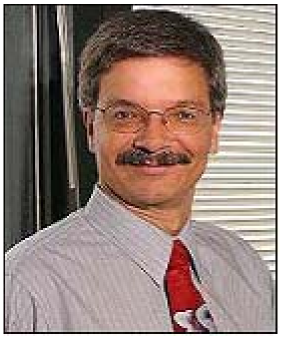
Daily Oil Bulletin

Sayer's Outlook For 2015 M&A Activity

JAN. 21, 2015 – VIEW ISSUE (/HEADLINES/2015-01-21)



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Every January, **Sayer Energy Advisors** publishes its outlook for oil and natural gas industry mergers and acquisitions ("M&A") activity for the coming year. Due to the large amount of uncertainty that currently hangs over the industry, we have been asked more times this year than ever before "*What's going to happen in the M&A market in the next few months*?" The quick answer is "*short term paralysis.*"

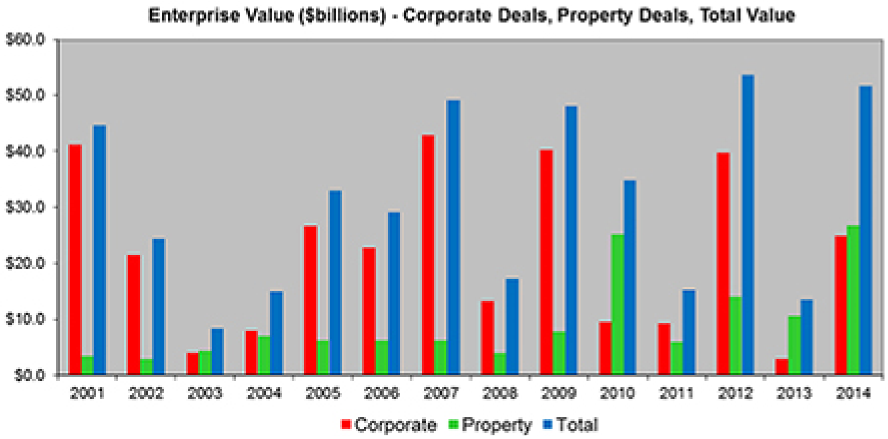
There is obviously more uncertainty in the industry than there has been for a long, long time, perhaps due to some twisted misalignment of the sun, the moon and the stars. Not many old-timers can remember the last time that we had to deal with, among other things, a combination of pervasively low natural gas prices, low oil prices, disinterested equity markets, increased corporate debt levels, pressure from activist groups and negative government intervention. Other than that, things are fine!

It's safe to say that most of us did not see this coming. When prices rise to historically high levels in a cycle our instinct is to convince ourselves that this time things are different and prices will remain high. When prices come crashing down, for whatever reason, we see a lot of industry players looking a lot like the proverbial *deer in the headlights*. In part because of this paralysis, in part because of denial, and in part because of wishful thinking, M&A activity is likely to get off to a slow start this year.

We saw a similar type of paralysis in 2008/2009, when Canadian natural gas prices began the precipitous fall to the +/- $3.00/GJ level. Early on in the natural gas price crash cycle, potential sellers refused to accept the fact that natural gas was no longer selling for over $6.00, and potential buyers were not willing to pay based on anything more than the current strip price, which at that time was in the $3.00 range.

It took several months before capitulation set in and companies were able to conclude transactions involving natural gas properties. Today, after a few years of sustained low prices, it is much easier to close a natural gas deal. Easier, but still not easy.

The following chart illustrates the yearly M&A activity, separating corporate transactions from property transactions. Note the significant drop in activity in 2008, followed by a rebound in 2009.



For a larger image [click here! (http://www.dailyoilbulletin.com/media/img/Large---Enterprices.jpg)](http://www.dailyoilbulletin.com/media/img/Large---Enterprices.jpg)

A recent example of a large-sized natural gas transaction is the recent purchase by **Ember Resources Inc.** of assets producing approximately 180 MMcf/d of natural gas in the Clearwater, Alberta area from **Encana Corporation** for $605 million. General acceptance of the new-norm in natural gas pricing should lead to further sales of natural gas properties and companies with a high weighting of natural gas production.

As most industry players currently believe that the oil price drop is going to be short-lived, with forecasts of the timeline for a modest price recovery ranging from a few months to inside of two years, it is not likely that there will be many large-sized transactions involving oil properties concluded in the short term. If prices rebound, activity should pick up. If prices remain low for a sustained period of time, reality will force companies to make some tough decisions and ultimately transactions will take place.

To raise capital in a tough environment, companies might be forced to put some of their higher quality assets on the block. These types of assets will remain attractive, more so than traditional non-core assets which may not be saleable in a tough market. This will lead to some decent prices being paid, as prospective buyers will realize that they will actually have competition to acquire quality assets that are on the market, even in depressed times. In good times it often seems that higher quality assets rarely hit the market.

A recent example of a high quality asset changing hands for top dollars in a tough market is the $100 million purchase of a 50 per cent working interest in the *Dixonville Montney "C" Oil Pool* by a subsidiary of **Eagle Energy Trust**. The acquisition from **Spyglass Resources Corp.** came with 1,250 boe/d of primarily (97 per cent) light, sweet crude oil which produces with an average annual decline of less than 10 per cent. WTI was trading at approximately $55 at the time this transaction was announced.

Many people believe that the lenders will force many companies to transact. We do not see this happening in the short term, except in special circumstances. Remember that banks are not in the business of putting their customers out of business, they are in the business of lending money. No lender would put down a company just because of low oil prices any more than you or I would liquidate our stock portfolios at these depressed prices. We believe that the banks will be patient (and cautiously optimistic) with companies that were in fine shape before the current price catastrophe.

For companies that were in financial distress at $90 oil, it will be a different story. These entities, and there are several, are likely to feel the heavy hand of the banks now. If there were capital issues at high prices, there are bigger issues that aren't going to be resolved with low oil prices.

Many of the entities that were in financial distress before the current price drop actually have some decent assets. Lender-initiated processes to liquidate the assets should result in a number of deals being concluded. For the lenders there will be an end to the bleeding and ultimate closure. For prospective purchasers of the assets there will be an opportunity to buy something strictly on the merits of the asset. All emotion will be taken out of the equation, and, in general, the high bidder will win the right to own the asset in question.

Corporate transactions will be tough to conclude in the next couple of months, as the previously-mentioned paralysis takes hold. Management teams will be reluctant to put their companies on the block, fearing that the result may not be palatable. This may open the door for a resurgence of the odd attempt at a hostile takeover, something that is rarely seen in the Canadian oil and natural gas marketplace.

As discussed in an article penned by Sayer for the *Daily Oil Bulletin* in October 2014, recent weakness in the equity markets has closed the door for all but a select few publicly–traded companies to raise additional equity for acquisitions, opening the door for private equity to step in. We expect to see continued aggressive buying presence by companies backed by private equity in 2015.

There is no doubt that we will eventually see a robust M&A marketplace in 2015, albeit a little different in makeup from the activity seen in recent years. After a relatively slow start, if the price of oil recovers to a more palatable level, or settles in at a predictable level, the M&A marketplace should really come to life. You are in the game, so find a seat, strap on the seat belt and hang on, as it should be an interesting ride!

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