Total buys Engie's LNG assets for $1.5bn in a race to boost its gas business

Total S.A. (NYSE: TOT) - market cap as of 17/11/2017: $138.514bn
Engie S.A. (PAR: ENGI) - market cap as of 17/11/2017: $34.837bn

Introduction

On November 08, 2017, the French multinational oil and gas company Total announced that it entered into an agreement to buy the Liquefied Natural Gas assets of electric utility firm Engie in a transaction that is valued at approximately $1.5bn. The transaction will allow Total to develop into the second largest industry player with approximately a 10% market share.

About Total S.A.

As a truly international conglomerate, Total offers oil & gas production facilities, service stations and refining & chemicals sites in over 130 countries. The firm covers the entire value chain ranging from the discovery to marketing of energy in a variety of forms. Total employs 98,000 staff members and manages 903 consolidated subsidiaries to provide consumers across the globe the safest and cleanest energy sources. Since 1990, Total has also been a vital investor in the Iranian power market.

The company has historically been very active in terms of M&A activity. In 2011, Total acquired a 64.65% stake in the photovoltaic firm SunPower for $1.38bn. In 2016, the firm purchased the French battery manufacturer Saft Groupe in a transaction valued at €1.1bn and took a $207m stake in the mid-scale natural gas liquefaction company Tellurian. Furthermore, in August 2017 Total expressed interest in buying Maersk Oil from A.P. Moller-Maersk.

In FY2016, the firm reported total revenues of $127.93bn, which represents a 10.8% decrease compared to the previous year. Total announced a net income of $6.20bn in 2016, compared to $5.09bn in 2015. The EBITDA also decreased from $26.74bn in 2015 to $22.23bn in 2016. Lastly, in FY2016 the company reported an EPS of 2.51x and free cash flow of $3.94bn.

About Engie S.A.

Engie is headquartered in La Défense, Paris, and operates in the business segments of electricity generation & distribution, natural gas and nuclear & renewable energy. The firm is present in 70 countries around the globe and possesses a natural gas supply portfolio of 105bn cubic meters per year. Engie also maintains 228 urban cooling and heating networks in 13 nations and 19.5 GW of installed power-production capacity in renewable energies.

The company actively promotes various initiatives and projects that aim to minimize environmental damage from core operations. Engie dedicates 50% of power generating projects to renewables, invests €1.5bn in solar technology and wishes to reduce greenhouse gas emissions by 20% by 2020. Engie also holds a 35% stake in the water treatment and waste management company Suez Environment. In 2015, the firm acquired Solairedirect, thus making Engie the major solar electricity producer in France.

As of FY2016, Engie reported total revenues of $66.64bn, which denotes a 4.6% decrease compared to $69.88bn of the previous year. The company reported a net loss (mainly due to impairments) of $415m in 2016, compared to a loss of $4.62bn in 2015. Engie's working capital also decreased from $6.17bn to $2.00bn in the same time interval. On the other hand, EBITDA increased from $10.08bn in 2015 to $11.98bn in 2016.

Industry overview

Total annual growth in liquefied natural gas (LNG) is expected to be around 4.5% by 2030, compared to a 2% annual growth forecasted for natural gas. This increase in demand will be mainly driven by Asia, which is currently the world's largest importer, followed by North America and Europe. Moreover, supply of LNG are also expected to increase by 50 % between 2014 and 2021.

LNG is the cleanest fossil fuel. In the context of the current energy transition sought by the European Commission, it represents an excellent alternative to reduce greenhouse gas emissions and help combat global warming. Indeed, to promote the use of LNG, The European commission has also launched the project "LNG Blue Corridors". The overall objective is to demonstrate the possibility to establish natural gas as the main alternative fuel to diesel in European long-distance transport and trucking.

LNG provides a way to transport gas over very long distances and with greater flexibility in terms of destination. Unlike pipelines, LNG can be stored and rotated according to demand around the world and respond immediately to periods of peak and down in consumption. Furthermore, natural gas is half as polluting as coal in relation to power production and thus ideally the right complement to renewable energies, making it an increasingly popular energy source. Total is already present across the entire natural gas discovery and production chain, with a focus on liquefied natural gas, that is easily transportable by ship.

Deal structure

The deal has an overall enterprise value of $1.5bn, which includes debts and liabilities which means that Total's final cash payment could be lower once the transaction is completed by mid-2018. Furthermore, Total declared that additional payments of up to $550m "could be payable by Total in case of an improvement in the oil markets in the coming years". Engie, on the other hand, said in a statement that the deal will also reduce the group's debt by $1.4bn, not including earn-outs.

Deal rationale

On the one hand, the acquisition represents for Total the opportunity to grow in the LNG sector and become a more integrated player. On the other hand, by divesting its upstream oil and gas assets, the takeover will allow Engie to pursue its strategic restructuring.

According to Total's CEO Patrick Pouyanné, the $1.5bn deal with the state-backed French utility will push Total into the second place in the LNG sector globally, cementing its position as a top-tier player and allowing it to respond to the increasing Royal Dutch Shell's dominance, upped through BG Group Plc's takeover in February. Total's market share is in fact expected to increase up to 10% by 2020 from the current 6%. Moreover, the acquisition of Engie's upstream LNG business will enable Total to accelerate the implementation of its strategy to integrate along the full gas value chain in an LNG market firmly growing at 5-6% per year.

The deal will contribute to enhance Total's LNG portfolio and to rebalance its geographical position: Total will benefit from additional interests in liquefied plants (e.g. 16.6% equity stake in the Cameron LNG project in the US – the key attraction of the deal – and 5% equity stake in the Idku LNG project in Egypt), long-term LNG sales and purchase agreements, an LNG tanker fleet, access to regasification capacities in Europe and Asia, and further business in the US, where Total is already a gas producer.

From Engie's perspective, this transaction will allow the French utility company to accelerate its development in downstream gas activities and become Total's preferred green gas supplier, focusing entirely on its downstream businesses, that are low-carbon power generation, infrastructures - notably gas - and integrated downstream customer solutions. Following the deal, as Engie is convinced that green gases, biogas, and renewable hydrogen are key to the energy transition, it will establish a new entity dedicated to the development of renewable hydrogen, thus becoming Total's preferred biogas and renewable hydrogen supplier as well. In parallel, in line with its transition strategy, the company is currently in a midst of a strategic restructuring which includes $17.39bn of asset sales to reduce dependence on fossil fuels and thermal power generation. A successful transition will allow Engie to reduce its exposure to commodity price swings, focusing on the more energy-efficiency services. Moreover, the proposed transaction is expected to translate into a $1.4bn reduction in Engie's consolidated net financial debt, excluding earn-outs. This transaction will enhance Engie's earnings profile for the upcoming years.

Finally, from both companies' perspectives, future growth opportunities look appealing. Trade in the $90bn market for gas is poised to double by 2040, underpinned by surging demand from Pakistan and China to generate power rather than burning coal. This translates, for the newly integrated company, in a better position to serve buyers from emerging markets with complex needs. According to Bloomberg New Energy Finance, combined demand from emerging nations will surge to as much as 61m tons a year by 2030 from about 3.2 million tons last year, or about 12% of the global market. Moreover, the combination of the two complementary portfolios will allow the new Group to manage an overall volume of around 40m tons of LNG by 2020.

Market reaction

Following the announcement of the deal, Total shed 5.4% of its market capitalization amid investor concerns over the agreement. On the other hand, Engie's stock dropped by little above 4%.

Financial Advisors

Société Générale and Rothschild advised Engie on the deal. Total has not disclosed its financial advisors.