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Balance of power shifts between national and international oil companies

Findings of KPMG's latest annual report, announced today, into National and International Oil Companies (NOCs and IOCs) have shown that volatile markets have hindered the ever-increasing power of national oil companies in favour of their international rivals. While the immediate market conditions may not be economically viable for some companies, global financial decline is starting to open up deal opportunities for international oil companies with access to debt. National oil companies with governmental support, such as the Chinese; also have the opportunity to access oil and gas reserves at prices which, 12 months ago, would not have been possible.

Anthony Lobo, oil and gas partner at KPMG, commented:

"As confirmed by the latest annual reporting season, international oil companies have been hit badly by the economic downturn. Our research, however, has shown that market volatility has created a shift in the balance of power between national and international oil companies in exploring new projects and transactions. Unlike in 2008 where our survey showed that NOCs were excluding IOCs from new reserves, the position has now changed. While volatility is starting to open up the field for IOCs, both IOCs and NOCs face the same problem of surviving the lower oil price whilst maintaining multi-billion pound capital projects. This is likely to lead to closer relations between IOCs and NOCs and partnering will be seen as a mutually beneficial way forward.

"With 9% of the world's oil, Iraq is a good example of the Government looking to IOCs to assist developing its huge reserves. Although pricing expectations still need to converge, with the Iraqi Government needing close to $50 billion to develop these reserves, the door has been opened to IOCs with strong balance sheets and those NOCs that are cash rich."

Commenting on future deal opportunities, Lobo went on to say:

"Our research with national oil companies in China has shown that they are in the enviable position of an almost unhindered access to capital and strong demand for oil and gas reserves. The Government has built up huge foreign currency reserves, which the NOCs can tap into. With such demand and capital reserves, the Chinese NOCs, and to a lesser extent Russian NOCs, are at the vanguard of M&A activity in the oil and gas sector. This could have a beneficial impact for the global energy industry - and the myriad of contractors which supply into the industry - at a time when the global economy needs investment more than ever. Indeed while the IOCs are well placed to capitalise on their strengthened positions, most will be waiting for the Chinese wave of M&A to complete so they do not have to compete on price. We therefore expect the next few months to be dominated by Chinese-led deals, with the IOCs continuing to look for innovative ways into new reserves with partnerships.

While the last oil price crash in the late 90s led to a rush of mega deal consolidation, this turn in the cycle is not expected to ignite a similar round of mega transactions. Lobo went on to say:

"While the major IOCs will be looking to make the most of the strength of their positions, we do not believe that we will see a repeat of the 'mega merger' activity of the 1990s. We think most deal activity will be taking place in the below £20bn deal range, which is still pretty big ticket stuff by any other industry's standards, but the £40bn plus deals seen last decade are unlikely to happen. The magic formula in the oil and gas industry is the combination of cash and reserves. At the moment, the IOCs have plenty of cash and access to debt but the NOCs hold the keys to many of the reserves. One IOC buying another arguably compounds an existing problem. As NOCs are not up for sale this means that we are likely to see IOCs proposing new joint ventures. Such joint ventures may be the dawn of a new age in the energy industry as they would require NOCs to disclose information which has hitherto been closely guarded."

Whether national or international, well-placed or cash-drained, the research shows that all oil and gas companies have implemented cost-cutting programmes, Lobo commented:

"While the global oil and gas sector looks ripe for multi-billion pound activity over the coming months, all companies in the sector are nervous of the repercussions of the volatile oil price and are adopting aggressive cost-cutting strategies to limit their exposure. Our research shows that IOCs have the advantage over the NOCs in adopting cost-cutting programmes in that they do not have the same Government pressure to limit labour costs. Both NOCs and IOCs, however, are making the most of cheaper commodity prices to renegotiate supplier costs (eg steel and aluminium for plant construction) and pushing down external contractor costs."

“The market uncertainty has not left regional oil companies unaffected either,” says Peter Kiss, KPMG`s Global Power & Utilities Sector leader.

“Considering the fact that MOL is maintaining steady performance even in the current circumstances, and that the company is retaining an advantageous position compared to its rivals, clearly highlights that MOL has chosen and is following the right strategy for regional expansion,” claims Kiss.

Kiss thinks that the Hungarian national oil company’s (NOC) ownership and management structure is a unique combination of characteristics of NOCs and IOCs. Its national character on the one hand comes from the fact that MOL plays a key role in ensuring Hungary’s security of supply, while on the other hand no one owner, shareholders group or professional (foreign) investor can obtain major influence within the company’s leadership. At the same time MOL is a listed, privately held stock exchange company whose shareholders are expecting dividends and that the company is able to constantly create value for them.

According to Kiss MOL’s efforts in carrying out efficiency improvement programmes have also been contributing to the company’s favourable position. The majority of corporations usually start launching such initiatives only when negative effects of the economic situation have already badly affected their results. However, as the first positive results of such programmes develop only after long months or even years, a late start might result in significant disadvantages compared to competitors that have efficiency improvement programmes already on the agenda.

“It is fairly clear that a successful corporate strategy and operational model are able to create market advantage from changing market conditions, capitalising upon both positive and negative trends by creating shareholder value, like MOL does.” says Kiss.

Notes to editor:

About the research:
Working with Dr Valerie Marcel, who has written widely on NOCs, KPMG gained unprecedented access to senior representatives at the China National Offshore Oil Corporation, CNPC, KMG-EP, Arab Petroleum Investments Corporation and an adviser to the Iraqi Prime Minister (representing 9% of the world’s oil supply), as well as a selection of banking experts to understand planned investment and costs in the global, oil industry. The full report, titled *‘The National Oil Company Investment Challenge’*, is available as a separate pdf on our website at the following link: http://www.kpmg.hu/index.thtml/en/virtual_library/advisory/business/energy/index.html

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