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Sevan's shares embark on a long path downwards

The necessity of simultaneously timing investor demand, while managing a new technology on a tight cash budget, has proved to be overwhelming for Sevan Marine

Barry Parker – New York

INVESTOR demand is not limitless, and sometimes there is too much of a good thing. Investors have been drowned, at least temporarily, by the seeming flood of pure play drilling companies, starting with a private placement from OceanRig — now looking at a listing in New York — and, then, Oslo.

The winter months saw successive listings from Aker Drilling and North Atlantic Drilling, both in Oslo.

The difficulties facing Sevan Marine, which had announced in late March that it would be spinning off a drilling unit, are illustrative of the financial challenges.

Shareholder demand in the oil service realm had been fuelled, in part, by rising oil prices that had flatlined by early May, when Sevan Drilling was listed.

The necessity of simultaneously timing investor demand, while managing a new technology on a tight cash budget, has proved to be overwhelming for Sevan.

Yet its troubles did not begin in the past six weeks, when the stock price has seen its sharp drop.

A leading Oslo shares analyst told Lloyds List: "Sevan Marine initially took in contracts for their FPSOs at low dayrates; the low rates arose from a combination of cost overruns from their original estimates and from the need to gain market share with their new FPSO concept."

The cylindrical shape, contrasted with the normal ship profile, eliminated the need for a turret.

In the latest set of transactions Sevan Marine, founded in 2001 and listed in Oslo since the summer of 2009, had planned to create a new entity, dubbed Sevan Drilling, which would raise money for its capital-thirsty drillship business, leaving its floating production, storage and offloading business within the original entity.

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"Two of the FPSOs, *Sevan Piranema* [on to Petrobras] and *Sevan Hummingbird* [on to Centrica in the North Sea], were priced low. The result is that they have not been able to earn a requisite return on capital," the Oslo analyst said: .

"A third FPSO, *Sevan Voyageur*, now on to E.ON Ruhrgas, also in the North Sea, had previously been fixed under unusual terms, with Oilexco, so that Sevan took on reservoir risk, related to the performance of the field, which turned out to be disappointing."

> *"To put it simply, they [Sevan Marine] were undercapitalised. They have too much expensive debt, and they are in discussions on a restructuring"*
> **Oslo shares analyst**

In a complex piece of financial architecture, Sevan Drilling was to have raised $350m for its own purposes in a share listing, complemented by a secondary offering in which Sevan Marine (a holder of Drilling shares following the new listing) was to sell off a portion of its holdings.

In a nutshell, the first transaction, the listing of Sevan Drilling, providing funds for ongoing drillship construction, was accomplished. However, shares were sold at a significant discount to the original price ideas, with Sevan Marine holding on to a larger stake in the new entity than originally contemplated, 28% rather than 16%.

The second transaction, the secondary offering of equity that would have partly filled Sevan Marine's coffers, did not come off. A subsequent rescue effort, in which DNB Nor had attempted to raise equity from existing shareholders, was also shelved.

The Oslo shares analyst said: "To put it simply, they [Sevan Marine] were undercapitalised. They have too much expensive debt, and they are in discussions on a restructuring.

"At their early stages, they could not get sufficient bank debt. The banks were sceptical, so they had to go to the very high-priced Norwegian bond market."

Sevan Marine's end-2010 financial reports show $1.4bn of debt, mainly bonds, at interest rates as high as 14%, on a $2.6bn balance sheet.

Another analyst, Egle Domataite, who runs Terra Securities' Offshore Services desk, said: "On the financial side, at least $45m is needed to cover the cost overrun on the *Sevan Voyageur* FPSO must be from equity and not from debt. By our estimates, they need more, $220m, in total.

"The secondary offering [sale of Drilling shares held by Sevan Marine] had initially been expected to raise $245m. The rights issue by DNB Nor that had not been finally proposed would have brought in $275m."

The Oslo analyst said: "If everything had gone according to the plans, [Sevan Marine] would have been able to pay down one or two of the expensive bonds. It would have also enabled them to raise money for production units number four and number five, which they've put equity into. This money would have come from the sell-down [secondary offering], which they chose not to do."

The Oslo analyst explained that a sell-down of Drilling shares is not possible in the near future: "Instead of doing the secondary offering, they are holding their shares of Sevan Drilling, there is a 12-month lock-up period, so they are considering other ways of bringing in equity." ■

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Share issue could be best way forward for troubled offshore firm

WHAT'S next for Sevan Marine? Terra Markets analyst Egle Domataite told Lloyds List: "The best case scenario would be a share issue. It would be dilutive because it would be issued at lower than the last share price, but at least it would save some of the values for the existing shareholders," *writes Barry Parker*.

An Olso analyst at a different firm offered a variation on this view, saying: "What is probably going to happen now is the bondholders may need to take a haircut and let new equity come in. Through DNB Nor, they were attempting to put together a $275m rights issue, aimed initially at existing investors."

The analyst said that the offer was pulled due to scant demand.

Ms Domataite also offered a comment on the recent announcement that Jens Ulltveit-Moe, a Norwegian investor who, through an energy holding, has made a purchase amounting to 5% of Sevan Marine's outstanding shares.

> *"What is probably going to happen now is the bondholders may need to take a haircut and let new equity come in"*
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"In my view, if there are such people, could be multiple investors, or one large investor, who could inject a large amount, that would obviously be positive," she said. "It's difficult to say what will happen, but the Ulltveit-Moe investment has brought some comfort to the market."

The share price had reached a nadir of NKr0.40, prior to the announcement of the investment, rebounding to around NKr0.80. The shares were trading steadily around NKr6.00 at the beginning of 2011.

Ulltveit-Moe has called for an extraordinary shareholders' meeting, which is scheduled for late June. At that time, a new board is to be elected. Uncertainties abound.

"Because of many unknowns in Sevan, we have found it fundamentally senseless to set the target price for the share," Ms Domataite said, adding: "We have stopped estimating it for the time being." ■

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Financial engineers craft more spin-offs, but not for drillers

LATE last month, another erstwhile drilling spin-off, Odfjell Offshore, which would have been spawned from Odfjell Drilling, pulled back an initial public offering slated to raise up to $600m, *writes Barry Parker*.

A company executive, in a statement, described the situation succinctly: "Right now the stock market is relatively weak and there have also been numerous recent drilling equity issuances in the market."

Odfjell Drilling has a minority ownership of 40% in two drillships, *Deepsea Metro I* and *Deepsea Metro 2*, on charter to BG and Petrobras (at delivery from Hyundai in the fourth quarter of 2011), respectively. However, financial engineers are busy with other corners of the energy business, at a time when the International Energy Agency has now proclaimed that we are on the cusp of a "Golden Age for Natural Gas".

In a widely watched transaction overseen by Goldman Sachs, the US natural gas producer and distributor El Paso Corp will be splitting out its upstream — exploration and production — entity.

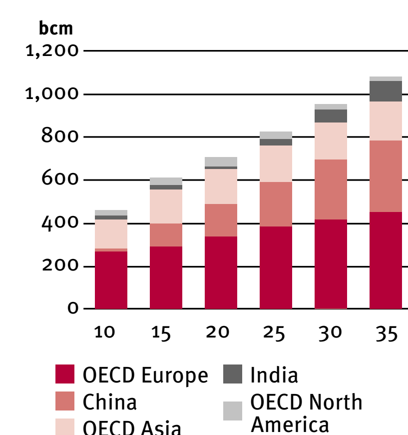
To achieve a tax-free status, the deal will be structured as a distribution of shares in the "new" entity, with existing holders being granted shares in proportion with their ownership.

Another energy distributor, Williams Companies, whose business includes pipelines linking Gulf of Mexico oil and gas production with the shoreside infrastructure, has also announced plans to separate out its upstream activities from its distribution business.

The new-found attractiveness of the historically unexciting pipeline distribution businesses is attributable, in part, to developments that are having an impact on liquefied natural gas shipping.

At the highest levels, new supplies of "unconventional" gas in North America have caused a glut. Lower US prices have, in turn, reduced import demand and backed up gas supplies into the international markets. The disruption of established trade flows has come with the salutary impact of more activity in the LNG shipping sector.

NATURAL GAS NET IMPORTS
By major region in the GAS scenario



Source: World Energy Outlook 2011

Going forward, additional supply chains will enter into the mix. US exports of gas are on the horizon, following an approval by the US Department of Energy of a proposal by Cheniere Energy to export LNG from its existing Sabine Pass import terminal, near Cameron, Louisiana.

One group, Freeport LNG and Macquarie Capital, is seeking to convert another import terminal, on the Texas coast, to an export facility.

Another pairing, of Houston-based pipeline operator Southern Union and BG Group, have recently submitted an application to bring export capabilities to an import terminal at Lake Charles, very near Sabine Pass.

The recent DOE decision will allow Cheniere to ship up to 803bn cu ft per year of US-produced gas, which equates to roughly 17m tonnes of LNG, to selected export destinations. For comparison, Wood Mackenzie estimates 2010 LNG demand to have been 213m tonnes.

For shipowners and for inchoate "operators" of LNG tonnage, it is not clear whether tie-ups between exporters and receivers will be an outgrowth as supply chains evolve. The implications of these shifting supply patterns (which may feature in the Golden Age) for shipping company spin-offs and restructurings are also unknown.

El Paso's LNG import terminal at Elba Island: the US natural gas producer and distributor is planning to split out its upstream, exploration and production entity. *Bloomberg*

Industry veterans can remember that a predecessor to El Paso-owned LNG vessels in the late 1970s through the mid-1980s.

Looking ahead, a US Gulf LNG import receiving terminal at Pascagoula, Mississippi, owned by El Paso, Sonangol, and a private equity partner, Houston-based Crest Investments, is set to come online during this summer.

El Paso also owns an LNG import terminal at Elba Island, on the US South Atlantic coast, which is included within its pipelines business, connected to the gas distribution grid in the southeastern US.

The financial engineers behind the spin-offs are aware that credit analysts view stability of pipeline companies (structured as publicly traded partnerships) positively. Standard & Poor's currently rates El Paso's credit as "stable".

As the exploration and production and pipeline businesses are unbundled, the company is being put on Credit-Watch "positive" status, meaning that its ratings might improve, a rousing endorsement of such decoupling. ■

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