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Oil price slump not all sweet for SPACs

THE current oil and gas price slump may be causing hardship to many players in the industry, except perhaps one group – listed special-purpose acquisition companies or SPACs.

by Ho Chung Teng

A SPAC is an investment structure which allows investors to put their money in a listed shell or blank-cheque company which has no operations but has an intention to acquire assets within three years of listing. Currently, the listed SPACs are CLIQ Energy Bhd, Sona Petroleum Bhd and Reach Energy Bhd. The first listed SPAC was Hibiscus Petroleum Bhd which has since graduated into a junior oil and gas (O&G) company.

On April 2, Sona Petroleum and Reach Energy closed at 42.5 sen and 62 sen respectively, below their initial public offering (IPO) prices of 50 sen and 75 sen. However, CLIQ Energy, which has entered into a conditional sale and purchase, saw its price closing at 65 sen on April 2, up 4% from its IPO price of 62.5 sen.

Given the current bearish sentiment in the O&G sector, SPACs should be able to snap up assets at bargain prices and grow them for the benefit of their shareholders. But in reality, such "sweet deals" aren't easy to come by.

Take Sona Petroleum for instance. The company experienced a setback when the acquisition of a qualifying asset (QA) – a 40% stake in Salamander Energy (Bualuang) Ltd – was aborted. The acquisition was approved by the Securities Commission (SC) last November for US$280 mil (RM1.03 bil) but it was terminated and later acquired by London-listed Ophir Energy Plc.

With the setback, Sona Petroleum is under pressure to identify a new asset before its three-year deadline expires in July next year.

Then we have CLIQ Energy which recently entered into an agreement to acquire a 51% stake in a special-purpose vehicle, which has two oilfields in Kazakhstan, for US$117.3 mil. However, the asset valuation was based on crude oil price of US$70.90 per barrel as opposed to US$55 currently. According to CLIQ Energy's managing director and CEO Ahmad Ziyad, the asset will be revalued according to the prevailing crude oil price prior to the shareholders' approval expected at an extraordinary general meeting in October.

Even Hibiscus Petroleum, which graduated into a junior O&G exploration and production company in 2012, is facing issues with its acquisition. Lime Petroleum Plc, in which it has a 35% stake, was reported to be having issues, after hitting a dry well in its newly-se-

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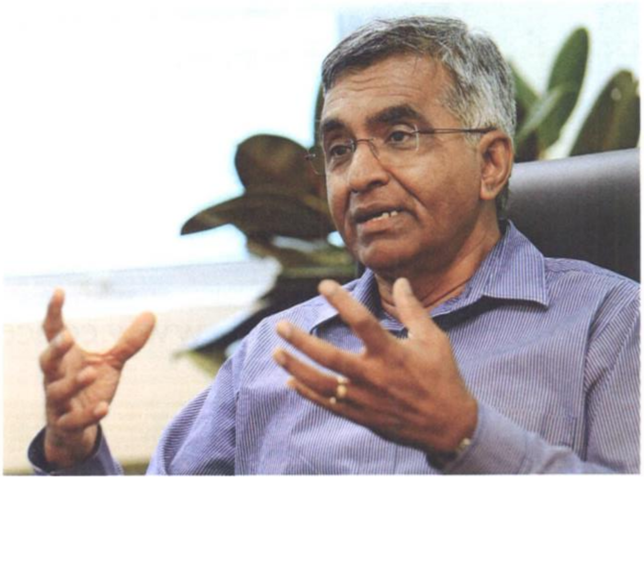
>
> – Shahul Hamid Ismail, MD/CEO, Reach Energy Bhd



REACH ENERGY BHD

Date listed: Aug 15, 2014

Key board members and management
Izlan Izhab *(chairman and senior independent non-executive director)*, Shahul Hamid Mohd Ismail *(managing director and CEO)*, Nik Din Nik Sulaiman *(independent non-executive director)*, Aonghus Joseph O'Caroll *(independent non-executive director)*

Major shareholders	
Reach Energy Holdings	**20%**
Leong Wye Keong	**3.75%**
Employees Provident Fund	**3.64%**
Market cap *(April 2)*	**RM792.2m**
Share price *(April 2)*	**62 sen**
IPO price	**75 sen**
Debut price	**70.5 sen**
52-week high *(Aug 15, 2014)*	**76.5 sen**
52-week low *(Dec 2, 2014)*	**56.5 sen**
Financial results *(H1 ended Jan 31, 2015)*	
Net loss	**RM4.84m**

Timeline

2009

- August – Securities Commission (SC) introduces the special-purpose acquisition company (SPAC) to the local market

2011

- July – Hibiscus Petroleum Bhd is listed on Bursa, raising RM235 mil. It is the first SPAC in Malaysia

2012

- April – Hibiscus secures qualifying acquisition of 35% stake in Lime Petroleum Plc for US$55 mil (RM202 mil)

2013

- April – Initial public offering (IPO) of CLIQ Energy Bhd raises RM364 mil
- June – SC rejects the IPO of two mining-related SPACs – Australaysia Resources and Minerals Bhd and TerraGali Resources Bhd – for not meeting listing criteria
- July – Listing of the third SPAC, Sona Petroleum Bhd, raises RM550 mil

2014

- June – Sona Petroleum's wholly-owned subsidiary Sona Exploration and Production (Thailand) Ltd enters an agreement to acquire 40% stake in Salamander Energy (Bualuang Holdings) Ltd for US$280 mil (RM1.03 bil)
- August – Reach Energy Bhd's IPO raises RM750 mil, the largest among the SPACs

  – SC rejects RM1 bil IPO of Matrix Capacity Petroleum Bhd, an O&G SPAC
- December – Prospectus exposure of Red Sena Bhd, a food and beverage (F&B) SPAC that seeks to raise RM400 mil

2015

- January – Agreement between Sona Exploration and Production and Salamander Energy (Bualuang Holdings) Ltd terminated

  – Crude oil plunges below US$50 (RM180) per barrel, making qualifying assets more attractive to O&G SPACs

  – SC rejects IPO of Chemara Palmea Holdings Bhd, a plantation-focused SPAC that plans to raise RM650 mil
- March – Cliq Energy signs a conditional sale and purchase agreement to buy 51% stake in a producing, onshore oil field from Kazakhstan-based Phystec Firm LLP for US$117 mil (RM421 mil)

CLIQ ENERGY BHD

Date listed: April 10, 2013

Key board members and management
Datuk Azmi Mohd Ali *(independent non-executive chairman)*, Ahmad Ziyad Elias *(managing director and CEO)*, Kamarul Baharin Albakri *(executive director and CFO)*, Abd Hamid Ibrahim *(senior independent non-executive director)*, Tai Keat Chai *(independent non-executive director)*, Andrew Alexander Young *(independent non-executive director)*, Julian Suresh Candiah *(independent non-executive director)*

Major shareholders	
Best Oracle Sdn Bhd	**20%**
Credit Suisse AG	**6.5%**
Julian Suresh Candiah	**3.41%**
Market cap *(April 2)*	**RM410.1m**
Share price *(April 2)*	**65 sen**
IPO price	**62.5 sen**
Debut price	**57 sen**
52-week high *(May 20, 2014)*	**70.5 sen**
52-week low *(Dec 1, 2014)*	**60.5 sen**
Financial results *(Q2 ended Sept 30, 2014)*	
Net loss	**RM6.63m**

cured licensed area PL338C in the North Sea, off Norway.

But despite listed SPACs facing issues of their own, players tell ***FocusM*** the slump in crude oil prices has been positive as the lower prices have reduced the valuation of potential acquisitions.

Based on the SC guidelines, the valuation of SPAC acquisition targets will have to pass through an independent fair valuer and will be based on the current crude oil price before the asset comes before the SC for approval.

Sona Petroleum managing director Datuk Seri Hadian Hashim says: "Given the current trajectory of global oil prices, there are opportunities and value investments for companies in the O&G sector. As assets are now cheaper, there are more choices within our financial capability."

Says Ziyad of CLIQ: "Our main focus is to get this qualifying asset [in Kazakhstan] done. Of course, there are a lot of opportunities given the prevailing uncertainty in oil prices, but we want to focus on the asset we acquired. We have only one year plus left and there is no turning back."

Reach Energy's managing director and CEO Shahul Hamid Mohd Ismail says: "For acquisitions, the market looks slightly better at this stage as the oil price's downward trend has been around for the last six months, so the scenario for acquisitions looks better for us."

In addition to the lower valuations, Shahul says the oil price slump has affected some companies which plan to divest due to issues with financing. "We have come across cases where the company faces a distress situation on the asset as it could not meet financing costs."

However, Hong Leong Investment Bank in a recent research report says the risk for the industry lies with the identification of the QA. Identifying a QA must not take more than three years and there's also the risk of a further plunge in oil prices.

Despite the risks, SPACs say their management has been fully focused on the evaluation of QAs to meet the SC's deadline.

CLIQ Energy explains valuation

CLIQ Energy was recently in the news following its signing of a conditional sale and purchase agreement (SPA) with Phystech Firm LLP. It raised some questions on the Kazakhstan oil exploration and production company as CLIQ used a discounted cash flow method to value the Kazakhstan asset. CLIQ had also used crude oil price of US$70.90 per barrel and this has raised eyebrows given the current lower price.

CLIQ's Ziyad says the company used December's prices as a reference point in negotiating the deal with Phystech, but will evaluate its acquisition price prior to the EGM.

On the US$70.90 per barrel price, Ziyad says: "That is what we call a reference value when we are discussing with the vendor. Even then we are not buying at the net present value. We are still buying below that number as there is room to capture December's price."

CLIQ hired AGR Group's Tracs Consult llc, an independent valuer, to provide an indicative asset valuation. The valuer priced the asset at US$262.4 mil as of March 1.

Ziyad says the company is buying at a discount as the total value for the special-purpose vehicle is US$230 mil which constitutes a discount. However, despite this, minority shareholders still want the company to do a valuation as they feel the acquisition price could be lower given the lower crude oil price now.

Based on Tracs Consult's report, its valuation is based on the discounted cash flow model based on the application of the enterprise value of the oilfield paid in previous acquisitions of companies and assets comparable to surrounding oilfields. It also takes into consideration the value generated from the proposed development plan by CLIQ.

Ziyad says CLIQ has placed a caveat where, if the independent fair market value of the acquisition target is below US$218.5 mil, CLIQ will have the right to renegotiate a new price or walk away from the deal.

"Internally we have done our homework. We know that it will fall within the fair market value, but I'm not saying 100% it will. We have intelligently analysed that the acquisition value is going to be within the fair market value unless oil prices fall to US$20," he adds.

"Even if the net present value (NPV) calculation is based on a 15% discount, we have to get a fair market assessment by an accounting firm to justify the value of the asset."

According to Ziyad, CLIQ has set a

▸ Continues on page 12

"Our main focus is to get this qualifying asset [in Kazakhstan] done. Of course, there are a lot of opportunities given the prevailing uncertainty in oil prices, but we want to focus on the asset we acquired. We have only one year plus left and there is no turning back."

– Ahmad Ziyad Elias, MD/CEO, CLIQ Energy Bhd

"Given the current trajectory of global oil prices, there are opportunities and value investments for companies in the O&G sector. As assets are now cheaper, there are more choices within our financial capability."

– Datuk Seri Hadian Hashim, MD, Sona Petroleum Bhd

SONA PETROLEUM BHD

Date listed: July 30, 2013

Key board members and management
André van Strijp *(chairman)*, Datuk Seri Hadian Hashim *(MD and non-independent executive director)*, Datuk Maznah Abdul Jalil *(CFO and non-independent executive director)*, Myo Thant *(non-independent non-executive director)*, Anton Tjahjono *(non-independent non-executive director)*, Mohamed Sabri Mohamed Zain *(non-independent non-executive director)*, Datuk Mohamed Khadar Merican *(independent non-executive director)*, Datuk Seri Panglima Sulong Matjeraie *(independent non-executive director)*

Major shareholders	
Platinum Autumn Sdn Bhd	**20%**
SMB Resources Sdn Bhd	**2.84%**
Islamic Banking and Finance Institute Malaysia Sdn Bhd	**1.67%**
Market cap *(April 2)*	**RM599.6m**
Share price *(April 2)*	**42.5 sen**
IPO price	**50 sen**
Debut price	**45 sen**
52-week high *(June 2, 2014)*	**62 sen**
52-week low *(Dec 2, 2014)*	**39 sen**
Financial results *(Q4 ended Dec 31, 2014)*	
Net loss	**RM19.47m**

CLIQ says sufficient due diligence on Phystech

▸ From page 11

minimum target internal rate of return of 15% per annum for its oil and gas asset. "We tell our investors that our return is 15%, so this purchase we are making at a 15% discount. From that alone we have passed our targeted rate already," he says.

Some shareholders have raised questions about Phystech being previously a target of Hong Kong's Willie International Holdings Ltd. The deal was terminated after Phystech failed the latter's due diligence test.

Ziyad says he has no comments on the termination of the acquisition by Willie International, but adds that during the due diligence process, CLIQ identified some issues. "I'm sure there are some issues but we are buying this company as if it's a new company because we are transferring only the subsoil use rights, human resources and licences to operate the oilfield and contracts."

In addition, Ziyad says the company has performed sufficient due diligence on Phystech's liabilities, financials and legal obligations, ensuring that "bad assets" are removed prior to acquisition.

"So we are smart in that way. We leave all the problems behind. We bring what is needed for the company, such as the subsoil use rights and human resources because they have a track record in running the field."

However, the company's announcement on the conditional SPA did not lift its share price. The counter closed at 65 sen on April 1 compared with 68 sen prior to the announcement on March 24.

Ziyad is positive the acquisition will pass the scrutiny of the SC as well as the investing public as the asset has potential.

Urgent for Sona Petroleum to acquire QA

Sona Petroleum, the third listed SPAC, is under pressure following CLIQ's acquisition of a QA. Sona Petroleum has 16 months left to complete its first QA.

Its managing director Hadian tells ***FocusM***: "Sona Petroleum would like to reiterate that it is currently fully focused on its strategy of securing a quality-producing QA, subject to the approval of the SC."

Following its failure to secure a 40% stake in Salamander Energy, Sona Petroleum's shares have fallen 29.5% from a 52-week high of 61 sen, closing at 43 sen on April 1.

Based on foreign reports, foreign analysts had viewed the deal between Ophir and Salamander as positive, but noted the former was required to assume Salamader's US$250 mil debt as part of the 100% acquisition.

On the termination of the Salamander acquisition, Hadian says there are many assets available and Sona Petroleum is at the advanced evaluation stage for several good quality acquisitions. He says Sona Petroleum's management will continue to work tirelessly to comply with the regulatory requirements and timeline.

Prior to the termination of the purchase, Hong Leong Investment Bank Bhd had in a research report viewed the acquisition positively as it was expected to provide some 45% upside.

The targeted asset represented a balanced portfolio as it had both an exploration unit and production unit. The investment bank said Sona Petroleum was expected to see a cash inflow immediately and for more than 10 years.

The asset would have provided potential upside to Sona Petroleum as the acquisition target was surrounded by existing oil-producing fields.

Hibiscus hits dry spot

Following its acquisition of a 35% stake in Lime Petroleum Plc in April 2012, Hibiscus Petroleum became the first graduated SPAC and the first listed independent O&G exploration and production company in Malaysia.

With its complete acquisition of Lime Petroleum, Hibiscus Petroleum saw its share price rising to an all-time high of RM2.74 on Dec 13, 2013, representing a 265% increase from its listing price of 75 sen.

Despite the good prospects, the slump in crude oil prices had affected the counter with its share price falling to 76 sen on April 1. Besides the poor crude prices, the company recently found itself in the news following the hitting of a dry well in its Gemini prospect in the North Sea.

However, Hibiscus Petroleum's managing director Kenneth Gerard Pereira was quoted as saying the dry well will not be a major concern to Hibiscus Petroleum as its associate, Lime Petroleum, is expected to drill more wells in the nearby prospect which has been proven to have hydrocarbon reserves.

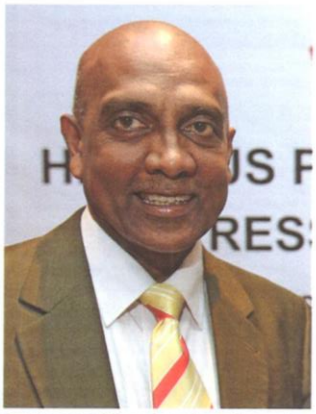
Based on the Lime Petroleum press release, Rolvsnes prospect, located near the Gemini prospect, is expected to have some 100 million barrels of oil reserves.

A press release issued by Lime Petroleum says drilling has stopped at 2,269m below sea surface, according to the minimum required level prior to drilling deeper and penetrating deeper to the full section where its Rex Virtual Drilling has provided evidence of available hydrocarbons.

During the drilling process, Lime Petroleum's subsidiary Lime Norway could not vote for the well to be drilled deeper as it was awaiting government approval.

On Hibiscus Petroleum's earnings, Pereira acknowledges the company will not be expecting to get any cash yet from its assets as none of them has begun production.

He adds that Hibiscus Petroleum is awaiting approval to acquire a 25% stake in Kitan oilfield, near Timor Leste, where production is expected to be around 10,000 barrels per day. FocusM



Pereira says Hibiscus Petroleum does not expect any cash from its assets as none of them has begun production

The first of four SPACs to be listed on Bursa Malaysia in 2011 was Hibiscus Petroleum Bhd, which saw an oversubscription of 3.8 times in its IPO

History of SPACs

SPECIAL purpose acquisition companies (SPACs) were once well-known in the United States and South Korea. However, their popularity has waned amid claims they are nothing more than a slick way for investment banks and management to collect huge fees with the investment risk falling on investors.

According to foreign media reports, SPACs are usually set up by corporate figures, who use them as a comeback to the corporate scene. Such SPACs can often be hit by problems as some are unable to acquire a willing target within the stipulated time, while others who acquire their qualifying assets (QA) face problems such as management turbulence or overpaying for their acquisitions.

According to SPAC Investment Ltd, the SPAC industry has seen 219 SPACs introduced since 2003. According to the analytics company, 34.7% or 76 of the SPACs listed have since been liquidated, while the other 121 which completed their acquisition targets within the requisite period reported a negative 16.5% annualised return.

In Malaysia, the first of four SPACs to be listed on Bursa Malaysia in 2011 was Hibiscus Petroleum Bhd, which saw an oversubscription of 3.8 times in its initial public offering (IPO). In 2012, it graduated from SPAC to first listed independent oil and gas exploration and production company in Malaysia.

A local analyst tells ***FocusM*** the success of the SPACs' listing is due mainly to the good governance, rules and regulations by the Securities Commission (SC). Among SC guidelines are that SPACs must adhere to strict standards designed to protect the investing community. One of the guidelines stipulates the qualifying asset (QA) acquired by an SPAC must be approved by the SC.

The analyst adds SC guidelines give investors the right to reject a poor asset investment proposed by an SPAC. "Shareholders are given the right to vote on the acquisition of the QA, and if they decide it is not good for the company, it cannot continue with the purchase," he explains.

An SPAC is a high-risk investment, as investors are buying into a shell or blank-cheque company, which has no value. The success of the company hinges mainly on the management team and its vision.

Based on SC guidelines, local SPACs are required to place 90% of their IPO funds in a trust account, refundable along with interest gained to investors in the event of the termination of the SPAC. SPACs have three years to finalise the acquisition of a QA.

In addition, a local fund manager says, local SPACs listed are focused on the Exploration and Production (E&P) sector where such listed counters are limited. Malaysia's oil and gas industry is focused on the service sector in areas such as maintenance and fleet services.

He adds local oil and gas counters are usually diversified; SapuraKencana Petroleum Bhd, for example, has diversified into various segments of the upstream oil and gas industry.

He adds SPACs, by focusing on the E&P sector, allow some investors the right to diversify their own investment while providing an opportunity to invest in "the experts".

"It is always better for investors to diversify their investments as, in the end, the risk is borne by the investor alone – and the returns belong to the investor, too," he says.