

Business Standard

Falling crude oil price: Valuation of foreign energy assets declines

With oil blocks needing big investments to keep the wells flowing, falling oil prices will lower cash flows

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Indian oil companies like Oil and Natural Gas Corporation Limited (ONGC), Bharat Petroleum (BPCL), Oil India, and Reliance Industries are seeing the value of energy assets bought overseas in the last few years eroding with the decline in crude oil prices.

India's energy asset buying spree occurred when Brent crude was hovering at above \$100 a barrel but with prices falling 35 per cent to a five-year low of \$65 a barrel, the valuation of these assets has fallen by as much as 25 per cent, analysts say.

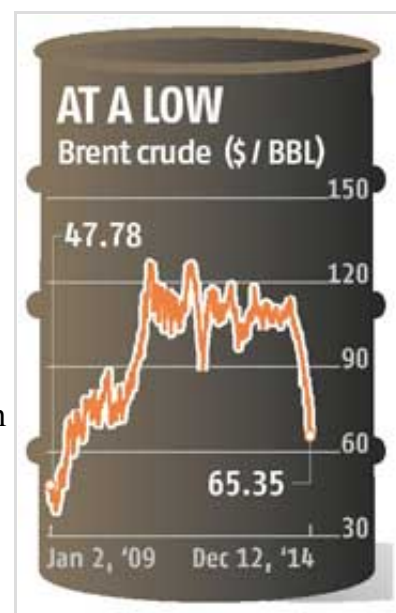
Reliance Industries has put its shale gas assets on the block. The company is expecting \$4.5 billion for its 45 per cent stake in a shale gas venture with Pioneer Natural Resources of the US. The problem is there are no takers. If the deal does go through, analysts say, the valuation will be far lower than what Reliance Industries expects.

"The oil assets all over the world are valued on the basis of net present value and depending on probable reserves. With the oil prices coming down so sharply, the valuation will also take a sharp fall," says Phani Sekhar, fund manager with Angel Broking.

"This (valuation) is more of a notional loss. If oil prices pick up again by 2016, the game will change for these companies," said an analyst with a foreign brokerage.

Reliance Industries is not alone. Last year, state-owned ONGC and Oil India bought a 10 per cent stake in a Mozambique gas field for \$2.5 billion from Videocon. Since then, the valuation of the field is down by as much as 25 per cent, say analysts.

BPCL, Oil India and ONGC are sitting on an asset whose valuation may fall further from its dizzy height of \$25 billion last year. "Oil price is just one of the reasons. The project will require investments worth \$18-20 billion for setting up infrastructure," said an analyst.



With oil blocks needing big investments to keep the wells flowing, falling oil prices will lower cash flows. ONGC is particularly affected because its \$2.1 billion acquisition of the Russia-focused Imperial Energy's oil reserves turned out to be way below projections made prior to the purchase.

Experts say there are other sides to the issue as well. "First, do we regard this fall in crude oil as being temporary in nature or a permanent one? Will conditions change once the world economy recovers and China starts pulling up demand? Besides, the future of shale gas is still uncertain and hence there could be reason to believe that this is temporary. Hence for these companies planning to sell assets, they have to take a medium term view. There is one theory that OPEC (Organization of the Petroleum Exporting Countries) is standing by allowing the price to fall so that it can squeeze the shale producers out of the market. Second, the lower price does provide a positive to these OMCs (oil marketing companies) in terms of savings from the subsidies and their own absorption of the same. This could counter a part of the potential downside to the asset value overseas," says D R Dogra, chief executive officer and managing director of Care Ratings.

Since most of these foreign acquisitions were done through loans taken abroad, a further fall in oil prices will make takeovers more expensive. The rupee is expected to fall to around Rs 65 to a dollar in 2015. Indian companies will have to pay more if the loans are to be repaid from cash flows of local companies. But if they have hedged against the currency risk, the cost may not be that high.

The last fall in oil prices in the 1990s led to consolidation in the global industry. Small oil companies will need cash to expand and the big ones will need money to prop up reserves. Indian companies can either buy out smaller firms at low valuations or wait for the tide to turn. In either case, they will need more cash.