Scotia Capital’s oil and gas expertise boosts M&A business

By Silvia Pavoni | Published: 12 April, 2011 |

Scotia Capital provides its oil and gas clients with in-depth geophysical expertise, something that vice-chairman Adam Waterous believes is just as important as advice on the structuring of mergers and acquisitions.

Adam Waterous is no typical investment banker. He got a taste of the business during the summer between the first and second year of his Harvard MBA, which he spent at First Boston. He then decided to set up his own business, Waterous & Co, at the age of 29 to provide advice on mergers and acquisitions (M&A) to oil and gas companies. His next taste of corporate life in a large investment bank came 14 years later, in 2005, when he sold Waterous & Co to Scotiabank.

“Most bankers who run boutiques work at a big firm for a long time, 20 or 30 years, leave and then they start their own venture,” says Mr Waterous. “I did it differently. My sole investment bank experience was 10 weeks at First Boston. I got the idea and thought ‘I can do this’.”

It turns out he could. At the time of selling the business, Waterous & Co was a leading independent M&A advisory firm in the oil and gas sector, with 75 employees, and offices in London, Houston, Denver and Buenos Aires. He is now part of a 1750 employee-strong investment bank and reports to Stephen McDonald, global corporate and investment banking head and co-chief executive of Scotia Capital, the investment banking arm of Scotiabank.

“I was in my twenties the last time I had a boss, but I really have enjoyed my time here [at Scotiabank], much to the surprise of many, because going from being an entrepreneur to being part of a big organisation is a big transition.”

Growth strategy

It was certainly a significant transition for Scotiabank too, which saw the number of oil and gas M&A deals grow by a factor of 20. With the acquisition, Scotia Waterous was created and incorporated into Scotia Capital, to focus on oil and gas transactions. Mr Waterous continued the growth strategy pioneered at his firm, consisting of deep technical knowledge in a limited number of sectors.

“[Scotia Capital] doesn't want to be all things to all people,” says Mr Waterous. “We want to be leaders in certain sectors. Not surprisingly, being in Canada, the sectors we focus on are oil and gas, then mining, and in third place financial institutions. If you’re successful in these sectors, that’s the vast majority of investment banking revenues in the country. We decided to develop very deep expertise in these narrow areas and, where possible, to globalise our expertise. The sector where we [first did this] was in oil and gas mergers and acquisitions, which was my historic business.”

This strategy seems to be paying off, as the bank’s M&A deals are equally spread across Canada, the US and the rest of the world. Since Scotia Waterous was founded in 2005, more than 124 oil and gas transactions have been closed globally, with a total value of $102bn. Last year, individual deal sizes ranged from less than $200m to $7.1bn.

Scotia ranks at 14 in the global league table for oil and gas M&A. While this is outside the golden top 10, it is faring pretty well against much bigger banks. In *The Banker* 's Top 1000 World Banks 2010, for example, Scotiabank ranks 38. Barclays, top in the oil and gas M&A league table, ranks at 10 in the Top 1000; JPMorgan, fourth in the M&A league table, is second in *The Banker* 's list.

Big deal

Chinese oil company Sinopec’s $7.1bn acquisition last year of a 40% stage in Repsol Brasil – which created one of the largest energy companies in private hands in Latin America – was one of the largest deals ever done by the bank. The Sinopec transaction was impressive also for its speed of execution. From the time the bank identified Repsol Brasil as an opportunity in the middle of last summer, to the time the transaction was announced, took less than three months, says Mr Waterous, who gives credit for this quick turnaround to the client's decision-making agility.

"A very popular myth is that dealing with Asian clients is slow and cumbersome. That is an outdated myth," he says. "That deal was very complicated and very large; the biggest joint venture ever done in the oil and gas business. We don't think that there is a Western-headquartered company that would have been competitive on that time frame."

Not surprisingly, Mr Waterous says that Asian appetite for oil and gas assets will continue to be a driver of M&A transactions. This is fertile ground for M&A given the high level of fragmentation: even a global giant such as ExxonMobil produces only about 3% of the global oil output. For oil and gas businesses, growth is also often more effectively achieved through M&A, given the role that economies of scale play in the sector. Moreover, in most cases it is cheaper to expand the business by acquiring another company rather than by growing organically.

Game changer

It is also an industry where technology can dramatically change the rules of the game, such as with the development of horizontal, multi-stage fracturing drilling technology. This has turned the extraction of shale gas – present in large quantities across the world, but trapped in rocks thousands of feet underground and previously too difficult or too expensive to recover – into a viable proposition.

Mr Waterous says this drilling method is the single most important technological change of recent years and that dozens of companies are now disinvesting from their traditional drilling operations to take advantage of untapped natural gas resources. The vast Marcellus Shale reservoir in the US – stretching across Pennsylvania, New York, Ohio and West Virginia – is one example.

"The structure of the oil and gas industry is an investment banker's dream – it is super-fragmented, super-capital-intensive and prone to rapid technological changes. You have all kind of reasons why you can have all kind of transactions," says Mr Waterous.

Thanks to the commodities boom, related equity and debt financing is also set to continue growing. Mr Waterous says Canada is the preferred destination for producers' fund-raising activities, thanks to favourable legislation and well-developed local expertise. Crucially, Canada has created a welcoming environment for smaller producers, as well as the large multinationals.

"The great thing about Canada, for the oil and gas and mining sectors, is that we have very supportive capital markets for smaller companies," says Mr Waterous. "If you look at the many success stories internationally, in Latin America and Africa, they have come to Canada to raise capital. We expect that to continue."

Technical depth

The technical expertise that Scotia Capital offers its oil and gas clients is the result of a business model that believes a thorough understanding of geophysics is as important as deal-structuring capabilities. "The strategy we pioneered [at Waterous & Co] is to have in-depth knowledge of the underlying assets of oil and gas companies. Twenty years ago we were the first investment bank to hire engineering geologists and geophysicists as core members of professional staff."

Others have since begun to recruit technical experts to their investment banking teams, but few firms have yet replicated the numbers of such professionals that make up Scotia's team, where they account for 40% of team numbers. Mr Waterous argues that this is a key differentiator. In natural resource industries such as oil and gas, it is crucial to have a deep understanding of the sub-surface because such businesses do not lend themselves merely to financial analysis. Naturally, loading up on technical experts in addition to investment bankers significantly increases costs, but Mr Waterous is adamant that this is the only way to provide real insight into this complex sector and to give the best possible advice to clients.

"You get into a lot of trouble in the oil and gas industry looking only at multiples of EBITDA [earnings before interest, taxes, depreciation and amortisation]," he says. "Looking at things from a purely financial matrix, on a comparative basis, is more straightforward for a cable TV company or a power utility. If you're looking at [natural resources] reservoirs, which is what you're banking on, you really need to understand the science behind it."

While many banks tend to focus on larger deals that generate bigger fees, Scotia Capital continues to work on transactions of any size. For smaller deals, profit margins may be smaller, but Mr Waterous says the high number of transactions makes up for it. Looking at Scotia Capital's revenue growth over the past few years, it seems as if the strategy is paying off: according to data provider Dealogic, net revenues for the investment bank grew by 50% between 2006 and 2010.

Career history

Adam Waterous

2008 – appointed vice-chairman, global head of investment banking, Scotia Capital. This includes Scotia Waterous, global mergers and acquisitions and equity capital markets. Mr Waterous retains his role as president and head of Scotia Waterous

2005 – appointed president and head of Scotia Waterous, following the sale of Waterous & Co to Bank of Nova Scotia (Scotiabank). Scotia Waterous is the global oil and gas M&A division of Scotia Capital

1991 – founded Waterous & Co, an independent M&A advisory firm to oil and gas companies

1988 – joined BCE Development, one of Canada's largest publicly traded real-estate development companies

1988 – obtained a Masters degree in Business Administration from Harvard. He was in the top 5% of his class and was designated a Baker Scholar

1987 – joined McKinsey consultancy as an analyst