Mergers Alliance

# Brazil Oil & Gas

## M&A update

Spring 2013

Key major oil & gas frontier for international corporates

# Companies targeting US$400 billion opportunity

**Brazil is on the verge of an energy boom. Recent major oil & gas discoveries in offshore deepwater 'pre-salt' fields will move the country into the top five producers globally by 2020.**

**The resumption of exploration auctions in 2013 will boost M&A activity as international corporates across the supply chain position themselves to benefit from the associated investment.**

"Brazil is transforming itself into one of the world's most important oil & gas producers. We are seeing large and smaller foreign corporations across the supply chain using different M&A strategies to enter the market."

**Leonardo Antunes**, Managing Director, BroadSpan

## Key findings from our research:

- State-owned Petrobras is investing US$225 billion in energy projects to meet its goal of doubling oil production by 2020. Local industry will be a major beneficiary of this investment due to government regulation regarding local content (see page 5). However, Petrobras also needs the expertise of international corporates. This is creating high value opportunities for foreign corporates across the supply chain.

- Three new auction rounds will take place during 2013 covering 289 exploration blocks, pre-salt and shale gas. They will be a catalyst for M&A and new investment as local and international companies look to add reserves and suppliers position themselves to win a share of the spend.

- Some international companies in the supply chain have established a local presence. However, many are using joint ventures and acquisitions of domestic businesses to ensure they meet local supplier content and gain the approvals necessary to supply to Petrobras.

Global majors are making a long-term commitment to Brazil

# A major offshore oil and gas frontier

**Brazil is now the ninth largest oil producing country, accounting for around 25% of global output. One third of global reserves discovered in the last five years were found in Brazil, including the major find in the offshore deepwater "pre-salt" layers off the South East coast. By 2020, Brazil is aiming to be a top five global oil producer.**

The country has been self sufficient in oil since 2006. Estimates that the pre-salt fields hold reserves of 20 billion barrels is leading to export forecasts of around 1.5 million barrels of oil per day (bbl/d) by 2020. This compares to 8.5 million bbl/d currently exported by Saudi Arabia.

### Petrobras dominates energy production

- State-backed Petrobras accounts for around 90% of Brazil's total oil & gas production. It benefits from regulatory advantages over other competitors. For example, the production sharing contract regime (PSC) established under the 2010 Pre-Salt Law requires Petrobras to be the operator on all pre-salt oil fields and to hold a 30% stake in other non-exclusive fields.

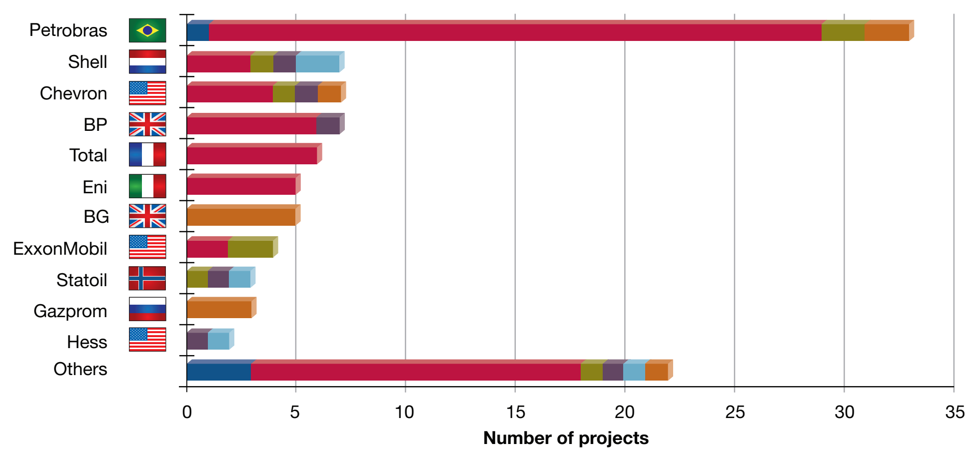
- Independent Brazilian oil & gas companies including Cosan, Queiroz Galvão and OGX are becoming established players.

Global oil & gas majors are committed to Brazil with around 40 international companies active in Brazil's upstream market (see Figure 1).

- US major Chevron holds working interests ranging from 30% to 52% in fields with average daily production of 71,000 barrels of crude oil and 28 million cubic feet of natural gas. Chevron's largest investment in Brazil is the development of its 37.5% interest in the subsea Papa-Terra field, located in the key Campos Basin. Planned total daily capacity of 140,000 barrels of crude oil is expected in 2013 via production using floating production, storage and offloading (FPSO) facilities.

- BG, the largest UK investor in Brazil, has invested over US$5 billion since the mid 1990s. It plans to invest a further US$30 billion over the next decade. BG is a partner in four offshore blocks alongside Petrobas, Repsol, Sinopec Brasil and Petrogal, with estimated total reserves of six billion barrels of oil equivalent. BG has a majority shareholding in Comgás, Brazil's largest natural gas distributor, and a stake in the gas pipeline which runs between Brazil and Bolivia.

Figure 1: **Petrobras and selected global oil majors offshore projects**




**Note:** Includes offshore projects in conceptual phase, FEED, under bidding or under construction

***Source:*** *Petrobras 2012, BG*

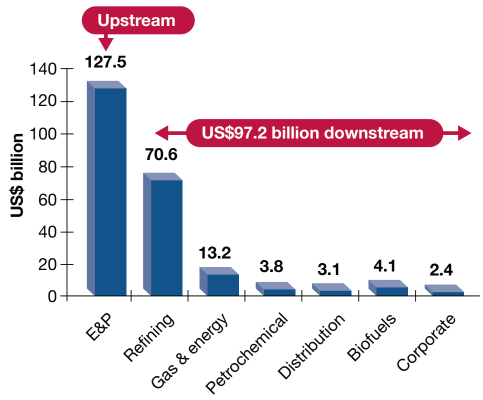
New auctions will boost activity by global majors

- China is becoming a significant player. In 2009, China extended a US$10 billion credit line to Petrobras to develop offshore oil. Terms included an increase in oil exports to China. Sinopec is now one of the sector's largest investors. Both Sinopec and Sinochem are growing their market share via acquisitions of assets in oil fields (see page 6).
- The Round 11 Auctions to be held in May 2013 (which will include 289 exploration blocks) and Pre-Salt and Shale Gas bidding rounds later in the year will increase the penetration of foreign majors and boost M&A. The strategies used to participate in bidding will be affected by the different rules governing each auction (concession agreements, production sharing contracts and the dominance of Petrobras as the operator of all pre-salt blocks for example). Different rules will also affect how the unitization process is conducted and therefore the value of individual blocks.

**Petrobras leading a massive investment programme**

- Petrobras has the highest production growth rate amongst the oil producers operating in Brazil. To achieve this, its current five year business plan is built around a US$225 billion investment plan which includes US$127.5 billion in the exploration and production (E&P) sector (see Figure 2). This investment will enable Petrobras to double its oil production for both domestic consumption and exports to over four million barrels per day by 2020.
- Local producers and the global majors are also making significant investments to develop E&P in strategically important oil fields. Total investment in Brazil's E&P sub-sector is forecast to reach US$400 billion (including Petrobras' expenditure) by 2020.

Figure 2: **US$224.7 billion investment by Petrobras**




**Source:** *Petrobras*

# The global outlook

**The world proven oil reserves total approximately 1,383 billion barrels of oil equivalent (BOE). The Middle East represents almost 54% of the total.**

**Increasing demand for energy**

In line with the increase in global economic growth estimates for 2013, forecasts for oil and gas consumption are positive, mainly due to Chinese import demand. BP is forecasting oil consumption will grow by 1.6% a year, leading to 36% growth between 2011 and 2030. More than 90% of the growth is forecast to come from non-OECD countries.

**High oil price supporting deepwater drilling**

The stable high oil price has underpinned investment in deepwater drilling technology and made difficult recovery environments economic. This has led to a significant shift in the outlook for new reserves and the recovery potential of previously difficult hydrocarbons – tight oil, shale oil & gas and oil sands.

Mid-market companies using tier 1 suppliers to enter market

# Long-term opportunities across the supply chain

A significant amount of infrastructure investment is needed to exploit Brazil's deepwater oil and gas reserves. Strict local content rules mean Brazilian companies are playing a major role across the supply chain (see page 5). However, limited local expertise and capacity means production targets will not be met without the participation and technical expertise of foreign operators.

Areas where Petrobras has highlighted it needs the expertise of foreign corporates include:

- Upstream opportunities related to E&P including testing and drilling equipment, oil platforms and drilling components, installation of exploration equipment and equipment maintenance.
- Downstream opportunities include oil & gas transport, refinery, petrochemistry and maintenance/monitoring equipment.

**Mid-market also seizing opportunities**

For some mid-sized component and service suppliers, the most effective approach to enter the market is via first tier suppliers. Large Brazilian and international companies like GE, Aker and Cameron are providing supply chain opportunities. Petrobras wants to develop standardization in many components and so supply contracts to both Petrobras and tier 1 suppliers can be substantial (see Spotlight below).

> "Our customers are moving more and more of their production to Brazil and it is crucial to ensure that we have manufacturing close to their units."
>
> **Lennart Johansson**, President Trelleborg Engineered Systems, commenting on the acquisition of a subsidiary of Veyance Technologies Inc
>
> ***Source:*** *Trelleborg press release*

## Spotlight: selected opportunities in the subsea E&P supply chain

| | Opportunity | Lead supplier | Support supplier |
|---|---|---|---|
| **Servicing**  | ■ Offshore oil drilling facilities need constant supplies during and after construction<br>■ Petrobras estimates it will need 235 support vessels by 2020 | ■ Brazil's Wilson Sons provides services within shipbuilding and shipping. It has a service contract with Petrobras to transport supplies | ■ Netherlands-based Damen Shipyards is building new tugs (in Brazil) and providing offshore supply vessels (OSV) to Wilson Sons. OSV engines include Caterpillar generator sets that power Rolls Royce azimuth thrusters |
| **Well construction**  | ■ Equipment which goes on the sea bed and enables production<br>■ Petrobras is constructing 48 drilling rigs and 38 oil production platforms | ■ GE's oil and gas business will supply Petrobras with 380 subsea wellhead systems valued at US$1.1 billion. Over 75% of parts will be made in Brazil | ■ In 2012 UK subsea engineering specialist Viper Subsea won an order with Petrobras through a first tier supplier to supply underwater components |
| **Drilling vessels**  | ■ Offshore drilling vessels<br>■ Petrobas needs over 30 new drilling vessels | ■ Singapore's Sembcorp Marine's wholly-owned Brazilian shipyard Estaleiro Jurong Aracruz secured a US$793 million contract from Guarapari Drilling BV, Netherlands, a subsidiary of Sete Brasil Participacões | ■ Austria-based Palfinger Dreggen has a US$121 million contract to supply cranes to the Jurong Shipyard |

***Source:*** *Mergers Alliance, company press releases*

# Market entry strategies influenced by local protection measures

**Government regulation influences the strategic options available to international companies targeting the sector. Most are entering the supply chain via joint ventures with, or acquisitions of, mid-sized domestic companies which ensure they can participate in Petrobras tenders and meet Brazil's local content policy.**

### Petrobras approved suppliers' register

- Companies awarded contracts and orders directly from Petrobras are chosen from the company's Supplier Approval Register. Registration can be highly bureaucratic and slow and foreign companies are required to have a legal representative in Brazil to fulfill legal and financial requirements.
- Acquisitions and joint ventures are often the easiest way to enter the register. There are over 5,500 companies on Petrobras' supplier register so significant M&A opportunities exist.

For example, US well completion specialist FTS International entered a joint venture in 2012 with privately-owned Brazilian E&P PETRA Energia, which will provide well completion products and services for onshore conventional and unconventional oil and gas wells in Brazil.

### Local content regulations

Legislation enforced by penalties requires goods and services used in the oil & gas industry have a significant level of "local content".

- Joint ventures enable international companies to ensure that they meet regulations while often increasing the competitiveness of their locally-based partner with regard to price, delivery schedule and quality requirements. For example, French oil service company Technip and Brazilian services provider Odebrecht agreed a joint venture which won a five-year contract estimated to worth US$1 billion to supply two pipeline installation ships to Petrobras.
- Some companies are using acquisitions to accelerate their entry into the sector. For example, UK-based Hydrasun acquired Remaq Ltda, a Brazil-based provider of flexible hose assemblies, in 2011 (see case study below).

M&A and joint ventures enable corporates to meet strict Brazilian regulation

## Market entry case study: Hydrasun, UK-based provider of fluid control equipment

**The strategic importance of Brazil**
Hydrasun was attracted to the scale of investment being made to access deepwater reserves. Customer feedback confirmed that demand from subsea operators and drill equipment manufacturers for Hydrasun's products would be high.

**Acquisition used to gain entry**
Hydrasun decided that an acquisition would fast-track its entry into Brazil and acquired Remaq, a local provider of flexible hose assemblies, in 2011. Remaq had a complementary business model and a proven record with Petrobras, ensuring Hydrasun would meet local content regulations and avoid Petrobras' supplier approval process.

**Local acquisition enhanced value to acquirers**
Equistone Partners led a management buy-out of Hydrasun in 2007 which valued the business at around US$115 million. Revenue has grown from US$75 million in 2008 to US$157 million for financial year 2013.

The Investcorp Gulf Opportunity Fund acquired a controlling stake in Hydrasun in February 2013 attracted by its presence in high growth markets including Brazil and the Gulf Coast.

Corporates will use M&A to meet demands of new deepwater projects

# New auctions will drive M&A

**The size of the potential deepwater oil & gas reserves and the level of investment by Petrobras and the global majors has driven M&A over the last five years.**

**The number of deals has fallen from a peak of 24 in 2010, a record year, to 15 in 2012 (see figure 3). The fall was due to uncertainty regarding the timing and terms of new exploration auctions, and concerns about the scale of capital expenditure being undertaken by Petrobras and its impact on the company's cashflow. However, the 2013 bidding rounds will act as a catalyst for partnerships and M&A as the majors and leading suppliers look to expand their operations.**

Domestic and international private equity active in the sector

Inbound M&A is being driven by three main types of international acquirers.

### National oil companies

- China has been one of the most active acquirers. In 2011, Sinopec acquired a 30% stake in the Brazilian assets of Galp Energia, the Portuguese energy company, for US$5.2 billion. Chemicals company Sinochem acquired a stake in the Peregrino Oil Field from Statoil in 2010.

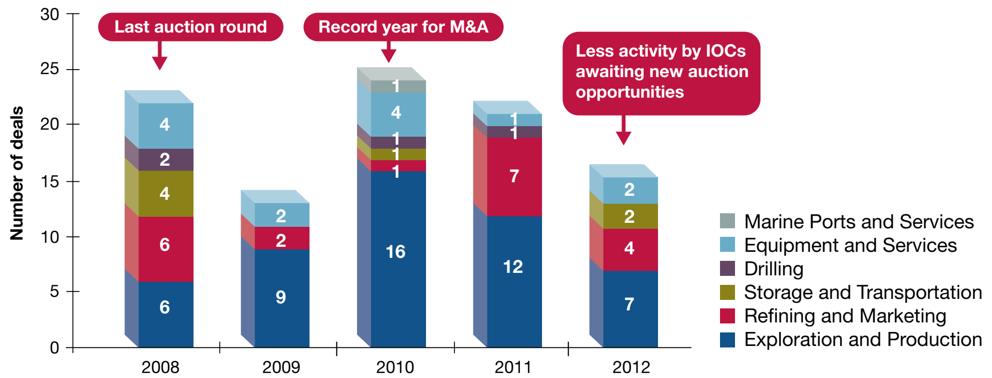
### Global majors and equipment providers

- Oil majors are using acquisitions to grow reserves. Maersk Oil's US$2.4 billion acquisition of SK do Brasil, owned by South Korea's SK Energy, gave the oil producer access to three offshore oil blocks.
- Trelleborg acquired a Brazilian subsidiary of Veyance Technologies Inc which produces hoses for surface and deepwater applications in Brazil in 2011 for US$6.3 million.
- Tuscany International Drilling's acquisition of Drillfor for US$62 million in 2011 quadrupled the company's Brazilian fleet, giving a 15% to 20% market share in the offshore drilling market. Contracts with Petrobras and Petrogal were part of the sale conditions.

### Private equity

- Private Equity (PE) is increasing its participation in projects. Both domestic energy-focused and generalist funds are investing. In 2011, BTG Pactual announced a partnership with Brasbunker, a holding company that controls companies in bunker transport, support for offshore platforms.
- International PE is active and competing for specialist operators. Singapore's Temasek acquired a 14.3% stake in the oil services unit of Brazilian Odebrecht for US$400 million.

Figure 3: **M&A in Brazil's Oil & Gas sector since 2010**




*Source:* *Capital IQ, Mergers Alliance*

# Figure 4: Selected M&A transactions

| Date | Target company | Country | Target Activities | Acquirer | Country | Deal value (US$ mm) | Deal Type |
|---|---|---|---|---|---|---|---|
| Feb-13 | Hydrasun | UK | Oil & Gas Equipment and Services | The Investcorp Gulf Opportunity Fund | Bahrain | NA | Private equity |
| Feb-13 | Georadar Levantamentos Geofisicos | Brazil | Oil & Gas Equipment and Services | Modal Administradora de Recursos | Brazil | 50.4 | Private equity |
| Dec-12 | Alvorada Petroleo | Brazil | Oil & Gas Exploration and Production | Fortress Energy | Canada | 37.0 | Inbound |
| Aug-12 | Sete Brasil | Brazil | Oil & Gas Exploration and Production | Petrobras and BTG Pactual | Brazil | 2,709.9 | Domestic, Private equity |
| May-12 | WFS Sondagem | Brazil | Oil & Gas equipment and services | Foraco International | France | 19.8 | Inbound |
| May-12 | Prooceano | Brazil | Environmental Services for Oil and Gas | Collecte | France | NA | Inbound |
| Mar-12 | Shell, BM-S-45 Exploration Block in the Santos Basin | Brazil | Exploration Block | Petrobras | Brazil | NA | Domestic |
| Feb-12 | Petrogal Brazil | Brazil | Oil & Gas Exploration and Production | Sinopec | China | 4,800.0 | Inbound |
| Dec-11 | Raízen, Aviation Fuel Assets | Brazil | Oil & Gas Storage and Transportation | BP | UK | 100.0 | Inbound |
| Dec-11 | Alvorada Petroleo | Brazil | Oil & Gas Exploration and Production | Fortress Energy | Canada | 37.7 | Inbound |
| Oct-11 | Repsol Gas Brasil | Brazil | Oil & Gas Refining and Marketing | Ultrapar Participacoes | Brazil | 27.5 | Domestic |
| Sep-11 | Shell, Block BS-4 in Santos Basin | Brazil | Exploration Block | Barra Energia | Brazil | 52.5 | Domestic |
| Sep-11 | Tropical BioEnergia | Brazil | Oil & Gas Refining and Marketing | BP | UK | 59.8 | Inbound |
| Jul-11 | SK do Brasil | Brazil | Oil & Gas Exploration and Production | Mærsk | Denmark | 2,400.0 | Inbound |
| May-11 | Drillfor Brasil | Brazil | Oil and Gas Exploration and Production | Tuscany International | Canada | 52.0 | Inbound |
| Apr-11 | Veyance Technologies, Plant Located in Santana de Parnaiba | Brazil | Oil & Gas equipment production Plant | Trelleborg | Sweden | 6.3 | Inbound |
| Apr-11 | Statoil, Peregrino Oil Field In Brazil | Brazil | Oil Field | Sinochem Group | China | 3,070.0 | Inbound |
| Dec-10 | Agua Grande Exploracao e Producao de Petroleo | Brazil | Oil & Gas Exploration and Production | Brookwater Ventures | Canada | 4.3 | Inbound |
| Oct-10 | Odebrecht Óleo e Gás | Brazil | Oil & Gas Exploration and Production | Temasek | Singapore | 400.0 | Private equity |
| Oct-10 | Repsol | Brazil | Oil & Gas Exploration and Production | Sinopec | China | 7,175.3 | Inbound |
| Sep-10 | Brasbunker | Brazil | Oil & Gas Services | BTG Pactual | Brazil | NA | Private equity |
| Apr-10 | Starfish Oil & Gas SA | Brazil | Oil & Gas Exploration and Production | Sonangol | Angola | NA | Inbound |
| Mar-10 | Delba Maritima Navegacao | Brazil | Oil & Gas equipment and services | BOURBON | France | NA | Inbound |
| Jan-10 | CNEC Engenharia | Brazil | Engineering and project management services | WorleyParsons | Australia | 96.5 | Inbound |

***Source:*** *Mergers Alliance, Captial IQ*

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