

Sona Petroleum Bhd listed on Bursa Malaysia on July 31, 2013 as the third oil and gas (O&G) special purpose acquisition company (Spac). Two years later, the clock is ticking for Sona to secure a qualifying asset (QA) which will allow it to graduate into a full-fledged O&G company.

From June 2014 to January 2015, Sona was involved in negotiations, first with Salamander Energy Ltd for two of its oil and gas blocks in the Gulf of Thailand for RM912 million. However, this fell through after Salamander chose to accept a higher bid from Ophir Energy Plc which valued the same assets at US\$492 million (RM1.8 billion). Sona then entered into negotiations with Ophir but failed to reach a deal – talks were called off for good in early June.

It is crunch time and Sona's management knows it. Nonetheless, both chief executive officer (CEO) Hadian Hashim and chief financial officer (CFO) Maznah Abdul Jalil remain confident they will be able to not just secure any QA, but one that will justify their shareholders' faith in their management abilities.

Hadian Hashim comes with 30 years of experience in the O&G sector and has worked with both Petronas and Sarawak Shell Bhd both in exploration and production (E&P) and in services. It was during his time at these two companies that he met most of the other members of Sona's team.

He also assumed executive director roles at Itochu Pipe and Tube Asia Corp Sdn Bhd which marketed tubular goods to oil companies, and in Integrated Petroleum Services Sdn Bhd, a company which provided support services to the offshore O&G industry.

Maznah Abdul Jalil, meanwhile, also comes with 30 years of experience in the corporate advisory sphere. She is most recognisable for her role in DRB-Hicom, where as its executive director she was responsible for corporate finance and advisory from 1998 to 2006.

Besides choosing to use the Spac investment model, which is a curious creature in itself, Sona's QA time frame has coincided, over the last year, with a significant plunge in the price of oil. This has had a dual effect on Sona's (and the other Spacs, Cliq Energy Bhd and Reach Energy Bhd) efforts to secure a QA.

On one hand, it has changed valuations and now assets which were out of range for Sona are coming back into focus. On the other hand, there is still a mismatch between sellers and buyers with the former not wanting to sell before prices and valuations recover.

In a recent interview with Sona's CEO and CFO, KINIBIZ asked them what the impact of the falling oil prices has been, the challenges of being a Spac company, Sona's prospects, and the viability of the Spac model.

We have seen the price of oil fall substantially since late last year. How has this affected Sona's efforts to secure a QA?

Hadian Hashim (Hadian): You see, what a lot of people are saying is that with the lower oil prices, assets are abundant. But the market did not prove that until recently. If you are looking at mergers and acquisitions after a few months from the fall in oil prices, they are mostly in British Columbia (in Canada) and in the US – with total deals of about US\$10 billion. The last big deal was the acquisition of the BT Group by Shell.

So paramount in all this is your view of the oil prices, what it was then and what are the prevailing oil prices now. If you look at all these deals, the long-term deals were all done at about US\$80 or US\$90, the median probably about US\$85, and the short-term deals from US\$55 to US\$65.

What has been happening is that the sellers feel like they can still get higher oil prices and the buyers think that they could get lower oil prices. So what has been happening in the industry is you want to see a stabilisation period and, if it does stabilise, for how long and also where is the price heading to.

Now once you have got a firm view of the period, in terms of the price going forward for the next three years and its long-term price, then you will see a lot more deals happening because the sellers are resigned to the fact that you won't see a US\$100 oil price in the near future. And the buyers are saying that now is the time to come in too, because if you come in late you will miss the pick up.

For any O&G players in that period there was turmoil in the industry. What do you do? You cut your capital expenditure. And then you go to your suppliers and say, "I cannot pay you, can you reduce your cost?" So these are the two things that oil

companies like to do (at first). You also might cut your dividends or look to restructure. It is only after all that has been done that they might say “I am still in the need of cash”, and then sell an asset.

So the price moves faster than the actual dynamics in the industry or the market

Hadian: Yes. You see the assets coming into the market are also reflective of the quality. The ones that come early are there because they have no options. And assets which we have bypassed last year or right after listing are now becoming attractive to us, partly because of the write-down on the value.

Meaning, there are some assets which we have looked at which were beyond our pockets. But now with the changes in the oil prices and also what is happening worldwide, they are becoming more affordable – partly because of valuation.

The other thing is that you are not going to say, “hey I am looking for an asset, do you have an asset?” Most of the assets we are looking at are through bilateral deals. There are pros and cons to this (way of negotiating) but it is speedier to do. Because we are not looking at just one asset, we are looking at several assets and this is where the time comes in – it can be time consuming.

Now why are bilateral deals considered? Because you have a time period and exclusivity versus a formal sale process. There have been a few assets (in general) which have gone through a formal sale process are still not sold. If you are a listed entity, that can impact your valuation and that is why you want to keep it quiet.

Because if you do a formal sales process and it does not happen, then your share price will fall because it (news of the failed deal) will affect your valuation. And that is what happened after the Salamander deal (was called off).

You spent a significant amount of time on the Salamander deal last year, which fell through. Can you update us on Sona’s progress in securing a QA?

Hadian: For assets which are available, there are a few that are going through the stress tests. The ones that have come on to the market may meet all the criteria but one. So you have that process of selecting, so that is what has been happening. We are looking at the number of potential QA – yes, there are several that we are looking at in our region of interest.

Maznah Abdul Jalil (Maznah): So while we remain quiet, we are working. Fortunately or unfortunately, our three-year period has coincided with this period (of a slump in oil prices). But we cannot rush into it because we have a selection process.

Hadian: Their concerns are valid, and we are also concerned. But both our interest and that of our shareholders are aligned. But we are confident of picking up something and getting our QA in the timeline.

Are you worried about your share price as the months pass by and how do you give you investors the confidence to stay invested?

Hadian: Movement of share prices is market driven.

Which can be sentiment based?

Hadian: Yes, it can be sentiment based and especially for a Spac company like ours. We have cash, but no assets. We are looking for assets. So there are only those three variables, so what do you do? But there has been some interest. All we can say is, we are focusing on getting our QA and we are positive that one will come around.

Are you perhaps more confident because you have cornerstone investors and you feel that they will stick with you? How does that play into the whole scenario?

Maznah: I think the key is the QA. If we are confident about the QA then I think the rest will be confident. Also unlike other companies, in Spac, the money is all in a trust account. At the end of the day we guarantee 45 sen to 50 sen.

Hadian: Obviously we do not want to use that (as justification for not securing a QA)...

Maznah: But at least it does not disappear.

Hadian: If you look back on our Salamander deal, not many people knew that there was going to be a slump in oil prices, which affected a lot of things. But the positive side of things is that we came out intact and it gave us a good feeling that there was going to be more assets and we are seeing that there are more coming on to the market. The other good thing is that the banks are still prepared to lend. So we are confident.

So you don't see a panic among your shareholders?

Hadian: Well, if you look at our share price it has been fairly stable – if you add in the warrants it is at about the initial public offering (IPO) price.

Maznah: Probably the noises you hear are just retailers.

Hadian: But we do respect the concerns, irrespective of where they come from. We are equally as concerned but in the end I think we will come in safe.

So what would your message be to your shareholders, are you telling them that “we are also shareholders”?

Maznah: We are on the same page. We also want it to happen, because if not our burn rate is much much higher than theirs.

And there are options on the table.

Maznah: Of course there are options on the table.

Okay. What about the regulatory process? Was there a problem when you took the Salamander deal to the regulators? Or do you find that the Securities Commission (SC) is on the same page as Spac companies?

Hadian: I don't think the difficulty was... we had to do our (part) and they had to do their (part). I do not see that as an issue. Because you see along the process, before you start to narrow down or are starting to get serious... You know it is like getting serious with a girl – if you want to get serious, you have to go ask the parents. Some might complain (about the regulatory rules), but those are the factors you have to meet, so you must meet it. It is the normal process.

Obviously you know that the Salamander deal attracted quite a lot of international exposure because of the participants. But otherwise it was business as usual. I do not see it as anything other than part of the process that we have to go through.

Maznah: Plus they (SC) are also looking out on the behalf of all the shareholders.

So it is not a particular burden on Spacs?

Hadian: Never has been.

Maybe we can move to the Spac model in general. Do you find that it is particularly harder for Spacs to negotiate for prospective assets? You have both been in companies before and you have negotiated deals, but because of Spacs having a timeline, do you think the other parties tend to play hardball?

Hadian: Well, you are looking for assets which people want to sell. So obviously you do your own due process. But I come back to... if the buyers and the sellers are convinced that this is the pricing scenario going forward, then the rest is just number crunching. It is just the process.

So I think the vendors and the buyers are now having that common believe that the pricing will be at about this for the near future. Obviously some companies will of course say, "well you know, this asset used to be worth so much before", but we say that has nothing to do with us. The fact is that you have to accept this is what happens when the prices go down.

Maznah: You ask if there is a particular challenge for Spacs. If we are doing a deal with another listed company, they also have a regulatory process. So they have that to contend with too.

Hadian: Let me put it this way... You knew when you set up this company what were the (Spac) guidelines and you have accepted those guidelines. Of course some others might have a different interpretation of those guidelines. But we have to accept them and work within them.

You chose to use the Spac model to start up Sona. Given the challenges of the three-year time frame and taking into account your fellow Spac

which is also nearing the end of its QA period, is it an issue of the industry environment we are in or is it an issue of the Spac model – is it flawed and can it be improved?

Hadian: You see it has evolved. If you look at the earlier Spacs in other countries, the time frame was for 18 to 24 months. So I think in terms of the three-year time frame, it is sufficient. But what has complicated this is the turmoil in the sector itself and also in the whole financial environment.

Considering the share price performance of the first Spac, which has now completed the QA and is trading as a normal company, if we look at it, it had its peak and now is trading at about its IPO level.

Are you concerned that post-QA you might struggle to present value to your shareholders?

Hadian: Well, part of it is market and part of it is what the business model (of the Spac) is. Ours looks at development and production assets, so you have cash flow. And once you have clarity and transparency in your cash flow, then it should reflect in your share price.

One of the criticisms of Spacs has been the amount of money the management and the initial investors made, because they got their shares at a very low price. Do you think the criticism is fair in the case of Sona?

Hadian: I think those are the requirements and you come in knowing that. So I come in and investors come in knowing fully what it (the deal) is.

Maznah: It is all laid out in the prospectus too, so you cannot begrudge anybody. Because those are the Spac requirements.

So you believe it is unfair for some to say that in a Spac, the management is a lot more insulated versus the regular investors?

Maznah: We don't get anything back (if they do not secure a QA).

So if it is a win then everyone wins, but if it is a loss, the management and initial investors lose more?

Hadian: We lose all (their investments).

So your initial investment is totally wiped out because the money that is kept in a trust only goes to regular investors?

Hadian: The management team and the initial investors (lose their investments).

So far there have been no Spacs outside the O&G sector. Why do you think that is?

(This interview was conducted before SC approved Red Sena Bhd, a food and beverage Spac.)

Hadian: The O&G sector is a high capital expenditure, high-value industry. But there are other mechanisms for investors and shareholders to invest directly – you could go through a private equity fund or buy a listed company. So Spacs are just another mechanism, similar to crowdfunding.

Maznah: If you want, for example, to invest in plantations, there are enough plantation companies out there which are listed that you can buy into. You don't need Spacs. The same goes with property – there is a whole lot of it. But O&G, there are not many aside from services. In upstream, there are none. That is why Spac is a model that we use.

Hadian: It gives you another spectrum to invest in the O&G. Otherwise in Malaysia, there is no listed E&P companies. We allow the public (to invest in E&P).

So it is not an issue of higher returns coming from O&G versus, say, property?

Hadian: Well naturally O&G comes with higher risks, so there are higher returns.

Would you personally invest in a non-O&G Spac, given you know how the model works

Hadian: I would not be able to tell.

Maznah: Our expertise is in O&G, that is what we know.

Do you think we are going to see more O&G Spacs? Do you think the market is conducive for it?

Hadian: Well I think there will be a cooling-off period because before you start introducing a lot of things into the market, you will want to see how the earlier ones have performed. It will also depend on which part of the O&G spectrum the Spac is in.

Aside from the oil prices and current market weakness overall, what are some of the other factors which are affecting Sona's efforts to secure a QA?

Hadian: A lot of it is logistical location, the infrastructure around it. But most importantly is, do you have the experience to manage the assets you are looking at? For the operational and subsurface experience, what do you know about the area?

I think one of the key issues will also be the relationship with the host country's authorities. So it is not just the money perspective, but how you will manage all these things. And this is where the value can come from.

Knowing what you know now, would you still choose to use the Spac investment model

Hadian: I have not faltered in that belief. The key is you must get a fundable asset – if it is then okay. The key is getting a good asset. There is an overhang, because it is new (in Malaysia), although the industry is not new. We are just another investment portfolio.

Maznah: There is nothing wrong with the model. It is just one method of fundraising. There is nothing wrong with the Spac model. The shareholders themselves have to evaluate (before investing).

Given the length of the process, with the regulatory approvals and all, is one year enough to get a QA?

Hadian: Well, we did Salamander within less than a year. And based on the Salamander experience, I think that a lot of things can be compressed further.

Maznah: The prep work is what takes time. When we go to SC, we would already have signed the sales and purchase agreement. And SC will process it within months and it will take another one month for the shareholders to meet.

Is it fair to say that you are in the advance stages of your discussions over some of these assets?

Hadian: Yes.

So full confidence that you will make it?

Maznah: Of course, we have to be.

Hadian: We have not faltered in that sense. It is something that we say everyday. But in the end the proof will be in the pudding. And it will be about delivering quality assets.

Are you concerned at all that there may be a run on your shares as the deadline comes closer?

Maznah: If you look at today's prices, 42 sen plus the warrants, it is still about 50 sen. So the original people who put in 50 sen will at the very least get (their investment back). But what we also see is opportunistic investors who want to buy at these levels. Because at the end of the day, even if nothing happens, you will get the full value. So there is good upside for them (the investors). If you were a shareholder from day one, there would be nothing to worry about.