QV UPDATE

Weekly Commentary | May 10, 2019
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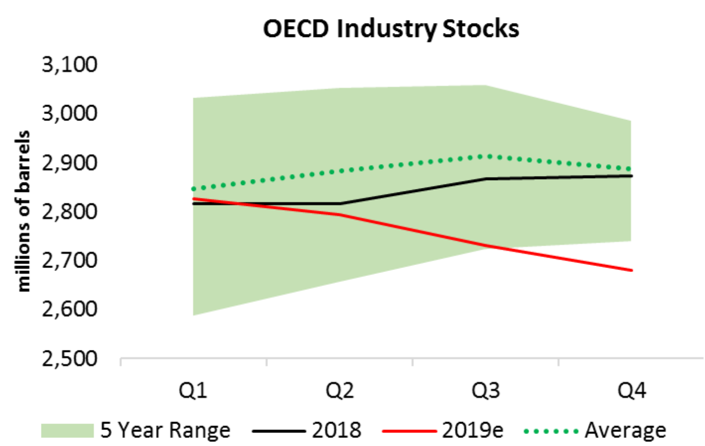
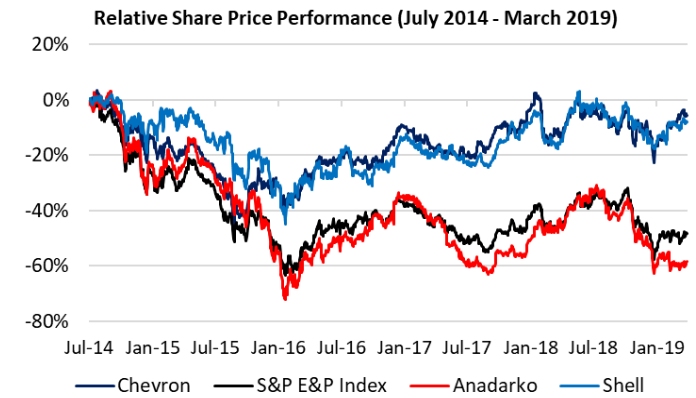
Energy Markets and M&A

One topic that hasn't gotten much news coverage is the relatively steady increase in crude oil prices since the beginning of the year. The price of Brent crude (the global oil benchmark) has increased each month this year and was approaching a six-month high at the end of April. Stronger fundamentals have been driven by declining global oil inventories and increasing expectations for a supply disruption. In late April, the US announced that sanction waivers on importing crude oil and condensate from Iran, initially granted to 8 countries, would not be extended beyond the May 2nd deadline, removing further volumes from the market. Overall, it is expected that the US along with a few members of OPEC can meet this shortfall over the medium term. In our view, supply/demand fundamentals appear stronger than they have been in some time. The image below showing OECD inventories highlights the declining surplus relative to history.



Source: BMO Capital Markets

Another hallmark of a changing environment has been the modest pick up in M&A activity. Anadarko, an oil and gas producer focused in the Permian, has received bids from both Occidental and Chevron over the past few weeks. After multiple years of underperformance by producers relative to integrated peers, it appears that companies are now willing to capitalize on this valuation differential. Consider that from July 2014 to March 2019, Chevron (an integrated oil company) outperformed Anadarko by 52% and the S&P Exploration and Production Index by 42%.



Source: S&P Capital IQ

As it currently stands, Occidental remains the preferred bidder. It has also struck an agreement with global equity fund holding Berkshire Hathaway to provide financing for the deal. Berkshire plans to invest a total of $10 billion in Occidental, contingent on the deal closing with Anadarko. Berkshire will receive 100,000 shares of cumulative perpetual preferred stock along with warrants to purchase up to 80 million shares of Occidental common stock at a price of $62.50. The preferred shares will accrue dividends at a rate of 8% rate per annum, or at 9% if the dividends are accrued but unpaid. We view the deal as attractive for Berkshire, allowing it to deploy capital at reasonable rates, with potential upside in a stronger energy price environment.

In another example, QV Global Equity Strategy holding TGS-NOPEC (TGS), a leading provider of geophysical and seismic data and services to the oil and gas industry, recently announced the acquisition of its competitor, Spectrum ASA. The deal solidifies TGS' market position as the world's largest geoscience company covering a range of frontier and mature oil and gas basins. The acquisition also improves its positioning in the South Atlantic region and diversifies the company's customer base. Over the past 15 years, this business model has generated very attractive returns. Its balance sheet remains strong, which should allow it to continue executing on its successful strategy.

While the tide in energy markets appears to be shifting, we remain committed to creating a balanced portfolio with diversified economic exposure and characteristics.