quickly to this new landscape.
Oil and gas transaction activity in India in 2014 was rather limited, but nonetheless increased from 2013. Reported deal values and the number of deals both increased for 2014. The upstream segment led in terms of deal volumes, but deal values involving Indian upstream assets were not publically reported. Inbound activity in the OFS and downstream oil and gas distribution space also increased.

While upstream transaction activity for Indian upstream assets is fairly limited, inbound and domestic deal activity in the upstream sector was very limited due to the prevailing policy environment in the first half of 2014. However, Indian oil and gas companies, principally the Indian NOCs, were also involved with several notable outbound upstream transactions in 2014. The largest of these outbound transactions in 2014 was Indian Oil Corporation's (IOCL) US$1 billion acquisition of minority interest in Pacific Northwest LNG project from Progress Energy. Located in British Columbia, Canada, the project provides access to substantial gas reserves for export to overseas markets via LNG, thus providing long-term supplies for IOCL.

Oil India Limited also acquired a 50% interest in a Russian oil field from Petronet and Prize Petroleum (the exploration and production, subsidiary of the downstream major Hindustan Petroleum Corporation Limited) acquired a minority stake in BassGas project in Australia from AWE. Both transactions provided the acquirers overseas producing assets to add to their existing portfolios.

Besides producing assets, 2014 also saw interest amongst Indian E&P players in late-stage exploration and discovered assets, as Reliance Industries (RIL) acquired the Ayacucho block 8 prospect in Venezuela in partnership with PdVSA, while ONGC Videsh acquired two exploration blocks offshore Vietnam.

Outbound E&P M&A activity is expected to pick up in 2015 with Indian NOCs looking to participate in license rounds, as well as acquiring producing assets. The Indian Government has also been actively working towards encouraging participation of foreign players and it is looking to attract financial and technical resources to increase exploration of conventional and unconventional oil and gas with the goal to increase domestic production. While the impact of softening crude oil prices on the global M&A market needs to be assessed, the appetite of Indian NOCs is expected to be high in 2015.

The Indian OFS sector witnessed increasing inbound interest in 2014 with the acquisition of Yennai Hydrocarbon Services Pvt Ltd by US-based Superior Energy Services Inc. The sector also witnessed consolidation in the offshore vessels space with HAL Offshore’s acquisition of Technip’s stake in SEAMEC. Recent policy reforms by the Indian Government to withdraw price preference available to domestic companies against their foreign counterparts are expected to create a more competitive OFS market. As a result,
2015 is expected to witness an increase in domestic E&P activity which augurs well for OFS demand in India. There could be greater inbound interest for global players to create market presence in India.

Major domestic downstream transactions in India included the Government of India selling its 10% stake in IOCL to ONGC and Oil India (both are Government of India owned upstream companies) for approximately US$900 million, as part of its plan to reduce its equity in public sector companies. Other downstream activity in 2014 saw inbound transactions by Gulf Petrochem Group, acquiring a majority stake in Sah Petroleum (lubricants) and a bitumen plant located in Gujarat from Royal Dutch Shell. Transaction activity also occurred in the petroleum products space with Itochu, a Japanese multinational, acquiring strategic interest in Aegis logistics (LPG storage terminals). The central theme for buyers in these transactions was to obtain access to the Indian market.

In November 2014, the Indian Government announced deregulation of diesel prices in the country. This move will enable privately owned fuel retailers to be profitable in the current crude price environment. As a result, 2015 is expected to witness increased inbound interest in the refining sector, particularly from Middle East-based players seeking to tie up long-term crude supply contracts to India.

The gas distribution sub-sector witnessed a consolidation transaction with Indraprastha Gas Limited (gas distribution company in National Capital Region, Delhi) acquiring a majority stake in Maharashtra Natural Gas Ltd. (gas distribution company in Pune). The Indian Government also concluded the fourth round of bidding for laying gas distribution networks for 14 geographical areas. More rounds of bidding are expected in the near term as it is high on the Government’s agenda, due to the associated social and economic benefits. With gas supplies in the country expected to improve with new upcoming LNG regasification terminals in the next three to five years, M&A activity in gas distribution sector is expected to continue through 2015 with inbound interest and consolidation in the sector.
The rather strong transaction activity levels in Latin America/Caribbean in 2013 was not repeated in 2014. Total reported oil and gas deal value in 2014 was US$12.4 billion, down 55% compared to 2013, while deal volumes were down 35%.

Activity in the region continues to be primarily upstream focused, but reported value was down more than 50%, and upstream deal volumes down 36%. And while the region again saw healthy activity in the midstream sector, reported midstream deal values were down relatively sharply in 2014.

While Brazil still remains a major focus for transaction activity in the region, regional activity has gradually become more diversified, growing particularly strongly in Colombia and Argentina. The region has historically been an attractive target for NOCs, particularly Asian NOCs however, its attractiveness has waned slightly in recent years.

The three major deals for the region in 2014 included: Pemex selling its 7.9% stake in Repsol, worth US$2.8 billion in the public market; Repsol selling an 11.9% interest in YPF to Morgan Stanley for US$1.3 billion; and Royal Dutch Shell selling its interest in a Brazilian offshore development to Qatar Petroleum for US$1.0 billion.
Middle East

While the Middle East has substantial oil and gas reserves and production, in the context of the global transactions market both current and historic levels of activity are relatively low. Transaction activity in 2014 was very quiet and only upstream witnessed any deal activity.

From an upstream perspective while the number of transactions decreased from 32 to 12 from 2013 to 2014, the total value was only marginally down at almost US$600 million. In terms of the upstream sector, Middle East transaction value relative to the total global upstream transaction value represented less than 0.3% in 2014, which is the lowest share over the past five years. The deal activity was geographically spread over the Middle East region with countries such as the UAE and Iraq being the locations of multiple transactions. Looking forward, Occidental Petroleum is still looking to sell stakes in their oil and gas assets in the Middle East, which could be material in the context of the Middle East transaction market in 2015.

As is consistent with the past three years, no midstream transactions were completed in 2014. This is a result of the very high level of state ownership with regard to these strategically important assets and therefore little, if any, availability in the market. Finally in the downstream sector, again, there were no transactions in the Middle East which is against a backdrop of only very limited transaction activity in 2012 and 2013. Looking forward there are a number of potential green field and brown field (upgrading and expansion) refinery projects in the region that could drive some future transaction activity.
Transaction activity in Russia and the CIS countries in 2014 was significantly down compared with the previous two years. The total announced value of deals in the region was US$11.2 billion (67% less than 2013). The number of deals declined from 82 to 50 in 2014. The main reasons for this decline include the macroeconomic uncertainties, geopolitical situation regarding Ukraine and a deterioration in relations between Russia, the driving country in the area, and certain western countries.

The biggest decline in M&A activity occurred in the upstream segment (40 deals in 2014 vs. 73 in 2013). From a regional perspective, the largest transaction value was in Azerbaijan. In October 2014 the Malaysian oil and gas company Petronas acquired Statoil’s interest of 15.5% in the Shah Deniz production sharing agreement, as well as 15.5% share in the South Caucasus Pipeline Company (SCPC), and a 12.4% share in the Azerbaijan Gas Supply Company (AGSC). The announced deal value was US$2.25 billion. In May 2014, Total sold its 10% interest in the Shah Deniz field and the South Caucasus Pipeline to the Turkish state-owned E&P company TPAO for US$1.5 billion.

In Kazakhstan, Lukoil, Russia’s independent vertically integrated oil company and the country’s second-largest oil producer, sold its 50% share in Caspian Investment Resources Ltd to Sinopec, the Chinese state-owned enterprise, for US$1.2 billion. The acquired company holds stakes in four projects in central Asia. Another Chinese NOC – CNPC – acquired 10% in Russia Vankorskoye field, Eastern Siberia from Rosneft for US$1 billion. This confirms that the Upstream CIS region continues to be interesting for Asian companies. About 20% of upstream buyers in CIS countries were Asian companies in 2014.

The activity in downstream was initiated by local companies. While downstream M&A activity was rather limited, reported deal value was up rather sharply to US$1.8 billion, compared to US$0.8 billion in 2013, while the number of downstream deals in the region was up from 4 to 6. The largest announced deal of the segment was for US$1.6 billion, when Russia’s integrated gas processing and petrochemicals company Sibur acquired the remaining 49% stake in Yugragazpererabotka, its joint venture with the state owned Rosneft, in early 2014. Yugragazpererabotka holds two gas processing complexes as well as pipeline infrastructure.
While the US oil and gas transaction market experienced a solid progression through the majority of the calendar year, the end of 2014 saw a precipitous decline in the price of oil. As a result, the expectations for 2015 (especially the first half) are not an extrapolation of the annual trends witnessed in 2014.

A consistent theme for US oil and gas transaction activity in 2014 was continuing investment in the midstream segment. Of the ten largest transactions in the year, six were midstream transactions including two megadeals seen in Q3 and Q4 of 2014 – Access Midstream’s US$34 billion acquisition of Williams Partners and Kinder Morgan’s US$71 billion roll-up of its two managed MLPs (Kinder Morgan Energy Partners and El Paso Pipeline Partners). US MLPs continued to dominate the transaction scene, given the tax and cost-of-capital advantages of these structures.

In 2014, the midstream sector was active but realized a 14% decrease in deal volume as compared to 2013. Conversely, deal values nearly tripled as compared to 2013, due largely to the Kinder Morgan and Access-Williams megadeals. One potential contributor to the activity in this space was the increased number of publicly-traded midstream companies (mostly MLPs) electing to grow through acquisition. In 2014, there were 11 MLP IPOs, including two of the largest MLP IPOs ever (Antero Midstream Partners LP and Shell Midstream Partners LP).

US upstream reported deal values increased by almost 55%; however deal volumes decreased about 14%. The US upstream transactions accounted for about 35% of all US oil and gas reported transaction values in 2014, which was much lower than what the sector typically accounts for due to five of the six largest deals accounted for in other sectors. However, from a deal count perspective the upstream sector continues to dominate the US oil and gas universe, accounting for almost 83% of all transactions. Some of the largest deals in the upstream sector included: Encana’s acquisition of Athlon Energy for approximately US$7 billion, and Whiting Petroleum’s acquisition of Kodiak Oil & Gas for about US$6 billion.

Looking at the US upstream deals by type, there seems to have been a shift in the preference for assets that are further along in terms of development maturity. Transactions featuring new exploration awards, farm-ins, and discovered/undeveloped assets are declining in relative terms, while corporate deals have increased, as have deals involving assets under development. Interest in producing assets continues to account for the largest portion of deals.
Unlike the other sectors, the US downstream space realized an increase of nearly 89% in both reported deal values and deal volumes in 2014 versus 2013. The marketing/retail space saw the most prominent activity of the downstream sector, with Hess selling its retail chain of convenience stores among other assets to Marathon Petroleum for US$2.6 billion and Energy Transfer Partners acquiring Susser Holdings and its retail operation of over 600 stores for US$2.4 billion. The refining and petrochemical space has remained relatively quiet; but in the absence of strong product demand growth, the price collapse should compress refining margins, potentially creating financial stress for some companies, and potentially some transaction opportunities. Similarly, the dramatic shift in relative petrochemical feedstock pricing (i.e., gas/ethane-based vs. oil/naphtha-based) may open some transaction opportunities.

Looking to the coming year, the US macro economy is generally seen as strengthening - consumer and business confidence continue to be quite strong, with lower energy prices generally seen as a net positive driver for the broader economy, while clearly adversely impacting some industry sectors, like oil and gas. The price of oil will remain at center stage as the market seeks to determine the current state of the commodity fundamentals. The uncertainty of the timing of a recovery in commodity prices, additional potential regulation, and uncertainty as it relates to the global economy all remain key factors for the US oil and gas industry. On the positive front, significant PE capital targeting oil and gas investments, divestitures from megadeals, and divestitures by companies seeking to reallocate resources and focus on core operations imply a potentially strong oil and gas deal flow in the intermediate future.

The lower prices that we expect for 2015 should, however, spur additional upstream transaction activity as they continue with rising cost pressures, an increasing focus on portfolio high-grading/optimization, and increasing capital market tightness. Some smaller, highly-leveraged E&P companies will struggle to fund their operations, with consequently more distressed assets on the market, and some rising risk of default.

The expected reductions to upstream spending will direct much of the pressure to the OFS segment, and we expect some further consolidation as a result. There are also expected to be some assets divested in 2015 by Halliburton/Baker Hughes as a condition of their merger approval.

The continuing infrastructure build-out should also feed continuing consolidation, particularly in the MLP part of the segment. In the downstream segment, with the low prices and the current forward market structure (i.e., a contango market), storage/terminal assets are becoming particularly attractive. These same assets will also be increasingly attractive if US product exports stay strong and if crude oil exports become fully allowed.
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Global Capital Confidence Barometer
The Global Capital Confidence Barometer is a regular survey of senior executives from large companies around the world, conducted by the Economist Intelligence Unit (EIU).

Global oil and gas reserves study 2014
The Global oil and gas reserves study is a compilation and analysis of certain oil and gas reserve disclosure information as reported by companies in their annual reports filed with the United States (US) Securities and Exchange Commission (SEC) or in their publicly available annual reports. This report presents the worldwide and regional exploration and production (E&P) results for 75 companies for the five-year period from 2009 through 2013.

Cash in the barrel
The study shows that global oil and gas companies decreased their working capital (WC) performance in 2013, with C2C increasing 2%. Despite the setback last year, the oil and gas industry as a whole still reported an overall drop of 4% in its C2C between 2007 and 2013.

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Four notable trends characterized the transaction year for oil and gas: bigger deals, less acquisition spend by National Oil Companies (NOCs), continued high interest in US unconventional assets and continuing expansion of private equity (PE) interest in the sector. Firstly, in 2014, there were 82 deals with a reported value of US$1 billion or more, including four “megadeals” with reported values in excess of US$10 billion. In contrast, 2013 saw 67 deals greater than US$1 billion, with only one megadeal. With the larger deals, the average deal size for the year was more than US$447 million, up sharply from the average of the previous four years. While the activity over the previous four years had been trending toward smaller average deals, that trend seemed to be reversed in 2014.

Global oil and gas transactions: 2014
(percent of deals by reported value in US$)

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NOC transaction activity, which had played a major role in recent years, was notably subdued in 2014, from a reported deal value and a deal volume perspective. Deals where NOCs were involved as buyers, either wholly or in partnership/consortium, accounted for less than US$21 billion of reported deal value in 2014, down from more than US$63 billion in 2013, and well below the record in 2012 of more than US$122 billion. Transaction activity by the three major Chinese NOCs was off sharply in 2014. After spending an average of more than US$27 billion per year over the previous four years, the three NOCs spent just over US$6 billion in 2014, as the companies focused on integrating earlier acquisitions and were somewhat distracted by the on-going government prompted management changes. Russian NOC activity, which had soared in 2012 with the big Rosneft deals, was also off sharply in 2014.

We would however, expect to see some resurgence in NOC activity in 2015, particularly from the Chinese and other Asian NOCs, as those organizations move to take advantage of more attractively-priced assets.

The impact that unconventional oil and gas development has had on the industry over the past 10 years or so has been nothing short of revolutionary, in every sense of the word. That revolution has so far been largely contained to North America, the US in particular. The US has long remained the most active region for oil and gas transaction activity. While the number of US upstream deals continued to decline in 2014, activity involving unconventional assets has been steadily increasing in the US, as a percent of all US upstream activity.

Average oil and gas deal size
(excludes deals without reported value)
Looking forward in 2015 to a volatile, lower-price market, but also a strengthening transactions market

We believe that a shift is underway in the oil and gas business as the industry takes account of the changing balance of supply and demand to a fully supplied market. For the global oil and gas industry, four key implications result from this structural shift:

1. **Costs matter.** In a fully supplied world future commodity prices will not preserve or rescue high-cost projects as the industry grapples with structural cost pressures. Capital intensive unconventional resource development, increasing regulatory and environmental costs, and the growing technology and service costs of unlocking abundant, yet complex and costly plays will drive new business models and a renewed focus on operational excellence, which will result in the bifurcation of winners and losers - those able to adapt and those who fail to adjust.

2. **Globalization.** The global nature of the industry continues to change. Growing unconventional production has disrupted old market dynamics creating new competition at a global level. Capital continues to flow to projects with little regard for borders, while players continue to evolve strategies and structures in ways to best address and succeed in the global energy marketplace.

3. **Innovation.** Essential to realizing the resource potential of the industry, new innovation (technology, business processes, structures, operating and funding models) will be required to offset high structural costs/technically challenging plays (for example, the deep water, oil sands, unconventional plays). Innovation will be a key driver of success.

4. **Resilience.** The future market looks to be moving back to higher levels of volatility and uncertainty. In this context a renewed focus on building operational, financial and portfolio resilience is inevitable and will be a critical consideration in much of the transaction activity.

In the absence of substantial short-term changes to the expected global oil balance - e.g., stronger oil demand, unexpected reductions/outages in supply or a slowdown in the growth of non-OPEC supply - oil prices could weaken further in the first half of 2015. The fundamentals should start to improve in the second half of 2015, albeit slightly, as demand is expected to increase and non-OPEC supply increases are expected to be moderate. The level at which the market eventually stabilizes, however, is still subject to much uncertainty.

So for 2015, we see the scope for a strengthening oil and gas M&A market, primarily driven by the implications of and responses to the recent price collapse, as companies:

- Re-allocate capital to optimize their portfolio and focus on higher returns
- Remove underperforming and lower-yield businesses and assets (e.g., carve-outs and divestments)
- Pursue opportunistic acquisitions of challenged or under-valued businesses
- Look to joint ventures to share capital and risk
- Increase investments into growth markets

In short, particularly in the remainder of 2015, we expect to see more motivated sellers and more consensus on valuations. Consolidation will be driven by over-capacity, intense margin pressures, and generally weaker capital markets.
After holding above the US$100 per barrel mark for more than three years, since mid-June 2014 oil prices (using spot UK Brent) have declined by more than 50% (through mid-January 2015). OPEC’s decision at their late-November meeting to maintain the current production ceiling, rather than cut production to support prices, exacerbated the decline.

The global oil market balance in recent decades can be characterized by three components - demand, non-OPEC supply and the derived “call” on OPEC crude oil production and inventories. Historically, non-OPEC supply has satisfied as much of global oil demand as it could, with the remainder to be supplied by OPEC and/or from inventories. But since 1Q 2014, OPEC has supplied more crude oil than the market has needed, and given current expectations for global oil demand growth and for non-OPEC production growth, the amount of crude oil needed from OPEC will decline sharply in the first half of 2015. With OPEC resolved (at least at this point in time) to maintain its current production ceiling of just over 30 million b/d, and oil demand declining seasonally starting in the first quarter, the market is likely to be over-supplied by as much as 1.5 to 2 million b/d in the first half of 2015.

The actions of OPEC in allowing a process of undisturbed price discovery to take place can be characterized as a reminder to higher-cost producers that there is no implicit price guarantee that OPEC (in effect Saudi Arabia) is prepared to underwrite when that primarily acts to support non-OPEC margins. Multiple explanations for OPEC’s motivations have been put forward. However, an explanation based on market fundamentals is compelling. A combination of ‘disturbances’ to the supply side after the global financial crisis masked the structural impact of growing unconventional (and other) non-OPEC supply leading to a fairly balanced market and stable price. As demand growth remained weak and supply ‘disturbances fell away,’ OPEC was placed in the position where price stabilization at recent levels would only be possible by continual market share erosion as higher prices motivated further high-cost production to be brought on stream. Given that market share losses would be more expensive to recover in the long term, OPEC is seeking to deter more high-cost production by providing a visible risk to economics and returns.

What does this mean for the industry in the short-term?

If the OPEC actions are motivated by the factors referred to above, then it is likely that they will look to see some hard evidence that the market is working to clear less economic barrels from supply before any decisive response is attempted. While there is a limit to the financial capacity of many OPEC players, Saudi Arabia as the swing producer has made it clear that it can and will withstand lower prices for some considerable time to come. In this context the following factors will drive the market finding a new price level:

- **Economic stimulus of the price reductions.** A US$50 reduction in the price of crude oil translates into a US$4.6 billion per day stimulus to the global economy, or more than US$1.7 trillion per year. In just the US, the stimulus would amount to almost US$950 million per day. An element of this could be offset in the form of less capital spending by some companies.

- **Contraction in upstream oil investment.** An immediate cut-back in upstream spending is happening as a direct result of the price decline. For conventional oil, cut-backs are most likely in exploration with some postponement or deferral of project sanctioning, particularly for the higher-cost, higher-risk projects, but little impact on short-term production. On the unconventional side, light tight oil (LTO) developers and producers are quickly reducing capital spending, “high-grading” their portfolios and increasingly concentrating on the “sweet spots.”

- Notably, LTO developers and producers are unlikely to shut-in existing production; rather, they will defer some new development drilling activity.
Over the course of 2014, the key themes were:

1. US tight oil is attracting the majority of capital investment globally as US companies sold down or exited their positions internationally to fund ongoing development and consolidate locally.

2. NOC acquisitions dropped off materially as they focused on investing in the projects secured in previous years.

3. Megadeals are stealing the show as the available acquisition capital increasingly concentrated into the hands of the few.

4. Exploration and appraisal assets are still getting attention with nearly half of the total number of transactions globally.

Throughout 2014, transaction activity remained constant despite the sudden drop-off in commodity prices in Q4. The number of failed transactions (i.e., announced processes that didn’t complete in 2014) was at a low, with a mere 20% of deals announced not finding a buyer. Mirroring the theme of a preference to oil cited by most IOCs and NOCs, globally oil-weighted transactions took 70% of the acquisition capital with gas production garnering 30%, however, this varied regionally.

There was US$185 billion of reported upstream oil and gas transaction activity in 2014 representing a 21% increase on 2013. Capital appears to be concentrated, however, as US consolidation and global mega deals stole the show. The 1,376 upstream deals in 2014 were 22% lower than 2013. Indeed, 65% of the total value of global 2014 transactions (US$120 billion) is comprised of 50 deals greater than US$1 billion each.

Almost half of the upstream transactions by reported value in 2014 were in the US (46%), with Canada adding another 22%, leaving North America to dominate. The US had its biggest M&A year in over five years, with US$85 billion in announced values, an increase of almost 55% compared to 2013’s total.

The vast majority of this activity was consolidation and asset trading within US and Canadian companies. With over 70% of acquisitions by reported value, being made by US companies and less than 15% made by Canadian companies. However, 2014 began and finished with two notable exceptions to the local investment theme: China’s Goldleaf Jewelry’s surprise acquisition of a 95% stake in ERG Resources for US$684 million in February and, closing out the year, Repsol’s US$13 billion acquisition of Talisman Energy.

The rest of the regions delivered a relatively balanced contribution to the global M&A reported values, with between US$8 to US$13 billion to the total. India and perhaps more surprising, the Middle East continued to lag behind the rest of the world with negligible transaction values (or undisclosed) since 2011.
Companies are increasingly selective as they focus on value and portfolio optimization rather than purely buying reserves and/or production. Capital discipline was an on-going theme for 2014. Perhaps as a result, corporate M&A and acquisition of producing assets tied for first place by reported deal value with 38% each. Adding in acquisition of development projects, 95% of the acquisition capital in 2014 was focused on established assets.

On a transaction volume basis, however, almost 50% of transactions were exploration and appraisal assets, this highlights the importance of portfolio replenishment. North America continued to dominate with 40% of exploration-related transactions by volume. The exploration transaction volume in Africa was a modest 12% of global total volume; matching Australia and to a lesser extent Asia and the North Sea.
**IOCs dominate the list of sellers**

Over half (55% or US$101 billion) of global upstream divestments by reported value were concentrated into 20 sellers: with six (~38%) corporate transactions and the remainder asset rationalization by major oil and gas companies. The majority (65%) of transactions were assets or companies in the US and Canada.

For the top transactions by reported value outside of the US and Canada (i.e., about US$50 billion), over half of the sellers by reported value were by European companies, with US companies taking second place with almost 30% of transactions.

These statistics reflect the renewed focus on portfolio discipline of the industry.
**Buyers are more globally diversified**

The top 20 buyers in 2014 made a combined total of US$85 billion of acquisitions. Although the buyer mix is more diversified, the modest presence of many NOCs in the top 20 suggests acquisition capital may remain underdeployed in certain previously active acquirers, such as NOCs in Korea, China and India.

There were 51 upstream transactions with reported deal value greater than US$1 billion. The major big buyers for 2014 were IOCs and PE, who both focused their acquisition capital on securing US companies and assets. NOCs and Sovereign Wealth Funds (SWF) were noticeably absent from the US. In contrast, all buyer groups invested in Canada. There were three large deals in Europe in 2014, including one by a Russian PE firm. Africa saw big investments from IOCs and SWFs. Asia’s three mega-deals were marked by US independents monetizing their international positions as they refocus their capital on their US domestic assets. The three big Australian acquisitions were a diverse group made by a SWF, NOC, IOC and Equity Capital Markets (ECM).

Global upstream transactions: buyer regions as a % of total value for deals over US$1 billion

![Graph showing buyer regions as a % of total value for deals over US$1 billion.]

Source: EY analysis of data from Derrick Petroleum

Global upstream transactions: buyer types as a % of total value for deals over US$1 billion

![Graph showing buyer types as a % of total value for deals over US$1 billion.]

Source: EY analysis of data from Derrick Petroleum
**NOCs were less active**

In contrast to 2013, the NOCs did not drive M&A activity in 2014. In fact, they had their lowest investment on record in five years; US$20 billion in contrast to 2013’s US$60 billion. They represented 12% of the acquisitions greater than US$1 billion.

NOCs are still digesting the material acquisitions made in the past few years. Many have met their objectives to secure resources, some are struggling with development project delays and/or cost overruns, and most are increasingly technically rigorous in their evaluations and investment decisions. Similar to IOCs, several NOCs are focusing increasingly on values and returns rather than strictly on securing resources and production. Some more mature NOCs are also entering the value chain earlier, securing exploration licenses.

As China continues to reorganize their NOCs in the wake of government investigations into improper business behaviour, 2014 marked the first year that Chinese NOCs represented one of the lowest reported values of global upstream M&A transactions with 75% less investment (based on reported value) than 2013, and an 80% decrease compared with their 2010-2013 average. Based on recent falls in valuation outlook, this looks like a timely pause from acquisitions.

**FSU: Lowest reported M&A transaction values in five years**

The former Soviet Union (FSU) was the biggest loser for drawing investment and transaction activity in 2014 with a mere US$9.2 billion (a 72% drop in transaction value from 2013).

The drop in foreign investment in the FSU overall is likely to be the direct result of international sanctions placed on Russia in reaction to Russia’s annexation of Crimea. International sanctions have caused Total to suspend their shale oil exploration joint venture with Lukoil. The Ukraine crisis also stopped upstream exploration in Ukraine’s Black Sea and resulted in the cancellation of the South Stream pipeline.

CNPC’s acquisition of a 10% working interest in the VankORSkoye field from Rosneft for US$1 billion was the largest foreign investment into Russia’s upstream oil and gas sector in 2014. Total’s acquisition of a 1.28% stake in Novatek announced in June 2014 for US$434 million marked the only investment by an IOC. The remaining Russian transactions were a result of internal consolidation.

Outbound investments by Russian firms were similarly minimal. Luxembourg-based LetterOne, the international investment vehicle of the shareholders of Russia’s Alfa Group Consortium made headlines with their US$7.1 billion acquisition of RWE’s Dea upstream business. The only other material outbound Russian investment in 2014 was Lukoil’s acquisition of a 37.5% stake in Bowleven Energy’s Etinde Project in Cameroon.
Outside of Russia, three >US$1 billion deals dominated with both Total and Statoil exiting the Shah Deniz and South Caucasus Pipeline for US$1.5 billion and US$2.25 billion respectively to NOCs Petronas and TPAO. In Kazakhstan, Sinopec bought up Lukoil’s assets for US$1.2 billion.

**Outlook for 2015**

In 2015, we expect M&A themes to be driven primarily by companies with strong balance sheets taking advantage of distressed sellers in light of depressed commodity prices. Providers of capital are likely to have a key role in choosing the winners and losers.

Companies that previously had a strict preference for oil-weighted production assets may broaden their acquisition parameters.

The biggest challenge to 2015 M&A will be buyers and sellers finding common ground on commodity prices, with projects that are marginal or uneconomic at US$60/bbl oil less likely to transact. Exploration assets will continue to languish as budgets are cut, and appetite to acquire high-risk opportunities continues to shrink regardless of the potential size of the prize. For cash-rich acquirers, however, the world in 2015, is their oyster.

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**The top ten upstream transactions in 2014, based on disclosed value:**

<table>
<thead>
<tr>
<th>Announced date</th>
<th>Buyers</th>
<th>Sellers</th>
<th>Nature of asset</th>
<th>Value (US$)</th>
</tr>
</thead>
<tbody>
<tr>
<td>15 Dec</td>
<td>Repsol</td>
<td>Talisman</td>
<td>Corporate acquisition of international assets</td>
<td>$13.0 billion</td>
</tr>
<tr>
<td>16 Mar</td>
<td>Letter One Group</td>
<td>RWE</td>
<td>European upstream businesses</td>
<td>$7.1 billion</td>
</tr>
<tr>
<td>27 Sep</td>
<td>EnCana</td>
<td>Athlon Energy</td>
<td>US unconventional assets</td>
<td>$7.0 billion</td>
</tr>
<tr>
<td>13 Jul</td>
<td>Whiting Petroleum</td>
<td>Kodiak Oil &amp; Gas</td>
<td>US corporate acquisition</td>
<td>$6.0 billion</td>
</tr>
<tr>
<td>14 Oct</td>
<td>Southwestern Energy</td>
<td>Chesapeake Energy</td>
<td>Unconventional US assets</td>
<td>$5.4 billion</td>
</tr>
<tr>
<td>15 Dec</td>
<td>Woodside Petroleum</td>
<td>Apache</td>
<td>Natural gas and LNG assets in Australia and Canada</td>
<td>$3.8 billion</td>
</tr>
<tr>
<td>7 May</td>
<td>EnCana</td>
<td>Freeport-McMoRan</td>
<td>US Eagle Ford assets</td>
<td>$3.1 billion</td>
</tr>
<tr>
<td>17 Jun</td>
<td>Public market</td>
<td>Royal Dutch Shell</td>
<td>9.5% stake in Woodside Petroleum</td>
<td>$3.0 billion</td>
</tr>
<tr>
<td>24 Jul</td>
<td>Breitburn Energy Partners</td>
<td>OR Energy</td>
<td>US corporate acquisition</td>
<td>$3.0 billion</td>
</tr>
<tr>
<td>4 Jun</td>
<td>Public market</td>
<td>Pemex</td>
<td>7.86% stake in Repsol</td>
<td>$2.8 billion</td>
</tr>
</tbody>
</table>

Source: EY analysis of data from Derrick Petroleum
Downstream transaction activity was up in 2014, recording its strongest deal volume and aggregate volume since 2012. Total disclosed deal value in the downstream segment was US$25.1 billion in 2014, up 88% compared to 2013. Deal volume in 2014 increased by almost 16%.

As usual, the US accounted for the largest number of downstream transactions – about 56% of the total – while Asia (including Australia) and Europe accounted for about 16% and 18% respectively. However, the decline in activity in European downstream was particularly notable, where activity was 30% lower than prior year, as companies continued to be cautious over growth in oil product demand, given the uncertainty surrounding the region’s economic recovery.

Historically, the largest downstream transactions tend to be those in the US or Europe. However in 2014, the two largest transactions (based on disclosed deal value) related to assets in Australia:

- Li Ka-shing’s Cheung Kong’s acquisition of the Australian gas pipeline firm Envestra in a cash deal worth US$3.4 billion.

- Royal Dutch Shell sold its downstream business in Australia to Vitol B.V. for US$2.6 billion. The sale includes the Geelong Refinery and 870-site retail business, along with Royal Dutch Shell’s bulk fuels, bitumen, chemicals and an exclusive distributor arrangement for Royal Dutch Shell Lubricants in Australia. It does not include the aviation business or the blending plant in Brisbane (which will be converted to a bulk storage and distribution facility).
There were 45 asset transactions and 42 corporate transactions in the downstream segment in 2014.

**Refining**

In the refining sub-segment, the two largest refining transactions during 2014 (based on disclosed deal value) were:

- Vitol B.V.’s acquisition of the Geelong Refinery as part of the overall acquisition of Royal Dutch Shell’s Australian downstream operations.

- Saudi Aramco’s acquisition of a further 28.4% stake in S-OIL from Hanjin for US$2.0 billion, increasing its ownership of S-Oil from 35% to 63.4%. According to Saudi Aramco’s chief executive, this transaction underscores the company’s confidence in the Korean economy and its strategy to enhance its presence in the growing Asian markets.

While there were also refining transactions in the US (including Bakken Energy’s acquisition of Green River Refinery in Utah and TrailStone’s acquisition of US Oil and Refining Co), it is worth noting that there was no outright refining transaction in Europe post the termination of the sale process of the Milford Haven Refinery in the UK as certain conditions precedent were not satisfied.

While refiners in the US are benefiting from higher crude runs and strong refining margins due to advantaged feedstock, overcapacity in Europe continues to impact utilization and the prospects of any real recovery in refining margins. More closures maybe needed to restore parity with demand.

Furthermore, the threat of exports from additional refining capacity coming online in the Middle East (with much of that capacity relatively complex) and the continuing upgrade of Russian refineries could further impact the attractiveness of the third and fourth quartile European refineries in particular.

Although Asian refining margins are also impacted by weak regional demand growth and surplus capacity, the region’s demand growth outlook is more positive than that of Europe’s.

As with previous years, there was no refining transaction in the Middle East given the high levels of state ownership. In Africa, pricing regulation and political instability have impacted the attractiveness of refineries in the region.

**Storage terminals**

In the storage/terminal sub-segment, the two largest transactions (based on disclosed deal value) in 2014 involved:

- Macquarie Infrastructure’s acquisition of the remaining 50% stake in International Matex Tank Terminals (IMTT), operator of one of the largest bulk storage terminal business in the United States for US$1.0 billion.

- DONG Energy’s divestment of its Stenlille Gas Storage Facility to state-owned entity Energinet.dk for US$386 million. The Stenlille Gas Storage Facility is the larger of two gas storage facilities in Denmark with a working gas volume of 575 mcm, corresponding to 57% of the total Danish gas storage capacity.

Demand for storage terminals is generally driven by:

- Increasing geographic imbalances between refining production and consumption

- Increasing products with different specifications in order to comply with regulations, leading to a greater need of segregated storage and blending capabilities

- Increasing activity from independent retailers/distributors and hypermarkets

- The requirement of oil traders and compliance with compulsory stock obligations

Over 70% of transactions in 2014 involved storage terminals in the US, driven by the difficulties in developing green-field sites in the country. Should the US start exporting crude oil, there is likely to be additional demand for storage terminals.

In Europe, investments during the early part of this decade have led to higher storage capacity in the region. However, combined with the decline in overall trade volumes, utilization and storage rates have eroded. Vopak recently announced its intention to divest 15 of its smaller, low-margin terminals to focus on its strategic markets.

Regardless, storage terminals remain a strategically important infrastructure asset and competition between oil and gas companies, independent storage operators, oil traders and infrastructure funds is intense for the right asset. The alternative is to build or acquire refineries and convert them to storage terminals. However this can often be more expensive than anticipated.
There was minimal storage terminal activity in Asia during the year. Infrastructure in Singapore, Malaysia and South Korea effectively acts as a trading hub for the region, similar to the role Amsterdam-Rotterdam-Antwerp plays for Europe. In Australia, its increasing reliance on imports of refined oil products has led to trading companies developing a significant regional downstream presence in the country, for example Vitol B.V.’s acquisition of Royal Dutch Shell Australia.

As with refining, there was limited activity in the Middle East and Africa during 2014 due to a combination of government and NOC ownership or the lack of salable assets.

**Retail**

In the retail/distribution sub-segment, the two largest deals (based on disclosed deal value) were:

- Hess’ divestment of its US retail business to Marathon’s Speedway for US$2.9 billion. The deal will add 1,256 Hess sites across 16 US states to Speedway’s 1,480 sites across 9 US states.
- Royal Dutch Shell’s divestment of its downstream business in Australia to Vitol B.V. for US$2.6 billion.

In the mature US and European markets, economies of scale (volume) is typically the key driver of profitability as competition naturally restricts fuel margin levels. However, this does not necessarily imply direct ownership of retail sites. As such, the strategy of major oil companies is based around optimizing the balance between value added and capital employed to minimize cost.

We expect that there will be further consolidation in these regions and continuing strong interest from various parties for retail marketing networks, particularly those with strategically advantaged throughputs, strategically located sites and strong non-fuel offerings (or an ability to develop one) from:

- Regional and national oil companies looking to expand within their supply envelope
- Independent retailers looking to improve their market share and economies of scale
- Financial investors looking to build competitive advantage through specialization and regional scale as opposed to control over the full supply chain

Given the level of competition, retail marketing networks of appropriate quality and scale in the right markets would likely command a premium.

There was limited transaction activity in Asia during 2014 as most of the market participants are focused on further developing their portfolio in this region, hence limiting transaction opportunities. As with other segments, there was not much activity in the Middle East and Africa during 2014.
Trends and future prospects

Fundamentals driving transaction activity in the downstream sector remain robust. The strategic focus of oil majors continues to be on upstream with capital expenditure weighted towards E&P.

As such, oil majors will continue to review their downstream portfolio which often leads to divestments of non-core downstream operations to improve capital returns; while also continuing to invest in their key growth core regions. However, the return of oil price volatility may delay this process as companies re-discover the benefits of the integrated business model.

The top ten downstream transactions in 2014, based on disclosed value:

<table>
<thead>
<tr>
<th>Announced date</th>
<th>Buyers</th>
<th>Sellers</th>
<th>Nature of asset</th>
<th>Value (US$)</th>
</tr>
</thead>
<tbody>
<tr>
<td>7 May</td>
<td>Cheung Kong, Power Assets Holdings Ltd</td>
<td>Envestra Ltd</td>
<td>Gas pipelines in Australia</td>
<td>$4.3 billion</td>
</tr>
<tr>
<td>22 May</td>
<td>Marathon Petroleum</td>
<td>Hess</td>
<td>1,256 Hess sites across 16 US states</td>
<td>$2.9 billion</td>
</tr>
<tr>
<td>20 Feb</td>
<td>Vitol BV</td>
<td>Royal Dutch Shell</td>
<td>Downstream business in Australia</td>
<td>$2.6 billion</td>
</tr>
<tr>
<td>27 Apr</td>
<td>Energy Transfer Partners LP</td>
<td>Susser Holdings Corp</td>
<td>630 retail convenience stores in Texas</td>
<td>$2.1 billion</td>
</tr>
<tr>
<td>2 Jul</td>
<td>Aramco</td>
<td>Hanjin Energy</td>
<td>28.4% stake in S-OIL</td>
<td>$2.0 billion</td>
</tr>
<tr>
<td>7 Apr</td>
<td>Laclede Group</td>
<td>Energen</td>
<td>US natural gas utility operations</td>
<td>$1.6 billion</td>
</tr>
<tr>
<td>28 Feb</td>
<td>SIBUR Holding OJSC</td>
<td>Rosneft</td>
<td>49% stake in Yugragaz, natural gas distributor</td>
<td>$1.6 billion</td>
</tr>
<tr>
<td>7 Jul</td>
<td>Macquarie Infrastructure Co LLC</td>
<td>International Matex Tank Terminals Inc</td>
<td>Remaining 50% stake in IMTT who operates one of the largest bulk storage terminal business in the United States</td>
<td>$1.0 billion</td>
</tr>
<tr>
<td>28 Feb</td>
<td>ONGC (India); Oil India</td>
<td>Government</td>
<td>5% stake each in the Indian Oil Corporation</td>
<td>$0.9 billion</td>
</tr>
<tr>
<td>14 Mar</td>
<td>Essar Global Fund, Ltd</td>
<td>Essar</td>
<td>Remaining stake in company</td>
<td>$0.8 billion</td>
</tr>
</tbody>
</table>

Source: EY analysis of data from Derrick Petroleum
Midstream transaction volumes dropped off in 2014, but disclosed value was up sharply, impacted by several large transactions. With 102 announced deals, activity was down by more than 23% in 2014. However, reported or disclosed deal value more than doubled to US$161 billion.

Midstream transaction activity, both in volume and value, is dominated by the US and Canada. Together, the two countries accounted for more than 78% of all midstream deals and about 94% of the global midstream disclosed value. Deal activity involving pipelines accounted for the largest portion of midstream activity—46 deals (40%) and about US$17.6 billion in disclosed value (about 11% of total value). There were 30 diversified deals in 2014, accounting for about 29% of the total number of deals, but with more than US$131 billion in reported value, these diversified transactions accounted for more than 81% of the total reported value in the segment. There were 17 transactions involving gathering/processing assets in 2014 (17%), with total disclosed deal value of almost US$11 billion (about 7% of the total).
Asset transactions dominate the midstream landscape, accounting for 49% of all deals but only 10% of the disclosed transaction value in 2014. Corporate transactions accounted for 31% of the deals, but 83% of the total reported value. A further 20% of the deals and 7% of the reported value came from dropdowns of midstream assets from corporates into master limited partnerships (MLPs).

With the unconventional oil and gas boom in the US, attention to infrastructure investment has been at an all-time high, with substantial new pipeline, processing and storage capacity being built. We’ve also seen increasing consolidation, spurred on by significant tax advantages for MLP structures.

The midstream’s largest deal in 2014, and by far the largest oil and gas transaction of the year, was the merger of Kinder Morgan Inc. and its three publicly traded subsidiaries – Kinder Morgan Management, LLC (KMR), Kinder Morgan Energy Partners, LP (KMP) and El Paso Pipeline Partners (EPB) – in a deal valued at an estimated US$71 billion (including debt assumed of US$27 billion). With Kinder Morgan as one of the pioneers of the MLP industry, the merger has drawn the attention of current and prospective MLPs, as well as various analysts and investor groups. Based on public statements, the merger was motivated by Kinder Morgan’s desire to accelerate its growth in North America by eliminating the parent company’s rights to cash distributions (resulting from its interest as the general partner) from the two MLPs. In particular, the concern was that the required distributions by the MLPs to their general partner had grown so large that the parent company’s ability to make acquisitions may have been hindered by a higher cost of capital. By eliminating the general partner distributions (i.e., the incentive distribution rights) from the MLPs, one of the goals of the merger was to significantly reduce KM’s overall cost of capital.

Although the merger represents a transformative transaction in the MLP space, attracting significant attention, the MLP as an investment vehicle and company structure continues to have a unique role in today’s marketplace. MLPs offer a wealth of benefits to both sponsor companies and individual investors while providing a low-cost, alternative form of capital for expansion and growth. The merger does, however, provide a glimpse as to a potential ultimate exit scenario for current or prospective MLPs, depending on growth and relative economic environment, and, as such, should be part of the broader conversation with respect to strategic alternatives to certain mature MLPs.

The top ten midstream transactions in 2014, based on disclosed value:

<table>
<thead>
<tr>
<th>Announced date</th>
<th>Buyers</th>
<th>Sellers</th>
<th>Nature of asset</th>
<th>Value (US$m)</th>
</tr>
</thead>
<tbody>
<tr>
<td>10 Aug</td>
<td>Kinder Morgan Inc</td>
<td>Kinder Morgan Energy Partners</td>
<td>Multiple US midstream companies</td>
<td>$71.0 billion</td>
</tr>
<tr>
<td>24 Oct</td>
<td>Access Midstream Partners</td>
<td>Williams Partners</td>
<td>Merger of US companies</td>
<td>$34.4 billion</td>
</tr>
<tr>
<td>13 Oct</td>
<td>Targa Resource Partners</td>
<td>Atlas Pipeline Partners</td>
<td>US corporate acquisition</td>
<td>$7.7 billion</td>
</tr>
<tr>
<td>15 Jun</td>
<td>Williams Partners</td>
<td>Global Infrastructure Partners</td>
<td>Additional stake in Access Midstream Partners</td>
<td>$6.0 billion</td>
</tr>
<tr>
<td>10 Dec</td>
<td>APA Group</td>
<td>BG Group</td>
<td>QCLNG (Australia) gas pipeline</td>
<td>$5.0 billion</td>
</tr>
<tr>
<td>1 Oct</td>
<td>Enterprise Products Partners</td>
<td>Oiltaking Holding America</td>
<td>Corporate US acquisition of GP and LP interests</td>
<td>$4.6 billion</td>
</tr>
<tr>
<td>19 Oct</td>
<td>Tesoro Logistics</td>
<td>QEP Resources</td>
<td>US midstream assets</td>
<td>$2.5 billion</td>
</tr>
<tr>
<td>28 Apr</td>
<td>El Paso Pipeline Partners</td>
<td>Kinder Morgan Inc</td>
<td>Dropdown of US gas assets</td>
<td>$2.0 billion</td>
</tr>
<tr>
<td>22 Sep</td>
<td>Enbridge Income Fund</td>
<td>Enbridge Inc</td>
<td>Dropdown of US gas and pipeline interests</td>
<td>$1.6 billion</td>
</tr>
<tr>
<td>28 Oct</td>
<td>Western Gas Partners</td>
<td>Nuevo Midstream LLC</td>
<td>US corporate midstream acquisition</td>
<td>$1.5 billion</td>
</tr>
</tbody>
</table>

Source: EY analysis of data from Derrick Petroleum
Transaction activity in the oilfield services (OFS) sector declined in 2014, with 320 deals announced compared with 406 in 2013. However, this was still a substantial increase from 2012, where only 222 deals were announced. Furthermore, aggregate deal value in 2014 was up 242% year-on-year to US$72.0 billion, reflecting the impact of several large transactions. The average disclosed deal value increased from US$126 million to US$600 million, dominated by the mega deal announced by Halliburton, the second-largest OFS firm, in November 2014. Their cash and shares offer for the third-largest OFS firm, Baker Hughes, was valued at US$38 billion. Excluding the Halliburton/Baker deal - the year-on-year growth would have been 62%, while the average reported deal value would have been US$283 million. The deal activity was relatively evenly spread over the first three quarters in 2014, with a sharp drop to just 46 deals announced in 4Q14.
2014 saw OFS customers focusing on industry cost inflation, corresponding to E&P operator’s operational cash flows coming under increasing pressure. With offshore E&P activities tending to have a higher cost base, the effect of the increasing cost focus was first observed by oil service companies who focused on offshore services. With the significant drop in oil prices over the second half of 2014, the cost focus further increased and also expanded noticeably into the US land unconventional oil production segment.

Based on the disclosed value of OFS M&A deals in 2014, 51% were completed by OFS companies who focused on land based operations, 40% were by companies with a clear offshore focus and 9% involved companies focusing on both of these service segments. As expected, the 2014 OFS M&A landscape was dominated by North America, with 66% of the disclosed value deals having a Canadian- or US-based buyer, and 60% having a North American-based seller. Moreover, 55% had both a registered North American seller and buyer – supporting the view of considerable, ongoing focus on domestic equipment and service supply optimization to the US unconventional land industry. Seventeen percent of acquirers and 24% of sellers were European-based companies. Asia and the Pacific oriented transactions had 15% and 12% of the buyer and seller universe respectively.

Within the various segments of the OFS value chain, the support services sub-segment accounted for 42% of 2014 M&A transactions, while the drilling sub-segment accounted for 21% of all transactions, and the well servicing sub-segment another 11%.

The top five transactions measured by reported value, were made by large corporations delivering equipment and services across multiple OFS segments, accounting for more than 11% of all transactions in 2014. The most notable deal was Halliburton’s US$38 billion acquisition of Baker Hughes, implying a LTM EBITDA multiple of 8.8x. The transformational deal will close the gap with main rival Schlumberger, as well as reduce Halliburton’s dependence on the North American market. Moreover, the strategic cooperation agreement between Baker Hughes and Aker Solutions will plug the Halliburton gap relative to the Schlumberger and Cameron One Subsea joint venture.

Another large deal was announced in September, when Siemens AG offered US$7.6 billion for the US-based and NYSE-listed rotating equipment manufacturer Dresser Rand Group Inc. The Siemens’ offer valued Dresser Rand Group at 17.4x LTM EBITDA. In a statement, Siemens highlighted their plans to concentrate their entire oil and gas products and services portfolio around the Dresser Rand Group platform and brand.

Next on the list came C&J Energy Services US$2.9 billion merger with twice its size Nabors Industries’ completion and production services business in Canada and North America. The combination creates the fifth largest pumping and fracking supplier in North America, measured on approximately 1.1 million hydraulic fracturing horsepower capacity. The transaction is viewed as a classic consolidation case, motivated on growth by means of greater scale, geographic reach, service capabilities and operating efficiencies.

Early in the year, AMEC acquired rival EPC firm, Foster Wheeler for US$3.2 billion. Another slightly smaller deal was the Canada-based engineering and construction company SNC Lavalin Group’s US$2.8 billion acquisition of London Stock Exchange-listed oil and gas specialist engineering and construction company Kentz.
The transaction added strength to SNC Lavalin Group in core markets like the Middle East, North America and Asia Pacific – as well as substantially increasing the SNC Lavalin group exposure to the oil and gas industry from 7% of annual revenue up to 24%.

From a valuation perspective, the longer-term trading history of large OFS players shows that the industry has not been able to recover fully after the financial crisis inflicted an oil price drop from US$147 per Brent barrel in July 2008 down to US$37 in February 2009. The corresponding average EV/EBITDA valuation pre (2002-2008) and post (2009-2013) are for the large oilfield service companies 9.8x and 7.4x respectively. The same analysis for the large oilfield equipment manufacturers shows an average EV/EBIDTA valuation of 9.0x prior to the oil price drop, and 8.7x thereafter. In some respects, the second half of 2008 oil price trend can be compared to the oil price movement in second half of 2014. However, the oil price recovered rather quickly during 2009, moving into the US$60-80 Brent band, before crossing the US$100 per barrel mark in early 2011. For 2014, the OFS industry had started to come under market pressure towards the end of 2013, in a relatively healthy oil price environment, on the basis of cost inflation arguments from the E&P operators.

Thus, we expect that a considerable supply chain restructuring and efficiency program will be required, which will take time to plan and implement. Further pressure was added by the oil price drop, which is likely to strengthen the market effect in the short-term, while a potential oil price recovery is not necessarily going to increase E&P spending in the short-term.

**Outlook for 2015**

We expect that the oilfield services transaction trend of consolidation will continue in 2015, as companies try to capitalize on scale, improve operational efficiency and cost bases. PE funds are well capitalized, and will likely use the opportunity to exploit short term valuation pressure to invest in quality companies with technologies and business models which are in tune with the E&P cost reduction focus. Leveraged companies will have to divest non-core business, and the expected decline in E&P spending will very likely facilitate a backdrop that can create a few surprises in the form of nontraditional mergers across the OFS value chain.

The top ten OFS transactions in 2014, based on disclosed value:

<table>
<thead>
<tr>
<th>Announced date</th>
<th>Buyers</th>
<th>Sellers</th>
<th>Nature of asset</th>
<th>Value (US$)</th>
</tr>
</thead>
<tbody>
<tr>
<td>17 Nov</td>
<td>Halliburton</td>
<td>Baker Hughes</td>
<td>Corporate acquisition – diversified OFS</td>
<td>$38.0 billion</td>
</tr>
<tr>
<td>22 Sep</td>
<td>Siemens AG</td>
<td>Dresser-Rand group</td>
<td>Corporate acquisition - OFS equipment manufacturer</td>
<td>$7.6 billion</td>
</tr>
<tr>
<td>13 Jan</td>
<td>AMEC</td>
<td>Foster Wheeler</td>
<td>Corporate EPC acquisition</td>
<td>$3.2 billion</td>
</tr>
<tr>
<td>25 Jun</td>
<td>C&amp;J Energy Services</td>
<td>Nabors Industries</td>
<td>Acquisition of completion and production businesses</td>
<td>$2.9 billion</td>
</tr>
<tr>
<td>23 Jun</td>
<td>SNC-Lavalin</td>
<td>Kentz</td>
<td>Corporate acquisition - OFS engineering and construction</td>
<td>$2.8 billion</td>
</tr>
<tr>
<td>7 Apr</td>
<td>Alpha Laval</td>
<td>Frank Mohn</td>
<td>Corporate offshore services acquisition</td>
<td>$2.1 billion</td>
</tr>
<tr>
<td>17 Mar</td>
<td>JACCAR Holdings</td>
<td>Bourbon</td>
<td>Stake in offshore service company</td>
<td>$1.4 billion</td>
</tr>
<tr>
<td>4 Nov</td>
<td>Seadrill Partners LLC</td>
<td>Seadrill Limited</td>
<td>Offshore drilling assets</td>
<td>$0.9 billion</td>
</tr>
<tr>
<td>20 Jul</td>
<td>Compressco Partners LP</td>
<td>Warren Equipment Co.</td>
<td>Acquisition of Compressor Systems business</td>
<td>$0.8 billion</td>
</tr>
<tr>
<td>1 Dec</td>
<td>Lubrizol Group</td>
<td>Weatherford International</td>
<td>Chemicals and drilling fluids businesses</td>
<td>$0.8 billion</td>
</tr>
</tbody>
</table>

Source: EY analysis of data from Derrick Petroleum
Regional perspectives

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In 2014, the African continent continued to see regional transaction themes driven by operating plays in East, West, South and North Africa. The transactions market saw a large number of sellers looking for JV partners, outright buyers or funders of assets. However, due to the large number of investment opportunities available to potential buyers, the most significant challenge for sellers has been to successfully complete deals. The steep drop in the oil price in the second half of 2014 has also adversely impacted investment decisions. Deal volumes and values fell significantly in 2014, in comparison to the bumper year of transaction activity in 2013. Including license awards and relinquishments, there were 95 deals in 2014 (2013: 146 deals) with US$8.7 billion of reported value (2013: US$22.2 billion).

**East Africa**

As anticipated in our outlook for 2014, deal volumes in East Africa were low. The region witnessed several sales processes, not all of which have succeeded. There has been a noticeable trend of companies declining opportunities to invest in gas assets, which in 2013 received significant interest from non-African NOCs.

The largest transactions with reported deal values during the year were Marathon Oil’s acquisition of a 50% working interest in Ethiopia Rift basin area from Africa Oil Corp for US$18 million, FAR and Pancontinental’s farm-out in Kenyan Block L6 to Mili International for US$10.5 million and Ophir Energy’s acquisition of a 75% working interest in an offshore Seychelles Block for US$8.3 million from WHL Energy Ltd. These modest deal sizes are in stark contrast to the largest transactions in the continent during 2013 involving assets in East Africa.

As companies have secured their equity positions in gas assets, unless there is material oil play in the region, we anticipate 2015 deal activity to remain low with relatively low deal values. A positive development has been the acquisition of licenses in less traditional geographies previously ignored, such as Ethiopia, Seychelles, Comoros Islands and Madagascar. We anticipate that companies will continue to build equity positions in these geographies, which is likely to fuel exploration and future transaction activity.

**West Africa**

As anticipated in our Outlook for 2014, West Africa witnessed a relatively robust year of transaction activity, including four corporate M&A transactions. Nigeria attracted a large number of deal-makers interested in participating in onshore divestments by IOCs, corporate M&A opportunities, or in partnering with indigenous Nigerian companies in the marginal field licensing round. Angola, Cameroon and Ivory Coast notably attracted investors in producing/discovered assets as well as exploration licenses. Elsewhere in West Africa, transactions involving exploration licenses were also seen in Gabon, Senegal, Ghana, Guinea and Liberia.

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**African oil and gas transaction activity**  
(excludes oilfield services)

![Graph showing African oil and gas transaction activity](source)

While non-African NOCs dominated the deal space in 2013, especially in East and West Africa, there were a very small number of transactions in 2014 involving such NOCs. There were eight corporate transactions in 2014 compared to ten in 2013 and the reported deal value of US$3 billion in 2014 was significantly higher than the US$0.4 billion in 2013 due to two separate large acquisitions by Glencore and Al Mirqab Capital in Chad and a pan-African asset portfolio company.
The three largest transactions with reported deal values in West Africa were:

- Aiteo Group, Tempo Energy Nigeria Ltd and Taleveras Energy Resources’ acquisition of a 45% working interest in OML 29 in Nigeria for US$2.7 billion from Royal Dutch Shell, Total and ENI
- At Mirqab Capital’s acquisition of an 80% stake in Heritage (pan-Africa portfolio with significant Nigerian asset weighting) for US$1.64 billion
- Total’s sale of a 15% interest in offshore Angola Block 15/06 to Sonangol for US$750 million

We note that the Royal Dutch Shell, Total and ENI consortium also sold interests in OMLs 18, 24 and 25 to Mart Resources and other undisclosed buyers, but the deal values of these transactions were not publically disclosed.

Despite lower commodity prices we anticipate 2015 deal activity to remain robust in West Africa as investors look for oil assets and exploration assets in the West Transform Margin to continue to attract explorers. The marginal field licensing round in Nigeria is likely to be concluded after the Nigerian elections, while selected onshore divestments by IOCs are rumored to continue in 2015.

North Africa

North Africa saw a healthy number of deals, as investment appetite returned to the Egyptian market and Morocco continued, as in 2013, to attract explorers. License awards exceeded relinquishments across the region and while deal values reported in 2014 were lower than 2013, there were three noticeable corporate M&A transactions in Chad, Egypt and Sudan.

The largest transactions in North Africa included Chevron’s sale of its Chad assets for US$1.3 billion to the Government of Chad, Glencore Xstrata’s acquisition of Caracal Energy for US$1.25 billion in Chad and Chinook Energy’s divestment of its Tunisian assets to PT Medco Energi for US$114 million. Both Sudan and Somalia also registered deal activity as Panorama Petroleum acquired State Petroleum in Sudan and Jacka Resources divested its interest in a Somali Block to Sterling Energy.

With numerous production and development assets in the region, we anticipate 2015 deal activity to remain at similar levels, subject to political and social stability. Deals may also be deferred by ongoing price volatility.

South Africa

Namibia continued to dominate the deal activity in the region, while South Africa saw a very small number of deals. Interestingly, Zimbabwe, Botswana and South Africa saw one deal each in unconventional assets and such deals are likely to continue. The only corporate M&A in the region was Tower Resources’ acquisition of Rift Petroleum for US$43 million. Other noticeable deals in the region without reported deal values were OMV and Murphy Petroleum’s acquisition of interests in two Namibian Blocks, ENI’s acquisition of an exploration Block from Sasol in South Africa and Tullow’s farm in into a Namibian Block.

We anticipate 2015 deal activity in the region to remain at low levels, as exploration activity is likely to be delayed due to the falling commodity prices.
Overall oil and gas transaction activities in the Asia region (excluding Oceania and India) were slightly down in 2014. Reported deal value for the combined upstream, downstream and midstream segments totaled US$10.4 billion, a decrease from US$11.1 billion in 2013. Transaction volumes were also down for the year, totaling 92 deals, compared to 101 in 2013.

North American midsize players re-balance portfolios and exit Asian upstream

Midsize North American companies are seeking capital to redeploy unconventional developments in their home countries, such as Murphy Oil and Newfield Exploration and some have also been looking into options to exit. Divestitures constituted the four top deals in the region:

- September 2014 — Murphy Oil sold assets in Malaysia to Pertamina for US$2 billion
- February 2014 — Anadarko divested offshore China assets to Brightoil for US$1.08 billion
- April 2014 — Hess divested Thailand assets to PTTEP for US$1 billion
- January 2014 — PGN pre-empted 75% interest in Hess' offshore Indonesia block for US$650 million

Asian refiners being challenged by growing US product exports

Downstream deals contributed more than 25% of the total transaction value in the region this year, as weak refining margins forced some players to reshuffle their portfolios and divest non-core assets to strategic buyers. Significant refinery deals included:

- July 2014 — Aramco acquired 28.4% stake in S-OIL from Hanjin for US$2.0 billion
- December 2014 — Petronas acquired remaining 47% stake in Malaysian Refining Company from Phillips 66 for US$635 million

Upstream continues to be the most active sector in terms of both deal value and deal volume.
Southeast Asian NOCs reinforce regional operations and continue to build overseas presence

The dynamics of midsize North American players re-balancing their asset portfolios presented an opportunity for indigenous players. Regional NOCs such as Pertamina and PTTEP took over oil and gas assets to bolster reserves and production. Malaysia's Petronas made the largest purchase among the three NOCs in the region, buying a 15.5% working interest in Shah Deniz and South Caucasus Pipeline, Azerbaijan, for US$2.3 billion from Statoil.

Besides asset acquisitions, Southeast Asian energy players have also entered LNG supply agreements with overseas counterparties. In July 2014, Pertamina completed their second LNG sale and purchase agreement with Cheniere Energy, covering 0.76 mtpa of LNG over a 20-year period. Keppel Infrastructure Holdings, the energy and engineering arm of Singapore's Keppel Corp, signed Heads of Agreement in November to buy up to 1 mtpa of LNG from Petronas over 10 years.

Chinese NOCs slow down global expansion

Chinese state-owned oil companies notably slowed their overseas investment, with acquisitions by Chinese NOCs dropping by over 75% to US$6.1 billion in 2014. Despite the significant decline in M&A activities attributed to the various reasons such as integrating acquisitions and government investigations into improper business behavior, CNPC, Sinopec and CNOOC each still made billion dollar deals in 2014:

- April 2014 – CNPC acquired remaining 40% working interest in the Dover oilsands project from Athabasca Oil for US$1.2 billion
- September 2014 – Rosneft sold 10% working interest in Russia Vankorskoye field, Eastern Siberia to CNPC for US$1 billion
- March 2014 – CNPC acquired additional 7.7% WI in West Qurna-1 from ExxonMobil for US$442 million

Besides purchasing oil and gas assets, China signed two blockbuster gas supply deals with Russia in May and October in 2014. Under the first agreement, China will import 28 bcm of gas from Russia annually over three decades starting in 2018. The deal value is expected to be around US$400 billion. OAO Gazprom is also negotiating to supply as much as 30 bcm of gas annually to China over 30 years.

Outlook: opening of Myanmar upstream

In March 2014, Myanmar awarded 20 oil exploration blocks for its first offshore bid round. Oil majors and IOCs were big winners receiving acreage; companies such as Chevron, ConocoPhillips, Royal Dutch Shell, Statoil, ENI, Total and BG Group were leading the way. The licensing round could mark a new chapter in the region's upstream sector.

- February 2014 – Sinopec, Indian Oil and China Huadian bought Petronas' Montney assets for US$2.3 billion
With the exception of a few large deals, transaction activity in Oceania was again relatively subdued in 2014. Tight conditions in equity markets meant Australia's deal-hungry junior oil and gas companies continued to remain relatively starved of opportunity, resulting in volumes collectively for the upstream, downstream, and midstream segments being slightly down (4%) in 2014. However, the value of regional oil and gas transactions over the period increased dramatically from US$2.5 billion to almost US$23.3 billion, helped along by five significant transactions that contributed almost US$18 billion to the total. Three of these deals were divestments by Royal Dutch Shell, raising a total of US$6.8 billion for the global oil major.

Australia/Oceania oil and gas transaction activity (excludes oilfield services)

Consistent with prior years most of the transactions (93%) were in the upstream sector, although this year upstream only represented 49% of the reported deal value as the major ownership positions in Australia's downstream/midstream landscape continued to change.

One of the largest deals of the year was Cheung Kong and Power Assets Holdings’ acquisition of Envestra valued at US$3.4 billion. Cheung Kong’s all-cash offer eventually defeated an earlier scrip bid from rival APA Group in a hotly contested takeover battle. Envestra, now known as Australian Gas Networks Limited, is Australia’s largest pipeline owner/operator with approximately 24,000 km of regulated natural gas pipelines servicing some 1.2 million customers. The deal adds to Cheung Kong’s existing regulated assets in Australia, including 51% stakes in SA Power Networks in South Australia, CitiPower and Powercor in Victoria.

During the year, there was further activity in the evolving regional downstream sector. Vitol acquired Royal Dutch Shell’s downstream portfolio in Australia for US$2.6 billion as part of the oil major’s global divestment program. The deal included Royal Dutch Shell’s 870 site retail network, its Australian refineries, as well as its bulk fuels, bitumen, chemicals and most of its lubricants business. Puma Energy (Traffigura) continued to build its platform in the region following on from its US$1 billion entry into the Australian market last year with a US$2.6m acquisition of InterOil’s oil refinery and distribution business in Papua New Guinea (PNG), as well as InterOil’s Napa Napa refinery, the deal includes 52 service stations and 30 depots, terminals and aviation sites in country. Puma Energy has plans to grow the refinery and sees PNG as a strategic hub in its regional supply strategy. For InterOil it provides much needed capital to develop its large onshore gas resources in PNG.

In the upstream segment, Royal Dutch Shell took significant steps in its efforts to rationalize its portfolio selling its non-operated interest in the Chevron-led Wheatstone LNG project to Kufpec for US$1.1 billion and selling down a 9.5% stake in Woodside for US$3 billion. Plans to sell down a further 9.5% stake and reduce its Woodside holding to 4.5% were stymied by Woodside shareholders, when they voted down a buyback of the Royal Dutch Shell shares in August. Late in the year, Woodside also featured with the announcement that it was buying Apache’s interest in Wheatstone, as well as Apache’s interest in the Kitimat LNG project in Canada for a combined US$3.8 billion. Included in the deal were upstream gas assets associated with both the Wheatstone and Kitimat projects.

Further activity is expected in the downstream segment in 2015 with refined product suppliers looking to position themselves to take advantage of Australia’s transforming fuel supply market. As slated refinery closures start to come into effect, Asian refiners and global trading companies are expected to play a larger role in Australia’s fuel supply chain with many of them thought to be considering acquisition of storage and marketing assets to secure market access. In upstream, Australia will not be immune to the effects of the dramatic fall in oil prices and investment related transaction activity is likely to be weak as a result. While high-profile projects such as Browse LNG will likely be deferred, the weak pricing environment is also likely to put the brakes on the continued evaluation of vast shale opportunities in the Canning, Cooper and central Australian basins. Australia’s mid-cap companies featured prominently in Asian buying activity during 2014 and we expect that this theme will continue into 2015 as well-heeled suitors to the north look to take advantage of depressed market values and tighter operating conditions to acquire quality assets.
Transaction activity in 2014 in Canada or involving Canadian companies reflected in many ways the market participant reactions to the implications of the structural shift underway, with executives and investors trying to reposition their companies and capitalize on emerging opportunities.

Supported by a host of significant transformative business transactions, favorable commodity prices and strong capital markets support in early 2014, aggregate Canadian transaction levels (excluding oilfield services transactions) grew significantly in 2014 – more than three times the 2013 total (US$14.0 billion). Despite these robust transaction figures, total “publicly announced” transactions completed in Canada in 2014 continued a downward trend – declining 17% compared to 2013 (with 281 deals vs. 337 deals). Some of this decline in completed transactions is likely attributable to lingering sector uncertainties at the start of the year coupled with a pronounced decline in overall transaction activity in the final months of 2014 as the oil price collapse took hold.

Across the major components of the Canadian energy industry (namely oil, natural gas, LNG, oil sands, midstream and oilfield services), a number of business themes played out throughout 2014. Notable transactions in Canada in 2014 focused on a variety of rationales including: creative farm-outs to “share” exploration, development or project costs; carve-outs to monetize non-core assets; deals to strategically reposition a business (selling gas and buying oil); or as a response to activist investor threats; and all combined with increasing levels of new private capital intent on pursuing Canadian energy assets.

**Oil (conventional, tight and shale oil)**

2014 oil transactions represented a number of big bets on reshaped corporate strategies, ongoing play consolidation and continued asset rationalizations, with companies aggressively pursuing what were perceived to be “lucrative” oil assets. Some of the most significant oil-focused Canadian transactions in 2014 were:

- Spain-based Repsol SA agreed to acquire Canada-based, Talisman Energy Inc. for US$13 billion
- Crescent Point Energy Corp. acquired CanEra Energy Corp. for US$1.1 billion
- Encana Corporation completed the IPO and secondary sale of its royalty interests through the creation of PrairieSky Royalty Ltd. for combined proceeds of over US$4.0 billion
- Calgary-based Whitecap Resources Ltd. acquired certain Western Canadian oil and gas assets with 15,000 BOE/day of production from Imperial Oil Ltd. for approximately US$0.7 billion
- Calgary-based Vermilion Energy Inc. acquired southeast Saskatchewan-focused Elkhorn Resources Inc. from a group of private equity-backers for approximately US$0.4 billion.
Natural gas

Similar to many Canadian oil assets, Canadian natural gas assets continued to attract international attention with notable transactions creating significant new players and reflecting the ongoing evolution of different production strategies and focuses. Some significant Canadian natural gas transactions in 2014 were:

- Canadian Natural Resources Limited (CNRL) acquired the Canadian conventional oil and gas assets (excluding certain Horn River and heavy oil assets) of Devon Energy Corp. for US$3.125 billion
- Jupiter Resources Ltd., a newly formed portfolio company of Apollo Global Management, acquired the Bighorn gas assets (acreage, pipelines and facilities) of Encana Corporation for US$1.8 billion
- Chevron Corporation sold a 30% interest in its liquids-rich Duvernay shale assets to Kuwait Foreign Petroleum Exploration Company (KUFPEC) for approximately US$1.5 billion
- Ember Resources Inc., a portfolio company of Brookfield Capital Partners, acquired the Clearwater CBM assets of Encana Corporation for US$542 million
- Canadian Natural Resources Limited (CNRL) agreed to acquire the Deep Basin assets of Apache Corporation for US$374 million

LNG

The “slow” advance of Canadian LNG projects continues to represent a significant opportunity and challenge for Canada, where a world-class asset base is at risk of becoming “stranded” without the export capacity represented by these projects. Multiple proponents (most of which are global LNG players) continue to advance projects but face a range of hurdles including global capital allocation choices, significant upfront capital commitments on long-term market calls, growing competition (especially from pending US LNG export projects) and continued “domestic” negotiations in Canada to set the right industry framework. Most notable Canadian LNG-related transaction activity in 2014 was principally focused on partnership building to share project development costs and portfolio rationalization to refocus on operations on “core” opportunities.

- PETRONAS sold a 15% interest in its Pacific NorthWest LNG project to Indian Oil Corporation Ltd. for an undisclosed amount and a 20-year 1.8 million tonne annual offtake agreement.
- Apache agreed to sell its 13% interest in Wheatstone LNG (Australia) and 50% interest in Kitimat LNG (Canada), along with certain upstream oil and gas assets (including Horn River and Liard basin acreage) to Woodside Petroleum Limited for US$2.75 billion plus approximately US$1 billion in cost reimbursements. Associated upstream assets for the Wheatstone LNG project were also included in the Woodside/Apache deal.
- Korea Gas Corp. sold 5% of its 20% interest in the LNG Canada project to Royal Dutch Shell for an undisclosed amount, with additional efforts being made to sell-down its remaining interest in the project as part of a debt reduction plan.

Oil sands

The significant capital necessary to advance oil sands projects continues to pose an issue for many players. Junior oil sands players continue to be challenged to secure necessary project funding due to the broad range of energy investment alternatives and the restrictions on foreign investment in the oil sands imposed by the Investment Canada rules. Most oil sands projects now underway are SAGD projects, where no mining is involved and where the top projects have economics that rival the best plays elsewhere in North America, with the benefit of very long, minimal decline reserve lives. Capital will continue to flow to these projects.

Midstream

The dramatic growth in North American oil and natural gas production has been a boon to the midstream sector, with substantial infrastructure investments required in every basin. Significant project activity in Canada has mirrored this demand with much of the growth being organically driven by existing players. The Canadian midstream space has not been directly impacted by the MLP model that has recently been driving the US midstream space, but the yield and fee for services models of Canadian midstream players continues to provide more plentiful access to lower cost capital than for Canadian upstream players. Midstream transaction activity in 2014 highlighted creative transactions reflecting the larger repositioning occurring across the industry.
Oilfield services

The Canadian OFS segment is highly fragmented and consists of several hundred entities, many of which are private. The growth in service intensive, “unconnected” resource development has led to a ‘service renaissance’ in Canada. For example, some analysis suggests the average multi-stage fracked horizontal well drilled in North America is now seven times more service intensive and 2.5 times more expensive than the average well was less than 10 years ago.

Transaction activity in the Canadian OFS space was very robust during the first 9 months of 2014 – driven by aggressive consolidation efforts by some global and US-based strategic buyers and strong interest from PE groups. In many cases, know-how and access to innovative and proprietary technologies, tools or processes developed to address the operational challenges of the Canadian environment drove transaction activity – with consolidation, geographic entry and service expansion driving additional activity. A very entrepreneurial sector, transaction success in OFS has required buyers to be careful to align interests in order to retain the key people. A renewed focus on cost control and the pending threat of excess service capacity – due to lower activity levels driven by commodity price declines – are at risk of significantly (and negatively) impacting the broader oilfield services sector in 2015.

Looking forward

Since mid-2014, the transaction market has been stalled by a dramatic plunge in oil prices, with natural gas and all other natural gas liquids also being severely pressured. At current prices and with current market conditions, fewer new oil or gas projects globally appear economical and the Canadian industry is not immune. In addition, Canadian producers now have to face that their largest customer for oil and gas production (most of which is exported) – the US – is now also their greatest competitor. As low energy prices persist, transaction activity in early 2015 will stall until companies, investors and funders are able to develop a clearer sense that the global oil supply/demand balance comes into equilibrium - whether by way of demand growth; supply reductions (either achieved through reduced capital investment or cuts by Saudi Arabia); or by some combination of both - and therefore a clearer call on future prices can be made.

Once the current market “shock” has worn off, we expect that 2015 will see a continuation of 2014’s portfolio rationalization efforts. In Canada, we expect these transactions to be driven by a variety of factors including the need for incremental cash to fund other operations or shareholder requirements; to remove non-core assets to streamline operations and reduce costs; to continue repositioning the business; and (increasingly) to address balance sheet necessities (stress). Capital preservation will be a key theme in 2015, and we expect current market challenges to create unique opportunities for well positioned and well financed companies. Unlike during the financial crisis in 2008-2009 where transaction activity effectively ceased, we believe transactions will accelerate through the course of 2015. In the meantime, Canadian companies are focused on actions to enhance their resilience - from an operational, financial and portfolio perspective.
Europe

Following relatively stable activity levels in the period 2011-2013, European deal volumes, exclusive of OFS activity, declined sharply during 2014. Announced deal volumes of 146 were 40% lower than the 243 deals announced in 2013. While the large majority of activity continued to be in the upstream segment, the decline from 207 to 125 upstream deals in the year was substantial.

The reported value of European oil and gas transaction activity remained slightly more robust during 2014, recording a more modest 15% decline from US$18.1 billion to US$15.3 billion. Although the US$7.3 billion of European midstream activity was not repeated in 2014, there was an almost corresponding US$6.9 billion increase in the value of upstream transactions.

The main driver of aggregate upstream deal value in Europe was Letter One Group’s US$7.1 billion acquisition of German-headquartered RWE Dea. RWE Dea was the upstream subsidiary of utility, RWE ag. Following a slightly different route, E.On, another large German utility, recently announced its plans to split its business into two by separating out businesses in E&P and conventional power generation. The other big deals for the region in 2014 were Norway Det Norske’s acquisition of Marathon Oil’s Norwegian production company for US$2.1 billion, announced in June 2014, and Wintershall’s acquisition of Norwegian assets from Statoil for US$1.3 billion.

The European downstream sector continued to remain relatively challenged, recording only 15 deals in 2014 at a total value of US$1.3 billion. While the totals in this segment are modest they mask a range of underlying trends. Refining assets without technical complexity, optimal configuration or advantaged logistical positions appear to be over-supplied, with several proposed transactions failing during 2014. Many storage assets, however, remain strategically attractive, particularly where increased imports of refined products are anticipated.

The OFS sector in Europe represents several thousand companies, many with proven capabilities in technically complex products and services, proven to operate in harsh environments, such as the North Sea. With this capability, the European industry has a strong export base and international dynamics have played a key part in many transactions in the sub-sector with companies either seeking capital partners for global growth or being acquired to expand overseas businesses’ product offerings. While not included in the European regional totals, SNC Lavalin’s US$2.8 billion acquisition of Kentz was the largest European OFS deal in 2014.
Beyond the established oil and gas industry, Europe is home to a range of capital markets which are important sources of funding for the oil and gas sector on a global scale. 2014 started on a positive note for both equity and debt markets, with optimism about returning IPO activity. The year ended, however, more bearishly with stock market indices following commodity prices downwards. EY’s Oil & Gas Eye index, which tracks the top 20 oil and gas companies listed on London’s AIM market fell 55% during the year. In debt markets, yield-hungry investors provided some support to the sector, but looming redeterminations on reserve-based facilities augurs for a difficult start to 2015.

Economic strengthening in Europe is a positive for 2015. However, a meaningful element of GDP growth in Europe is likely to be as a result of the recent significant declines in oil prices, which began in the last half of 2014. This depressed price environment will be the much more significant factor shaping Europe’s oil and gas transaction landscape in 2015. The North Sea is a relatively high-cost environment and falling commodity prices are likely to have an immediate impact on project economics, with postponements or divestments likely to follow in the upstream market. Volumes and margins will come under pressure for the supply chain. In contrast to prior years, well-managed downstream operations may prove to be the most resilient market segment.

We expect capital conditions for many operating in the sector to tighten as reduced operational cash flows combine with lower lending capacity and equity markets favoring other sectors. This is likely to lead to transactions born of necessity and opportunism, with consolidation progressing in the supply chain. Fiscal policy setters in North Sea regions, as well as the UK’s new industry regulator, will need to adapt quickly to this new landscape.
India

Oil and gas transaction activity in India in 2014 was rather limited, but nonetheless increased from 2013. Reported deal values and the number of deals both increased for 2014. The upstream segment led in terms of deal volumes, but deal values involving Indian upstream assets were not publically reported. Inbound activity in the OFS and downstream oil and gas distribution space also increased.

While upstream transaction activity for Indian upstream assets is fairly limited, inbound and domestic deal activity in the upstream sector was very limited due to the prevailing policy environment in the first half of 2014. However, Indian oil and gas companies, principally the Indian NOCs, were also involved with several notable outbound upstream transactions in 2014. The largest of these outbound transactions in 2014 was Indian Oil Corporation's (IOCL) US$1 billion acquisition of minority interest in Pacific Northwest LNG project from Progress Energy. Located in British Columbia, Canada, the project provides access to substantial gas reserves for export to overseas markets via LNG, thus providing long-term supplies for IOCL.

Oil India Limited also acquired a 50% interest in a Russian oil field from Petroneft and Prize Petroleum (the exploration and production, subsidiary of the downstream major Hindustan Petroleum Corporation Limited) acquired a minority stake in BassGas project in Australia from AWE. Both transactions provided the acquirers overseas producing assets to add to their existing portfolios.

Besides producing assets, 2014 also saw interest amongst Indian E&P players in late-stage exploration and discovered assets, as Reliance Industries (RIL) acquired the Ayacucho block B prospect in Venezuela in partnership with PdVSA, while ONGC Videsh acquired two exploration blocks offshore Vietnam.

Outbound E&P M&A activity is expected to pick up in 2015 with Indian NOCs looking to participate in license rounds, as well as acquiring producing assets. The Indian Government has also been actively working towards encouraging participation of foreign players and it is looking to attract financial and technical resources to increase exploration of conventional and unconventional oil and gas with the goal to increase domestic production. While the impact of softening crude oil prices on the global M&A market needs to be assessed, the appetite of Indian NOCs is expected to be high in 2015.

The Indian OFS sector witnessed increasing inbound interest in 2014 with the acquisition of Yennai Hydrocarbon Services Pvt Ltd by US-based Superior Energy Services Inc. The sector also witnessed consolidation in the offshore vessels space with HAL Offshore’s acquisition of Technip’s stake in SEAMEC. Recent policy reforms by the Indian Government to withdraw price preference available to domestic companies against their foreign counterparts are expected to create a more competitive OFS market. As a result,
2015 is expected to witness an increase in domestic E&P activity which augurs well for OFS demand in India. There could be greater inbound interest for global players to create market presence in India.

Major domestic downstream transactions in India included the Government of India selling its 10% stake in IOCL to ONGC and Oil India (both are Government of India owned upstream companies) for approximately US$900 million, as part of its plan to reduce its equity in public sector companies. Other downstream activity in 2014 saw inbound transactions by Gulf Petrochem Group, acquiring a majority stake in Sah Petroleum (lubricants) and a bitumen plant located in Gujarat from Royal Dutch Shell. Transaction activity also occurred in the petroleum products space with Itochu, a Japanese multinational, acquiring strategic interest in Aegis logistics (LPG storage terminals). The central theme for buyers in these transactions was to obtain access to the Indian market.

In November 2014, the Indian Government announced deregulation of diesel prices in the country. This move will enable privately owned fuel retailers to be profitable in the current crude price environment. As a result, 2015 is expected to witness increased inbound interest in the refining sector, particularly from Middle East-based players seeking to tie up long-term crude supply contracts to India.

The gas distribution sub-sector witnessed a consolidation transaction with Indraprastha Gas Limited (gas distribution company in National Capital Region, Delhi) acquiring a majority stake in Maharashtra Natural Gas Ltd. (gas distribution company in Pune). The Indian Government also concluded the fourth round of bidding for laying gas distribution networks for 14 geographical areas. More rounds of bidding are expected in the near term as it is high on the Government’s agenda, due to the associated social and economic benefits. With gas supplies in the country expected to improve with new upcoming LNG regasification terminals in the next three to five years, M&A activity in gas distribution sector is expected to continue through 2015 with inbound interest and consolidation in the sector.
Latin America/Caribbean

The rather strong transaction activity levels in Latin America/Caribbean in 2013 was not repeated in 2014. Total reported oil and gas deal value in 2014 was US$12.4 billion, down 55% compared to 2013, while deal volumes were down 35%.

Activity in the region continues to be primarily upstream focused, but reported value was down more than 50%, and upstream deal volumes down 36%. And while the region again saw healthy activity in the midstream sector, reported midstream deal values were down relatively sharply in 2014.

While Brazil still remains a major focus for transaction activity in the region, regional activity has gradually become more diversified, growing particularly strongly in Colombia and Argentina. The region has historically been an attractive target for NOCs, particularly Asian NOCs however, its attractiveness has waned slightly in recent years.

The three major deals for the region in 2014 included: Pemex selling its 7.9% stake in Repsol, worth US$2.8 billion in the public market; Repsol selling an 11.9% interest in YPF to Morgan Stanley for US$1.3 billion; and Royal Dutch Shell selling its interest in a Brazilian offshore development to Qatar Petroleum for US$1.0 billion.
Middle East

While the Middle East has substantial oil and gas reserves and production, in the context of the global transactions market both current and historic levels of activity are relatively low. Transaction activity in 2014 was very quiet and only upstream witnessed any deal activity.

Middle East oil and gas transaction activity (excludes oilfield services)

From an upstream perspective while the number of transactions decreased from 32 to 12 from 2013 to 2014, the total value was only marginally down at almost US$600 million. In terms of the upstream sector, Middle East transaction value relative to the total global upstream transaction value represented less than 0.3% in 2014, which is the lowest share over the past five years. The deal activity was geographically spread over the Middle East region with countries such as the UAE and Iraq being the locations of multiple transactions. Looking forward, Occidental Petroleum is still looking to sell stakes in their oil and gas assets in the Middle East, which could be material in the context of the Middle East transaction market in 2015.

As is consistent with the past three years, no midstream transactions were completed in 2014. This is a result of the very high level of state ownership with regard to these strategically important assets and therefore little, if any, availability in the market. Finally in the downstream sector, again, there were no transactions in the Middle East which is against a backdrop of only very limited transaction activity in 2012 and 2013. Looking forward there are a number of potential green field and brown field (upgrading and expansion) refinery projects in the region that could drive some future transaction activity.

Source: EY analysis of data from Derrick Petroleum
Transaction activity in Russia and the CIS countries in 2014 was significantly down compared with the previous two years. The total announced value of deals in the region was US$11.2 billion (67% less than 2013). The number of deals declined from 82 to 50 in 2014. The main reasons for this decline include the macroeconomic uncertainties, geopolitical situation regarding Ukraine and a deterioration in relations between Russia, the driving country in the area, and certain western countries.

The biggest decline in M&A activity occurred in the upstream segment (40 deals in 2014 vs. 73 in 2013). From a regional perspective, the largest transaction value was in Azerbaijan. In October 2014 the Malaysian oil and gas company Petronas acquired Statoil’s interest of 15.5% in the Shah Deniz production sharing agreement, as well as 15.5% share in the South Caucasus Pipeline Company (SCPC), and a 12.4% share in the Azerbaijan Gas Supply Company (AGSC). The announced deal value was US$2.25 billion. In May 2014, Total sold its 10% interest in the Shah Deniz field and the South Caucasus Pipeline to the Turkish state-owned E&P company TPAO for US$1.5 billion.

In Kazakhstan, Lukoil, Russia’s independent vertically integrated oil company and the country’s second-largest oil producer, sold its 50% share in Caspian Investment Resources Ltd to Sinopec, the Chinese state-owned enterprise, for US$1.2 billion. The acquired company holds stakes in four projects in central Asia. Another Chinese NOC – CNPC – acquired 10% in Russia Vankorskoye field, Eastern Siberia from Rosneft for US$1 billion. This confirms that the Upstream CIS region continues to be interesting for Asian companies. About 20% of upstream buyers in CIS countries were Asian companies in 2014.

The activity in downstream was initiated by local companies. While downstream M&A activity was rather limited, reported deal value was up rather sharply to US$1.8 billion, compared to US$0.8 billion in 2013, while the number of downstream deals in the region was up from 4 to 6. The largest announced deal of the segment was for US$1.6 billion, when Russia’s integrated gas processing and petrochemicals company SIBUR acquired the remaining 49% stake in Yugragazpererabotka, its joint venture with the state owned Rosneft, in early 2014. Yugragazpererabotka holds two gas processing complexes as well as pipeline infrastructure.
While the US oil and gas transaction market experienced a solid progression through the majority of the calendar year, the end of 2014 saw a precipitous decline in the price of oil. As a result, the expectations for 2015 (especially the first half) are not an extrapolation of the annual trends witnessed in 2014.

A consistent theme for US oil and gas transaction activity in 2014 was continuing investment in the midstream segment. Of the ten largest transactions in the year, six were midstream transactions including two megadeals seen in Q3 and Q4 of 2014 – Access Midstream’s US$34 billion acquisition of Williams Partners and Kinder Morgan’s US$71 billion roll-up of its two managed MLPs (Kinder Morgan Energy Partners and El Paso Pipeline Partners). US MLPs continued to dominate the transaction scene, given the tax and cost-of-capital advantages of these structures.

In 2014, the midstream sector was active but realized a 14% decrease in deal volume as compared to 2013. Conversely, deal values nearly tripled as compared to 2013, due largely to the Kinder Morgan and Access-Williams megadeals. One potential contributor to the activity in this space was the increased number of publicly-traded midstream companies (mostly MLPs) electing to grow through acquisition. In 2014, there were 11 MLP IPOs, including two of the largest MLP IPOs ever (Antero Midstream Partners LP and Shell Midstream Partners LP).

US upstream reported deal values increased by almost 55%; however deal volumes decreased about 14%. The US upstream transactions accounted for about 35% of all US oil and gas reported transaction values in 2014, which was much lower than what the sector typically accounts for due to five of the six largest deals accounted for in other sectors. However, from a deal count perspective the upstream sector continues to dominate the US oil and gas universe, accounting for almost 83% of all transactions. Some of the largest deals in the upstream sector included: Encana’s acquisition of Athlon Energy for approximately US$7 billion, and Whiting Petroleum’s acquisition of Kodiak Oil & Gas for about US$6 billion.

Looking at the US upstream deals by type, there seems to have been a shift in the preference for assets that are further along in terms of development maturity. Transactions featuring new exploration awards, farm-ins, and discovered/undeveloped assets are declining in relative terms, while corporate deals have increased, as have deals involving assets under development. Interest in producing assets continues to account for the largest portion of deals.

Total reported transaction value in 2014 was significantly up versus that in 2013, although transaction volumes were down approximately 11%. Reported oil and gas transaction values collectively for the three segments (i.e., upstream, downstream and midstream, excluding OFS) increased almost 120%; however two megadeals constituted more than 43% of the total reported US deal value of the year. The exclusion of these outliers still saw a 25% year-on-year increase for 2014. In general, the year was characterized by a thinner flow of US oil and gas M&A transactions, but with larger transaction values in nearly all sectors, including a particularly large uptick in reported deal values for the third and fourth quarter of 2014, due to the megadeals.

**Source:** EY analysis of data from Derrick Petroleum
Unlike the other sectors, the US downstream space realized an increase of nearly 89% in both reported deal values and deal volumes in 2014 versus 2013. The marketing/retail space saw the most prominent activity of the downstream sector, with Hess selling its retail chain of convenience stores among other assets to Marathon Petroleum for US$2.6 billion and Energy Transfer Partners acquiring Susser Holdings and its retail operation of over 600 stores for US$2.4 billion. The refining and petrochemical space has remained relatively quiet; but in the absence of strong product demand growth, the price collapse should compress refining margins, potentially creating financial stress for some companies, and potentially some transaction opportunities. Similarly, the dramatic shift in relative petrochemical feedstock pricing (i.e., gas/ethane-based vs. oil/naphtha-based) may open some transaction opportunities.

Looking to the coming year, the US macro economy is generally seen as strengthening - consumer and business confidence continue to be quite strong, with lower energy prices generally seen as a net positive driver for the broader economy, while clearly adversely impacting some industry sectors, like oil and gas. The price of oil will remain at center stage as the market seeks to determine the current state of the commodity fundamentals. The uncertainty of the timing of a recovery in commodity prices, additional potential regulation, and uncertainty as it relates to the global economy all remain key factors for the US oil and gas industry. On the positive front, significant PE capital targeting oil and gas investments, divestitures from megadeals, and divestitures by companies seeking to reallocate resources and focus on core operations imply a potentially strong oil and gas deal flow in the intermediate future.

The lower prices that we expect for 2015 should, however, spur additional upstream transaction activity as they continue with rising cost pressures, an increasing focus on portfolio high-grading/optimization, and increasing capital market tightness. Some smaller, highly-leveraged E&P companies will struggle to fund their operations, with consequently more distressed assets on the market, and some rising risk of default.

The expected reductions to upstream spending will direct much of the pressure to the OFS segment, and we expect some further consolidation as a result. There are also expected to be some assets divested in 2015 by Halliburton/Baker Hughes as a condition of their merger approval.

The continuing infrastructure build-out should also feed continuing consolidation, particularly in the MLP part of the segment. In the downstream segment, with the low prices and the current forward market structure (i.e., a contango market), storage/terminal assets are becoming particularly attractive. These same assets will also be increasingly attractive if US product exports stay strong and if crude oil exports become fully allowed.
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Global Capital Confidence Barometer
The Global Capital Confidence Barometer is a regular survey of senior executives from large companies around the world, conducted by the Economist Intelligence Unit (EIU).

Cash in the barrel
The study shows that global oil and gas companies decreased their working capital (WC) performance in 2013, with C2C increasing 2%. Despite the setback last year, the oil and gas industry as a whole still reported an overall drop of 4% in its C2C between 2007 and 2013.

Global oil and gas reserves study 2014
The Global oil and gas reserves study is a compilation and analysis of certain oil and gas reserve disclosure information as reported by companies in their annual reports filed with the United States (US) Securities and Exchange Commission (SEC) or in their publicly available annual reports. This report presents the worldwide and regional exploration and production (E&P) results for 75 companies for the five-year period from 2009 through 2013.

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