Daily Oil Bulletin

Sayer's Outlook For 2014 M&A Activity

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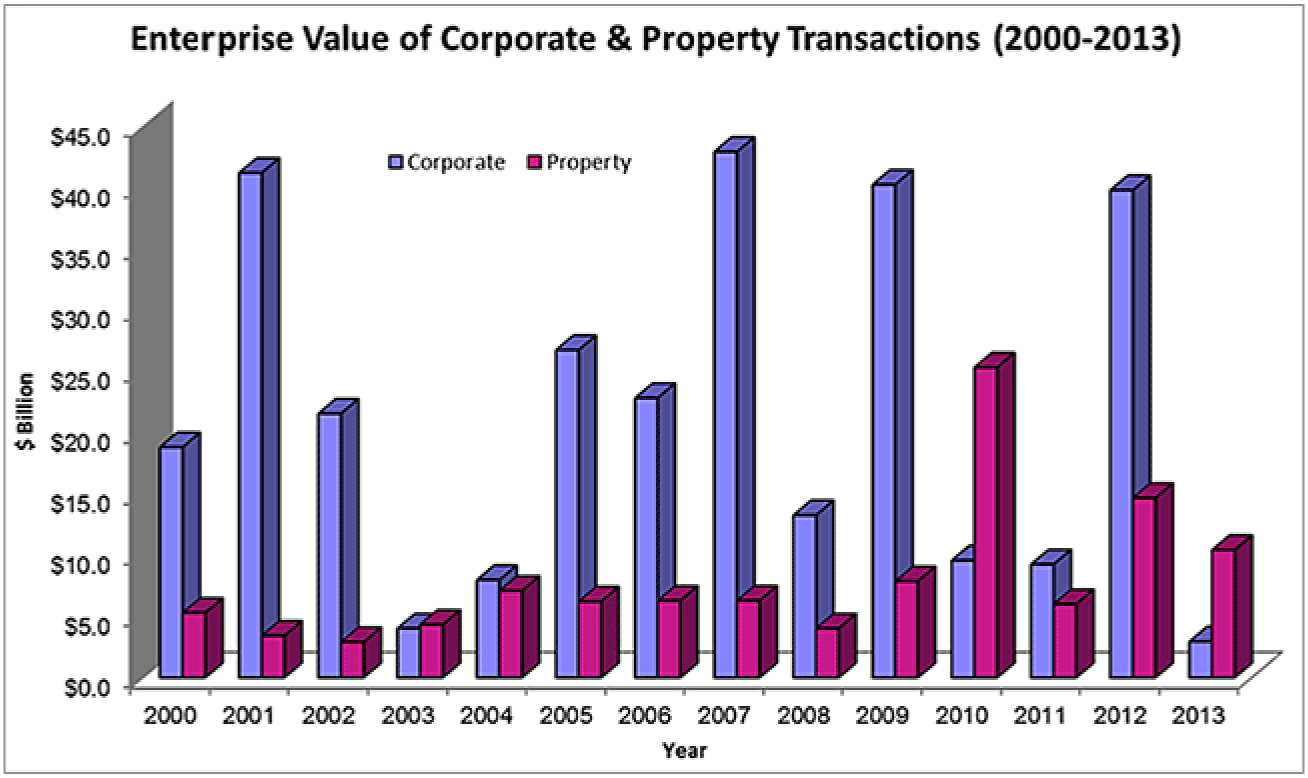
The past year was a relatively quiet year for merger and acquisition ("M&A") activity in the Canadian oil and natural gas industry, with a total of $14 billion of deals. In comparison, there was a total of $55 billion in M&A activity in 2012. Throughout the past year a number of adversities have developed which are central to projecting the activity in the M&A marketplace for 2014. The outlook for 2014 is a low total value of transactions, but there is expected to be an increase in the number of property deals.

During 2013, a lack of risk capital in the Canadian oil and natural gas industry became apparent, with most of the capital coming from private sources and foreign investors. The lack of risk capital has forced many junior oil and natural gas producers to divest of non-core assets in order to refocus capital to core areas.

The slowdown in M&A activity in 2013 was caused in part by the lack of risk capital, and also by the purchasers of significant assets being absent from market while digesting large acquisitions made the year before. For example, **Crescent Point Energy Corp.** completed a total of $2.2 billion in large acquisitions in 2012 but was not a notable participant in acquisitions in 2013.

Historically, corporate transactions have made up the bulk of M&A transaction value. In 2013, corporate transactions made up only approximately $3.0 billion of the large (over $5 million) transactions, proving 2013 to bean anomaly. Last year, **Cenovus Energy Inc.**, **Enerplus Corporation**, **Pengrowth Energy**

Corporation and **Suncor Energy Inc.** sold large packages of assets. Asset deals may continue to be more prominent in 2014, as large companies such as **Devon Energy Corporation** and **Penn West Petroleum Ltd.** have announced plans to divest assets in an attempt to focus operations on core areas.



Relatively low prices over the last year enabled purchasers to pick up natural gas assets counter-cyclically. Prices paid for dry natural gas assets were down in 2013, with generally limited value given for upside. Because of the rising prices since October of last year, reserves evaluators are forecasting higher natural gas prices for 2014. This could create a problem for selling natural gas assets.

Due to the current lack of capital in the industry, offers from purchasers have not been in line with the expectations of many vendors, creating a disconnect between buyers and sellers. The problem stems from the fact that buyers are not convinced that the price of natural gas will remain high over the long term, whereas the sellers suddenly see a much higher value. In several cases we have seen management teams refuse realistic offers because the lending value given to them by banks exceeds the realized proceeds from the sale of the assets. Some sellers become more realistic with expectations of value after a sales process, which helps to keep deals happening.

In combination with the lack of capital in the M&A marketplace over the last year, the changes to the Licensee Liability Rating program ("LLR") by the **Alberta Energy Regulator**, and pressure from banks and other secured creditors became constraining issues for countless junior oil and natural gas companies.

Due to the changes to the LLR program in 2013, companies with significant abandonment liabilities are forced to pay higher deposits to the provincial government, stressing the balance sheets of these companies. In a capital-restricted environment, selling assets can be the easiest way to raise capital. Selling assets with a positive LLR is a trend we expect to see throughout 2014, with purchasers effectively treating assets with positive LLR ratios as additional value that can reduce or neutralize amounts owing for a deposit.

Only certain management teams, typically those with a good track record, were able to continue raising capital throughout 2013. For example, **Tourmaline Oil Corp.** raised $228.6 million in March and $193.6 million in October through two separate bought deal financings, and again this month Tourmaline announced a bought deal financing of $156.8 million. **Whitecap Resources Inc.**, **Surge Energy Inc.** and **Kelt Exploration Ltd.** are also among the small group of companies able to continually raise capital in the constrained markets and early indicators in 2014 show that this trend is likely to continue.

In early January, Surge announced the purchase of assets from **Renegade Petroleum Ltd.** for $109 million, concurrent with a $70 million bought deal financing. **Cardinal Energy Ltd.** recently announced the purchase of properties from two private companies for $27 million concurrent with a $28 million private placement financing, continuing its activity in the M&A marketplace into 2014.

With as many difficulties as we saw in 2013, the M&A marketplace continues to move along and companies find ways to prosper. There will continue to be a mixture of opportunities for buyers and sellers in the year ahead.

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