DATE: 26 JULY 2014
PUBLICATION: THE STAR
SECTION: COMPANIES AND STRATEGIES SECTION
HEADLINE: REACH FOR THE STARS
CATEGORY: COMPANY NEWS

Reach for the stars

New SPAC eyes acquisition in one to two years

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AMID a rout in the shares of Sona Petroleum Bhd and the still-untested business models of special-purpose acquisition companies (SPACs), soon-to-be-listed Reach Energy Bhd will have much to prove as the new kid on the block.

Sona, fresh from announcing an RM895.2mil deal this week to buy two Thai oil and gas (O&G) blocks from UK's Salamander Energy Ltd, saw its shares retreat from a high of 61 sen in mid-May to 53.5 sen as at Thursday.

Hibiscus Petroleum Bhd and CLIQ Energy Bhd, respectively Malaysia's first and second SPACs, are trading near their year-lows. Hibiscus is the only one of the three listed SPACs to have completed its qualifying acquisition (QA) and made the leap from SPAC to junior exploration and production (E&P) firm.

SPACs are companies with no operations or income-generating business at the point of their initial public offering (IPO). They undertake a listing to raise funds for the acquisition of operating companies, businesses or assets – the so-called QA.

With no income or track record, SPACs depend wholly on the strength of their managements to locate, buy and grow an asset or business.

Despite their high-risk nature, investors are slowly warming to the SPAC model because of their potential to deliver alpha returns.

Reach Energy's listing on the Main Market, the largest so far for a SPAC on Bursa Malaysia with gross proceeds of RM750mil, has clinched seven cornerstone investors, namely, tycoon Tan Sri Chua Ma Yu's son Chua Sai Men, Lembaga Tabung Haji, fund managers CIMB-Principal Asset Management Bhd and Hong Leong Asset Management Bhd, MKW Jaya Sdn Bhd, MTD Capital Bhd and Paul Poh, a close associate of Hong Leong Group chairman Tan Sri Quek Leng Chan.

It will also be the first SPAC to count a Government-linked investment corporation as a cornerstone, after the Securities

(From left) Shahul, Hong Leong Investment Bank managing director Lee Jim Leng, and Reach Energy chairman Izlan Izhab at the prospectus launch in Kuala Lumpur.

Commission tightened its guidelines for SPACs to safeguard investors.

The seven cornerstones will take up a combined 210 million shares, or 16.43%, of Reach Energy's enlarged share base, its prospectus shows.

Institutions such as Koperasi Permodalan Felda Malaysia Bhd, Pelaburan Mara Bhd and Norwegian sovereign wealth fund Norges are also understood to have committed to a further 15% of the share sale. Daya Materials Bhd, a pre-IPO investor in Reach Energy, will dilute its stake to 1.74% upon listing.

The IPO is offering one billion shares priced at 75 sen each. Some 980 million shares have been set aside for selected investors via a placement. The remaining 20 million shares will be sold to the Malaysian public.

Each share comes with one free warrant. Reach Energy will debut with a market capitalisation of RM958.37mil, dwarfing CLIQ and Sona's current market value.

Reach Energy says in its prospectus that it is eyeing brownfield O&G assets in the Asia-Pacific region which are producing or in development, with a minimum internal rate of return (IRR) of 15%. If an acquisition is made outside of its desired region, then the asset will have to pass a higher IRR hurdle of 20%.

It can buy either an asset or company, but the asset must have proven and probable (2P) reserves exceeding 10 million barrels of oil equivalent (mmboe). Should it decide to acquire a company, the target needs to hold over 20 mmboe in 2P reserves.

"If we acquire an asset, we will have a working interest of more than 33%, and if we acquire a company, we will have majority ownership of more than 50%. In addition, we will be the operator where we will have management control," Reach Energy notes in its prospectus.

Crucially, the firm must assume control of the strategic and financial decisions, as well as the day-to-day running of the asset.

Over the longer term, Reach Energy aims to achieve a 70:30 split between its production and exploration assets. As a start, it is looking to obtain a producing asset that can generate revenue within two years of acquisition, managing director Shahul Hamid Mohd Ismail tells *StarBizWeek* in an interview.

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"There is still much value to be extracted from ageing wells. I used to tell my staff that dollar-for-dollar, the oil you get out of existing wells is a lot cheaper than drilling new wells. It's like finding a new tenant instead of building a house," he says.

Shahul, 64, was brought into Daya to advise the-then E&P aspirant on its bid for a risk service contract for the Tembikai and Chenang marginal fields offshore Terengganu.

'Skin in the game'

Petroliam Nasional Bhd eventually called off the tender exercise, but it got Shahul thinking about how Daya could participate in other aspects of E&P. This led to the idea for a SPAC.

However, the proposal met with resistance from private equity funds in Singapore and Australia when he presented it there.

"They were risk-averse and more familiar with services companies than E&P. When we came back to Malaysia, we asked ourselves whether the market was ready for another SPAC.

"Nonetheless, I was confident that if we assembled a thoroughbred E&P team, that could make all the difference," explains the seasoned O&G man.

"I want to stress this – we don't want to be an also-ran. So, we have to put our skin in the game. In our case, we have our bone in the game."

Reach Energy's management team will own 20% of the company post-IPO, double the minimum requirement set by the regulators.

Key officials are also bound by a moratorium which prevents them from selling shares or warrants until the company achieves one full year of audited operating revenue upon commercial production.

Moreover, the management is subject to a much smaller discount for their shares at only 10% of the 75 sen issue price, meaning they had to pay 7.5 sen per share.

Top executives of SPACs before Reach Energy had bought their shares at one sen apiece.

Although mature fields typically have a shorter lifespan, the production and operation phase for these assets could last as long as 30 years.

Brownfield focus

"During this time, ownership of the asset can change hands multiple times. If you get in there with enough years left for production, the upside can be rewarding," Shahul says.

Reach Energy explains in its prospectus that brownfields are mature fields in decline or in the final stages of their productive life.

"Their associated facilities may require more maintenance and rehabilitation or improvement with additional infrastructure.

At some point, this may become non-cost-effective to a large operator.

"For a smaller operator, however, it provides an opportunity to exploit the reservoir potential due to the small operator's lower cost base."

Reach Energy is betting that a swathe of exits by foreign players from Asia Pacific and the increasing appeal of unconventional resources like shale will lure oil majors elsewhere, opening the way for new and nimbler independent oil firms to flourish.

Shahul, a Colombo Plan scholar and mechanical engineer by training, has had a long and varied career.

In Reach Energy, he will bring to bear his more than 30 years experience in the industry working for the world's two largest O&G multinationals.

He started out as a development engineer in Esso Malaysia, the only Malaysian at that time, and later decamped to Shell.

In 1996, he took charge of Shell's entire E&P assets in Sabah, Sarawak and the Fairley-Baram Unitisation with Brunei as operations director.

Shahul was also the first Malaysian to helm Shell Refining Co (M) Bhd, the local refining unit of Dutch energy giant Shell.

While Reach Energy has three years to make its QA, Shahul is aiming to wrap it up as quickly as possible.

"We can't go globetrotting all over Asia or Africa. Time is money."

Even so, he concedes that the current high oil prices could spill over to asset prices. It is also likely that Reach Energy will have to pay a premium to snag both ownership and operatorship of an asset.

"It can be done," he says. "An independent party was engaged to find out if assets that fit Reach Energy's criteria existed in Asia Pacific, and they came back positive," Shahul says, referring to the 656 acquisitions inked between 2008 and 2013 across Asia Pacific.

Of that, 575 transactions cost less than US$250mil (RM795mil), well within Reach Energy's price range.

And with the 4th SPAC about to hit the market, is there too much money chasing too few assets?

Shahul doesn't think so. "There's no race between the SPACs (for assets) or even a shortage of acquisition targets," he says.

An analyst who tracks the O&G sector opines that for SPACs, the proof is in the pudding.

"Reach Energy is certainly the 'safest' SPAC of the four.

"But without a core business, we have no basis on which to value the stock, at least until the QA is found," says the analyst.

"They will need time. We just have to wait and see."

The listing is scheduled for Aug 15.