Low oil prices will renew M&A activity in the oil sector for 2015

Yesterday, Wall Street continued to gain ground as the Dow Jones and the S&P 500 set yearly records highs for the fourth straight session in a row since last Wednesday – that is since the Fed announced it would not be raising interest rates just yet. Significantly, yesterday's rally suggests that the market may have already digested the drop in oil prices; if that is the case, the Saudis have served yet another 'course'. Rather than trying to stop the oil price hemorrhage, Saudi Arabia has announced that it has no intention of cutting oil production for the time being; indeed, the Saudis intend to extract even more oil.

Ali Al Naimi, the Saudi oil minister, the very 'architect' of the oil collapse seems to be almost 'pleased' by the fact that oil prices have not rebounded, taking every media occasion to send the message that OPEC has no intention of cutting production – the latest such pronouncements coming on the sidelines of the Arab Energy Conference in Abu Dhabi and an interview with the London based and Saudi owned newspaper al-Hayat. Saudi production now stands at 9.7 million barrels a day (bpd); al-Naimi told al-Hayat that this production level would stand "unless a new client comes along and then we may increase it." Al Naimi says that he is in no way happy about the oil price, stressing that it is not in OPEC's interest to cut production. The Saudis needed high oil prices to sustain the generous state subsidies system, which covers anything from education to long term employment in the public sector. Low oil prices are risky because the social security system is recognized as having had a major 'calming' effect on the population, reducing the risk of 'Arab Spring' like revolts. Al Naimi said that Riyadh can sustain the situation without having to reduce state spending: “Banks are full of money and we can always take a loan, conserving our reserves.”

Other OPEC members from the Gulf such as the UAE or Kuwait nod in apparent approval, while others are more concerned (Iran, Venezuela, Algeria, Nigeria). Non-OPEC players such as Russia have conceded that the situation is dire and that if oil were to go below USD$ 50/barrel, then the situation could become “critical.” Therefore, as the price of oil has almost halved over the past six months with few prospects of a quick Cartel orchestrated turnaround, one of the few market alternatives for the many oil companies that are now beginning to struggle, as the costs of exploration and extraction have become prohibitive, is consolidation; indeed, the oil industry could experience a renewed taste for mergers and acquisitions. Oil services companies, which usually suffer much more than the majors during the negative cycles in the oil market because of the inevitable drop of exploration. Halliburton fired the first salvo, offering USD$ 35 billion to absorb its rival Backer Hughes in what is the largest acquisition of a US energy company in the last three years. Accordingly, the merger and acquisition bug may soon hit the majors and rumors – just rumors for now – have already been spreading of Royal Dutch Shell’s intention to buy rival British Petroleum (BP). This is just a rumor but the historical pattern does point to the fact that every time that oil prices take a significant plunge, mergers and acquisitions intensify and end up redrawing the oil sector itself. In the 1990’s, under analogous concerns: Exxon merged with Mobil, BP, Amoco and Arco incorporated while Chevron bought Texaco.

Few of the big oil names of the past have survived as ‘individuals’, but enough of them are left to feel the merger impetus rising again. Certainly, many small to medium size oil companies have been feeling the brunt of the market and they will have to join forces to survive. The ideal candidates are US shale and Canadian tar sands producers; many of the smaller players are heavily indebted and the low market valuations prompted by the current market flood, have put them in a near collapse situation. Larger and established companies such as Tullow, which has invested heavily in turning such countries as Kenya, Ghana and even Somalia (Somaliland) into oil producers, may have to merge with their competition to survive. The identity of the biggest shark in the present oil market is Glencore. Glencore has already made merger headlines in 201 by trying to corner the iron ore market, proposing to merge with Rio Tinto in the wake of an especially troubled year for iron ore, the price of which suffered considerably in view of the Ebola crisis in West Africa. Glencore, the giant commodities trading and mining production. Ivan Glasenberg, Glencore’s CEO, seems determined to find an oil sector acquisition target, saying quite clearly that his Company is evaluating acquisitions in the oil industry. The problem now is that the oil price is still unstable – it could go lower still or recover in spite of OPEC positions, given the high geopolitical risk in the Middle East and in non-OPEC countries like Russia. A stabilization of the oil market, however, might be the first sign of a potential M&A wave. Meanwhile, in Asia, the region that consumes most of the world’s oil, the drop in prices may be an opportunity for the national oil companies to and increase their oil production through acquisitions abroad. India’s Oil & Natural Gas Corp (ONGC) has already committed to spend USD$ 177 billion in foreign assets by 2030.