Upstream Financed Acquisition: a case study

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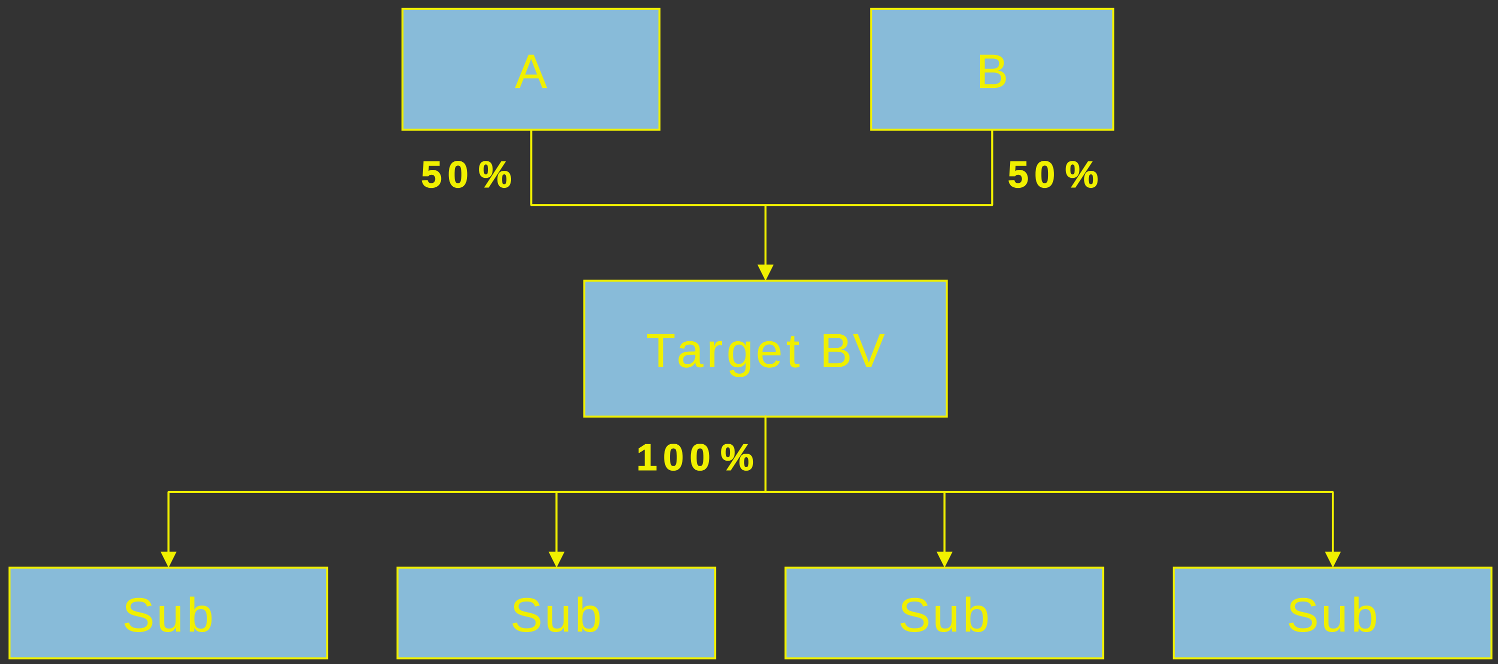
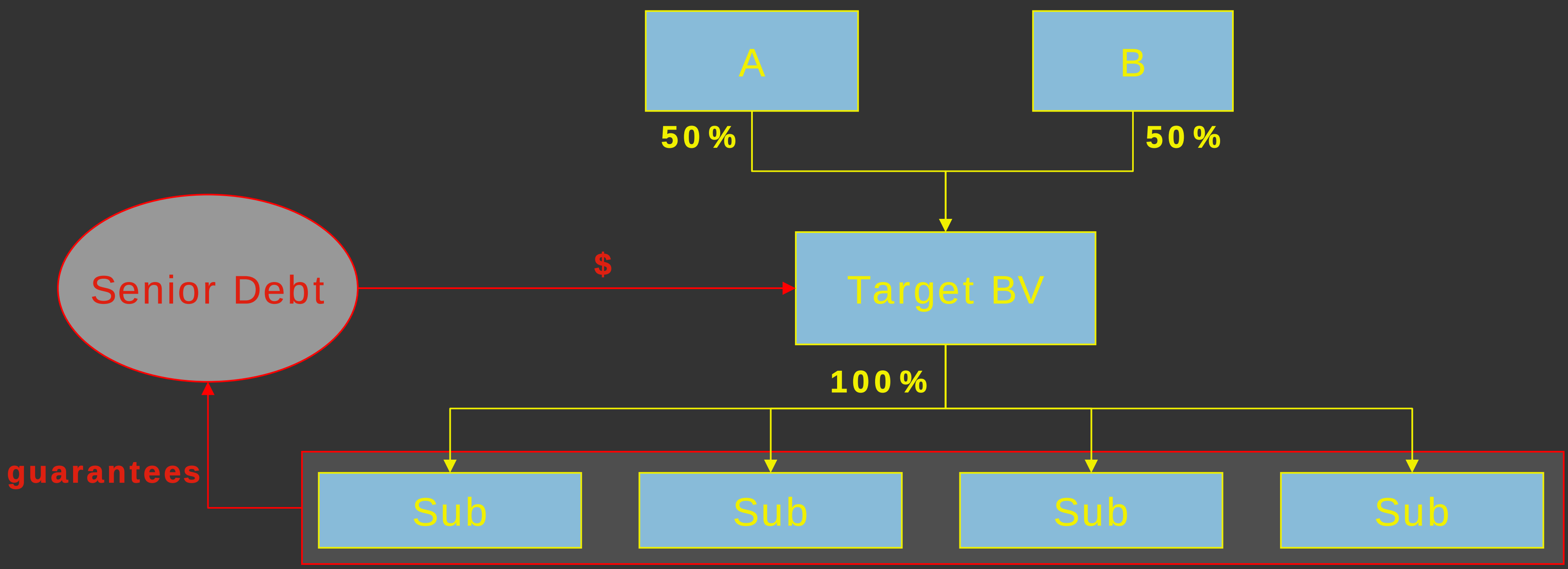
Ambition Oil – acquisition of producing assets in Indonesia

- Seller (Megafund Inc.) looking to take a profit on its upstream investment in Target BV
- Buyer (Ambition Oil) an independent E&P company looking to build a portfolio for an IPO
- Seller has 50% of shares in Target BV's holding company
  - non-operated interests in mature gas producing assets in Indonesia
  - gas sales to state-owned offtakers
  - Small amounts of condensate which are lifted by tanker
- Seller also has 100% senior debt in Target BV

Target BV: Equity



Target BV: Senior debt



Ambition Oil Case Study

- Other shareholder in Target BV has pre-emption rights and tag-along rights
- Existing debt – buying the debt and the equity? Where is the value?
- PMP restrictions - “Financial institution”?
- Parallel negotiations with banks (term sheets and mandate letters) and seller (SPA)
- Financiers providing just debt or debt and equity?
- Involvement of financiers with SPA?

Financing Options

Ambition Oil decided to use limited recourse debt

- Use of acquired assets to secure the financing for the acquisition
- Tends to limit risk of default to the project/acquired asset
- Higher debt leverage => lower cost of capital => increase in equity rate of return
- Risk systematically shared
- Political risk mitigation
- Lender involvement

But increased level of covenants and restrictions

Borrowing Base Finance

In particular Ambition Oil decided to use a borrowing base facility

- The use of an SPV
- The bank will carry out its own thorough survey of the assets because the value is based on reserves
- The facility available is based on the value of the base assets as determined by the modelled NPV of those base assets
- The facility will be increased or decreased depending on modelled NPV
- Assets and NPV are closely monitored by the bank through reports compiled by borrower

Focus on Borrowing Base Finance

Model calculates NPV by assessing:

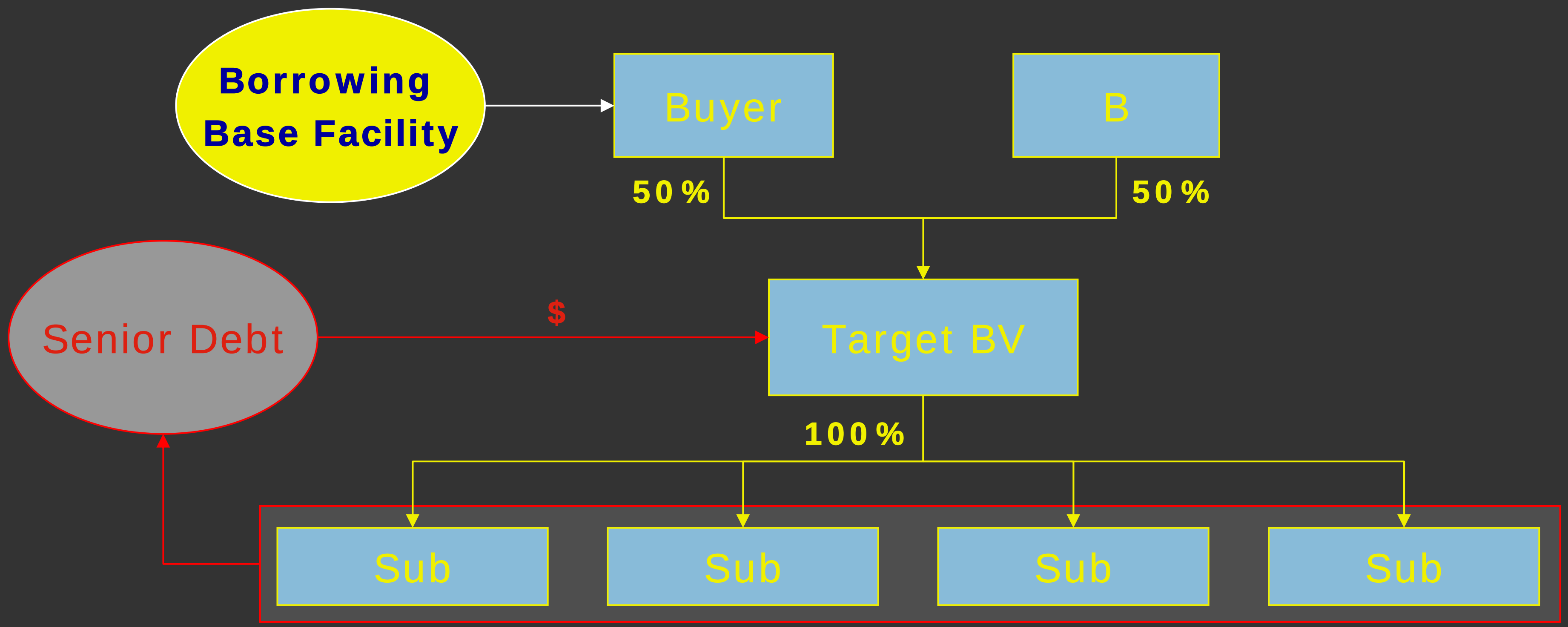
- Proven reserves
- Probable reserves (a negotiable factor)
- Production
- Market Price
- Projected Capex and Opex
- Financial Ratios and covenants
- Project life coverage
- Loan life coverage
- Producing assets
- Non-producing assets
- Contribution by each well

Focus on Borrowing Base Finance

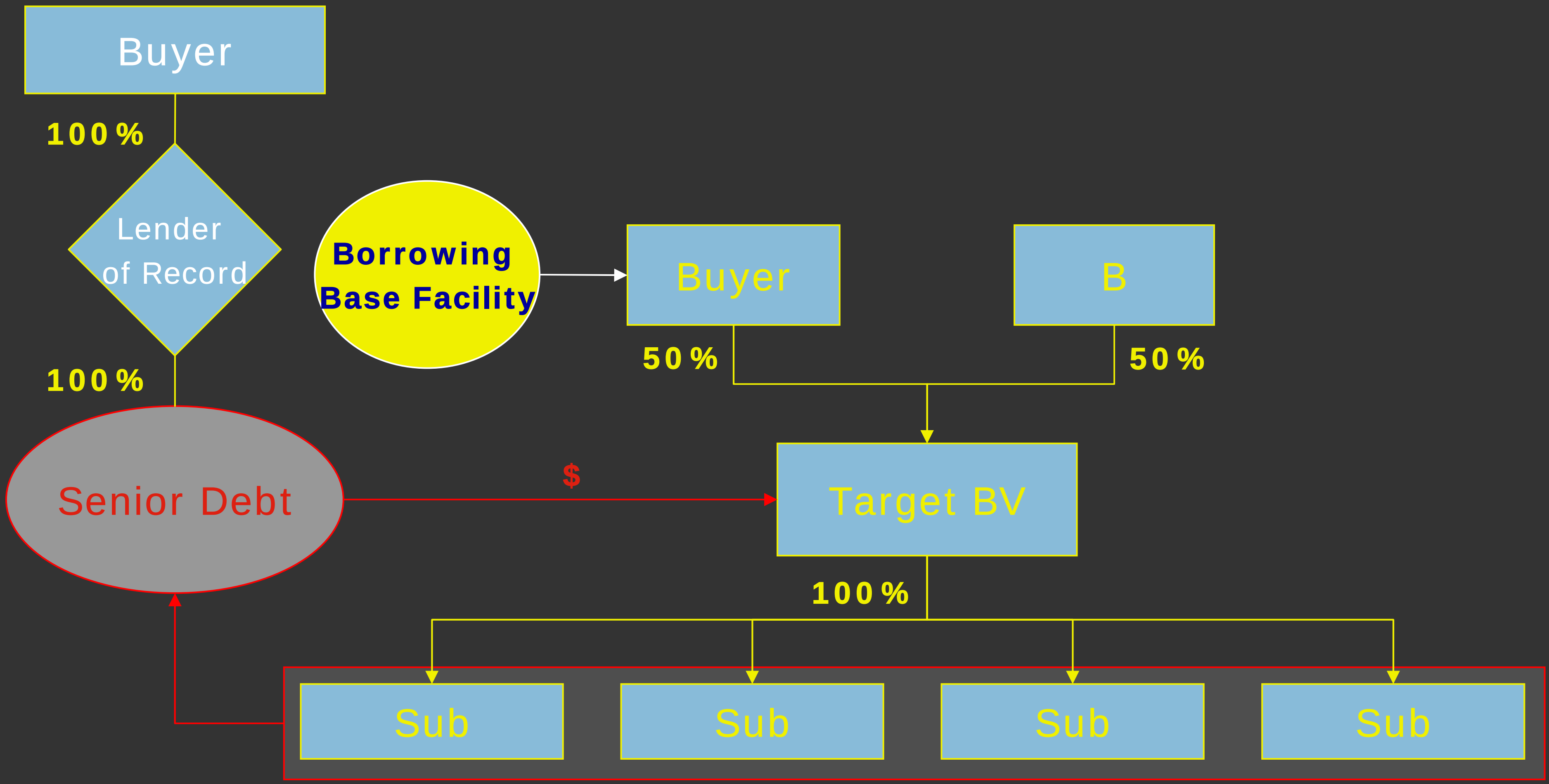
Security

- Can be local law restrictions on using target's assets as security for its acquisition
- Also local law restrictions on securing the interest in the asset (need to get governmental permission to either the creation of a security interest or exercising the security and taking ownership)
- Possible to secure moveables?
- Possible to secure future cash flows/ production?
- Instead use share pledge over the shares of the acquiring SPV
- Instead revenues to offshore DSRA with controlled cash "waterfall"
- Shareholder support may help credit approval

Ambition Oil: Borrowing Base



Ambition Oil: Novation and Participation



Potential Drawbacks of Borrowing Base Finance

- Although buyer and lenders are generally aligned, Banks will prioritise mitigation of risk given debt's fixed return
- Relatively high maintenance and expensive debt – refinancing threat
- Lenders will seek to impose controls through:
  - Covenants restricting [major] changes to the business and spending
  - The use of financial ratios
- Bank may impose compulsory hedging policy
- Bank will require regular reports on the assets

So, what makes a successful upstream leveraged buy out?

- Clear objectives from outset
- Choice of lender – package of:
  - Loan cost
  - Terms and conditions
  - Experience
  - Relationship with borrower/buyer
- Buyer's relationship with seller
- Financier – involved but not at the SPA negotiating table
- Experience of buying management team – how good is their deal?

So, what makes a successful leveraged buy out?

- Prior knowledge of assets
- Appropriate levels of due diligence
- Realistic timetable – can be done in 6 weeks but much depends on the seller and the third party
- Organisation of buyer:
  - Decision by committee usually inefficient (whether in buyer or buyer/financier)
  - One fulltime decision maker
  - Full range deal team
  - Open communication

So, what makes a successful leveraged buy out?

- Keep lending relationship going otherwise pre-payment!
- Control expenses but emphasise execution to achieve objectives not to cut costs
- Clear division in roles between financial adviser to buyer and lender to buyer
- Consider power of financier if financier taking majority equity position

So, what makes a successful leveraged buy out?

- Financiers to remember to keep lending relationship going otherwise pre-payment!

Thank you.