

Capitalising on the high market? Repsol to sell 25% of its oil business in search of a greener identity

Introduction

On September 7, 2022, Repsol announced it would sell a 25% stake of its worldwide upstream business to EIG for \$4.8bn, consisting of both equity and net debt. The transaction is expected to close within the coming six months, subject to customary closing conditions. The deal comes as Spain's largest oil company pushes to raise funds to invest in renewable alternatives seeking a lower-carbon future, while supplying the still needed and highly profitable hydrocarbons. As so far most of Repsol's biggest competitors, such as BP and Shell, have decided to keep both their E&P and renewable power divisions integrated, this has been the first attempt to cash in on the value of its entire legacy business. The transaction valued Repsol's most prized asset at \$19bn, implying an enterprise value to 2P reserves (total of proven and probable reserves) ratio (EV/2P) of \$8.3/barrel of oil equivalent, above the 2022 global transaction EV/2P average.

About Repsol

Repsol is a multinational energy and petrochemical company. Although it is engaged with both upstream and downstream segments, the upstream branch, Repsol Upstream, the one involved in the transaction, is the company's most profitable and main responsible one for the company's \$19.4bn market capitalization. Repsol Upstream is forecast to produce approximately 590,000 barrels of oil equivalent per day for 2H 2022. Moreover, it has proved and probable reserves of 2.3 billion barrels equivalent as of December 31, 2021, approximately 70% of which is gas, for which prices have soared after Russia choked supply to Europe. The company is nonetheless committed to lead and contribute to the energy transition, having been amongst the first oil and gas companies to set a net emissions target back in 2019. Since then, the company has started investing in sustainable mobility, through the development of environmentally-friendly synthetic fuels with zero carbon footprint, and in renewable energy, through offshore wind farms and renewable hydrogen.

About EIG

EIG is one of the private equity industry's biggest oil and gas investors. As of June 30, 2022, the institutional investor had \$24bn under management, and its clients include many of the leading pension plans, insurance companies, endowments, foundations and sovereign wealth funds in the U.S., Asia and Europe. EIG specialises in private investments in energy and energy-related infrastructure on a global basis, having committed over \$41.5bn to these sectors throughout 38 countries in the last four decades. EIG has expertise in formation, transformation, and public listing of companies, having recently successfully listed Harbour Energy, UK's North Sea largest oil and gas producer, in which they first invested in 2014.

Deal structure

As mentioned before, the oil industry is wrestling with how to fund investments in cleaner energy while retaining sufficient profits from legacy assets to continue to pay shareholders. This transaction will enable Repsol to do exactly that: play a leading role in the energy transition, as it frees up capital to invest in further portfolio decarbonization initiatives, and unlock the embedded value of its upstream business, whilst maintaining significant exposure in a robust price environment. In line with Repsol's strategic plan, the proceeds will boost the growth of

All the views expressed are opinions of Bocconi Students Investment Club members and can in no way be associated with Bocconi University. All the financial recommendations offered are for educational purposes only. Bocconi Students Investment Club declines any responsibility for eventual losses you may incur implementing all or part of the ideas contained in this website. The Bocconi Students Investment Club is not authorised to give investment advice. Information, opinions, and estimates contained in this report reflect a judgment at its original date of publication by Bocconi Students Investment Club and are subject to change without notice. The price, value of and income from any of the securities or financial instruments mentioned in this report can fall as well as rise. Bocconi Students Investment Club does not receive compensation and has no business relationship with any mentioned company.

Repsol's low-carbon ventures, which include investments in low carbon generation, H2, e-fuels and value-added energy products and services.

Moreover, the transaction implies an attractive enterprise value to 2P reserves ratio (EV/2P) of \$8.3/barrel of oil equivalent for Repsol Upstream. This is substantially above current analysts' consensus valuations and the global 2022 transaction average of \$5.7/barrel of oil equivalent, which is likely due to the soaring energy prices. Additionally, the transaction is expected to strengthen Repsol's Balance Sheet through the \$3.4 billion cash proceeds from EIG's investment and to reduce Repsol's leverage ratio below 10%.

For EIG, this deal allows them to be invested in the energy transition and an opportunity to cash in its profit at a possible coming Repsol Upstream IPO. With an increasing presence in the oil & gas industry, PE firms have become more vocal on the energy transition. While still believing in a greener future, EIG sees in Repsol a firm that will lead such transition, while still supplying the world with needed low-cost energy complying with ESG standards in a specially profitable scenario. EIG's extensive track record and valuable expertise will push for a more optimal and ESG-compliant production and boost value creation for Repsol Upstream. Moreover, EIG will provide its knowledge of global debt and equity capital markets and upstream experience, particularly in the United States, the North Sea, Brazil and Asia Pacific, where Repsol Upstream currently already holds operations. Finally, in the signed deal, it also stated that this transaction laid the foundation for a potential initial public offering of the upstream business in the US in 2026 or later, which could enable EIG to cash in on its investment and should feed Repsol Upstream with further investments.

Deal structure

Repsol is planning on selling a 25% equity stake in its upstream business to EIG for \$4.8bn consisting of \$3.4bn of equity and \$1.4bn of net debt. The transaction indicates an enterprise value of \$19bn and a total debt holding of \$5.6bn for 100% of Repsol Upstream. This values Repsol's upstream business just under the firm's total market capitalisation of \$19.4bn and, according to Repsol, stands substantially above previously made consensus valuations. The net cash proceeds of \$3.4bn will be paid to Repsol Group through a 70% upfront payment on completion of the deal and three further instalments of \$340mn each over the course of 3 years. The proceeds from the deal are expected to strengthen Repsol's balance sheet and reduce the group's leverage ratio to below 10%. The signed agreement also states the potential of holding an initial public offering of the upstream business in the US from 2026 onwards, subject to "favourable market conditions".

Repsol will retain operational control of the upstream business unit as the group remains the majority shareholder. Repsol's upstream assets and business activity will continue to be consolidated within the wider Repsol Group using the same accounting methodology. The eight-person Board of Directors of the upstream business entity will include two directors appointed by EIG, four directors appointed by Repsol and two independent directors.

Additionally, Repsol will be given the power to appoint the Board of Directors Chairperson, who will be given a casting vote. This newly structured entity will keep its current workforce, management and business plan while focusing on expanding and strengthening its global network. Furthermore, it will carry on Repsol's existing ESG upstream policies and targets, which include a 75% reduction of carbon intensity by 2025 from 2016. In addition, EIG will provide its expertise and extensive track record of investing in the global energy and infrastructure sectors to enhance value creation and optimise production, while maintaining its ESG standards.

The deal is expected to be completed within the next six months, once the upstream business' corporate structure has been finalised, subject to regulatory approvals. Goldman Sachs and J.P Morgan acted as financial advisors to EIG throughout the transaction, with Repsol advised by independent advisory firm PJT Partners.

All the views expressed are opinions of Bocconi Students Investment Club members and can in no way be associated with Bocconi University. All the financial recommendations offered are for educational purposes only. Bocconi Students Investment Club declines any responsibility for eventual losses you may incur implementing all or part of the ideas contained in this website. The Bocconi Students Investment Club is not authorised to give investment advice. Information, opinions, and estimates contained in this report reflect a judgment at its original date of publication by Bocconi Students Investment Club and are subject to change without notice. The price, value of and income from any of the securities or financial instruments mentioned in this report can fall as well as rise. Bocconi Students Investment Club does not receive compensation and has no business relationship with any mentioned company.

Impact on the oil and gas industry

The oil and gas industry and the energy sector are currently experiencing turbulent times with soaring energy prices and a long-term transition to a low-carbon future. Repsol has made it clear that this transaction is a pivotal moment towards a greener future for the firm. The upfront capital proceeds will be used by the company to increase its investment in the green energy transition. Furthermore, the \$3.4bn in proceeds will allow Repsol to become a larger player in the Spanish renewables sector, currently dominated by few companies such as Acciona SA, or Iberdrola which has an installed renewable energy capacity of over 38,000 MW. Many have praised Repsol for this move, as it presents one of the most aggressive, yet creative ways to fund the transition towards renewables while still providing the fossil fuels required today.

Repsol has been a leader in the energy transition since 2019 when it became one of the first major oil and gas companies to target net zero emissions and begin expansive renewable energy production. The oil and gas industry has been facing increasing pressure from investors, governments, and regulators to cut their planet-warming carbon emissions and invest in renewable energies. Many of the largest firms, however, such as Exxon and Chevron, are reluctant to do so, possibly in fear of losing profits and hence disappointing shareholders. Some argue that energy companies like Repsol are at risk of being left with “stranded assets”. Analysts expect oil prices to drop sharply in the long term, following a dramatic decrease in demand once governments are forced to take aggressive actions to combat climate change. This leaves fossil fuel companies with little diversification and high costs exposed to significant risks in the long term.

The Repsol deal is the first example of a big oil and gas company cashing in on the value of its traditional fossil fuel business to invest in renewables. Repsol likely profited from the soaring energy prices to sell a slice of their upstream assets at a higher valuation. Given the current high-priced market and pressure to transition to greener energies, major oil and gas companies may follow suit. However, with European leaders urging and fighting to reduce energy dependence on Russia, there have been calls to raise the short-term output of fossil fuel energy.

Furthermore, the triple-digit oil prices have led to sky-high profits for energy firms, with Shell, BP, TotalEnergies, Equinor, and Eni announcing over \$37 billion in Q2 profits, doubling the norm from the last couple of years. However, for the majority, upstream business has not increased so starkly. Up until now, most of the profits have been transferred to shareholders through higher dividends or share buybacks. This has led to calls for energy majors to invest in both energy security and the energy transition.

Europe is worried about whether it will be able to make it through the winter without a destructive crisis and is looking to the upstream industry to increase production and investment in fossil fuels in the short term. Neptun Deep, an offshore gas field development project located in the Romanian waters of the Black Sea is set to become a major alternative supplier of natural gas for Romania and the rest of Europe. Romanian state-owned oil and gas producer Romgaz signed a \$1bn deal with ExxonMobil giving the Romanian government full control over the Neptun Project, allowing the country to double its gas production and provide regional energy security. European energy giants TotalEnergies, BP and Shell have also pledged to find short-term solutions to alleviate the situation. Total, for example, is increasing gas production and deliveries to European nations from the North Sea. Shell is renovating existing floating production vessels to extract more gas out of existing oil fields, in addition to sanctioning a new gas field which will be operational by the second half of 2022. Eni has stated that its developing upstream business with BP in Angola, an LNG project in Qatar, and is in talks to commence the construction of an LNG vessel off the coast of Mozambique. Further investments are expected as Europe looks for alternative sources and decreases its reliance on Russian supplies.

All the views expressed are opinions of Bocconi Students Investment Club members and can in no way be associated with Bocconi University. All the financial recommendations offered are for educational purposes only. Bocconi Students Investment Club declines any responsibility for eventual losses you may incur implementing all or part of the ideas contained in this website. The Bocconi Students Investment Club is not authorised to give investment advice. Information, opinions, and estimates contained in this report reflect a judgment at its original date of publication by Bocconi Students Investment Club and are subject to change without notice. The price, value of and income from any of the securities or financial instruments mentioned in this report can fall as well as rise. Bocconi Students Investment Club does not receive compensation and has no business relationship with any mentioned company.

Summary

Repsol's \$4.8bn sale of 25% of its oil and gas business is an innovative method to increase investments in the green energy transition. With the current record high energy prices, decreasing reliance on Russian gas, and the green energy transition, we will likely see large energy companies striking a balance between investments in upstream business and renewable energies. Therefore, energy companies are unlikely to follow by spinning off their polluting businesses, as they will continue to provide significant profits to fund investments into green energy.

TAGS: Porsche, Volkswagen, IPO, Taycan, EV

All the views expressed are opinions of Bocconi Students Investment Club members and can in no way be associated with Bocconi University. All the financial recommendations offered are for educational purposes only. Bocconi Students Investment Club declines any responsibility for eventual losses you may incur implementing all or part of the ideas contained in this website. The Bocconi Students Investment Club is not authorised to give investment advice. Information, opinions, and estimates contained in this report reflect a judgment at its original date of publication by Bocconi Students Investment Club and are subject to change without notice. The price, value of and income from any of the securities or financial instruments mentioned in this report can fall as well as rise. Bocconi Students Investment Club does not receive compensation and has no business relationship with any mentioned company.