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Contents | Previous Article | Next Article

Dividend-Paying Companies Active In M&A

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A recent trend which has emerged in the Canadian oil and natural gas industry is the increasing presence of dividend-paying oil and natural gas companies as purchasers of oil and natural gas companies and properties. Along with this recent trend, we have seen a number of companies announcing their intention to begin to pay out dividends to their shareholders.

The dividend-paying model is not a new structure idea, as seen by the former royalty income trusts ("RITS") which continue to be active on the merger and acquisition ("M&A") front. For instance, **Pengrowth Energy Corporation**, a former RIT, recently acquired **Equal Energy Ltd.**'s Cardium assets located in the Lochend area of Alberta for $62 million. The assets acquired included approximately 525 boe/d (93% light oil) along with related infrastructure and undeveloped land, consolidating Pengrowth's assets in one of its core operating areas. Pengrowth identified 32 net drilling locations on the lands acquired.

Baytex Energy Corp., also a former RIT, recently acquired 46 sections of undeveloped oilsands leases in the Cold Lake area of northeastern Alberta for $120 million. These lands are proximal to Baytex's heavy oil assets in Cold Lake and are prospective for both thermal and cold flow development.

Former RITS are not the only dividend-paying entities that have been active in M&A. **Twin Butte Energy Ltd.** became a dividend-paying corporation upon completion of its merger with **Emerge Oil & Gas Inc.** early in 2012. Since then, Twin Butte has remained an active participant in the merger and acquisition marketplace. Twin Butte acquired **Avalon Exploration Ltd.** in the second quarter of this year for approximately $85 million and on November 1, 2012, Twin Butte completed the acquisition of **Waseca Energy Inc.** for approximately $135 million through a combination of cash and shares. Concurrent with the acquisition of Waseca, Twin Butte increased its monthly dividend by 6.7 percent as the acquisitions of Avalon and Waseca created accretive growth for Twin Butte, allowing it to increase its return to its shareholders.

Toscana Energy Income Corporation is a relatively new publicly-traded dividend-paying entity which amalgamated with Senmar Capital Corp. in October of this year, at which time it listed its shares on the TSX Venture Exchange. Toscana has been very active with acquisitions since its amalgamation, announcing two significant deals. The first announcement was its acquisition of approximately 750 boe/d of long-life liquids rich natural gas production for $17.5 million concurrent with the completion of its amalgamation with Senmar. Shortly thereafter, Toscana announced a second acquisition, consisting of approximately 440 boe/d of long life, low decline liquids-rich natural gas production and 20 MMcf/d of natural gas processing and gathering facilities in west central Alberta for $10.5 million. Both acquisitions are expected to close by the end of November.

Newly formed dividend plus growth entities include **Renegade Petroleum Ltd.**, **Pinecrest Energy Inc.** and **Whitecap Resources Inc.** Both Renegade and Pinecrest announced transitions to dividend-paying companies along with significant acquisitions, whereas Whitecap determined it has established the right asset base through past acquisitions and development to start paying a dividend.

Renegade recently announced its intention to transition into an income plus growth dividend-paying corporation, with the first monthly dividend to be declared at the end of December 2012 and paid in January 2013. This announcement came alongside the acquisition of certain light oil and natural gas assets in southeast Saskatchewan for approximately $405 million, as well as the acquisition of **Canadian Phoenix Acquisition Corp.**, a wholly owned subsidiary of Canadian Phoenix Resources Corp. for approximately $83 million.

Last week, Pinecrest and **Spartan Oil Corp.** announced a business combination of the two companies which will have a combined enterprise value of nearly $1 billion. The combined entity will be managed by Pinecrest's existing executive team and is anticipated to declare a dividend in the first month subsequent to the completion of the transaction. It is believed by management that the combination of Pinecrest and Spartan's oil-weighted assets at Red Earth and Pembina allow for the transition to an income and growth model that supports sustainable dividend payments to shareholders, as well as provides the opportunity for annual per share growth.

Also last week, Whitecap announced its plan to transition into a dividend and growth entity with focus on sustainable dividend payments while maintaining emphasis on per share growth in production, reserves and funds from operations. The company plans to commence its monthly dividend policy in January 2013 with the first dividend payment in February 2013. Whitecap's management is of the view that the company has a concentrated asset base of low decline, oil-weighted properties, with room to grow; all the right characteristics to support a dividend-paying model.

Dividend-paying companies have to be selective with acquisitions that fit the dividend plus growth model. The ideal assets have a low decline with sustainable production and cash flow. Typically these acquisitions involve consolidation of an existing core area, in efforts to streamline operational efficiencies and ultimately enhance netbacks.

We expect dividend plus growth oriented companies to continue to be active in the M&A marketplace in the remaining weeks of 2012 and into 2013. We also expect to see additional exploration and production companies convert to income plus growth entities concurrent with the announcement of a merger or acquisition. Some investors are cheering the dividend plus growth model as they seek a higher yield in the current low interest rate environment, while there is some speculation of whether this model is suitable and sustainable for the juniors and intermediates in the capital intensive oil and natural gas sector.

Contents | Previous Article | Next Article