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## Market Comment: Small, Midsized Firms Keep M&A Activity Buoyant in Canada's Upstream

When Royal Dutch Shell announced its \$82 billion megamerger with BG in April, speculation swirled that it may be the event to kick off a wave of consolidation in the oil and gas industry, but so far that just hasn't proved to be the case ([EIF Apr.15'15](#)). Analysts have insisted recently that the bid/ask spread is too wide, with sellers valuing their assets too high and potential buyers unwilling to pay premium prices in a depressed commodities environment. The trend has been particularly noticeable in the US, where mergers and acquisitions have slowed to a trickle, with few exceptions. But in the Great White North, the oil and gas industry's appetite for M&A deals has been less suppressed through the first half of the year, with small and midsized companies in Canada showing they are more willing to pull the trigger on deals than their US counterparts.

Crescent Point Energy took the lead among 2015 Canadian M&A deals with its C\$1.53 billion (US\$1.26 billion) acquisition of tight oil player Legacy Oil+Gas and its 22,000 barrels of oil equivalent per day of production. The acquisition came at an opportune time for Legacy, which analysts with Barclays had identified as one of the Canadian midcap E&Ps most at risk of breaching its debt covenants this year, as its cash flow had slipped 56% in the first quarter compared to the same period of 2014. First Energy Capital noted that the price paid for the assets was in line with the current commodity environment, precisely the hurdle many buyers and sellers have been unable to overcome. Crescent Point will take over assets with attractive growth potential, as Legacy reported quarter-over-quarter output was up 21% during the January-March period. Additionally, operations include acreage in Saskatchewan's Torquay tight oil play, where Crescent Point expanded its position last year via a C\$1.1 billion acquisition of private CanEra Energy ([EIF Apr.29'14](#)).

By selling out, Legacy was able to avoid the fate of Canadian independent oil sands producer Ivanhoe Energy, which filed for bankruptcy protection earlier this year after missing an interest payment due at the end of 2014. The firm essentially ran out of cash in October of last year, and suspended its operations even before crude oil prices crashed in December. Alan Tambosso, with Calgary-based Sayer Energy Advisors, told *EI Finance* that "in the smaller company space, many of the deals have been bank-driven." He noted that while larger companies may have access to capital through the equity markets, that isn't the case for smaller players.

Tambosso added that there have been several smaller oil sands producers, of the same ilk as Ivanhoe, that have found themselves stretched recently. "This is in part due to oil pricing and in part due to the Canadian government's restriction on the sale of oil sands assets to [NOCs]," he said. "This makes foreign entities very nervous about investing in Canadian oil sands."

Canada's relatively robust M&A market isn't just being kept afloat solely by distressed sellers. One of the key differences between many of the struggling Canadian firms and similarly strapped E&Ps in the US is the quality of their assets. The best, most economic acreage in the US lower 48 is mostly held by firms with strong balance sheets - EOG Resources, Pioneer Natural Resources and other shale giants. But the same can't always be said in Canada ([EIF May20'15](#)).

Sayer's Ben Rye noted in March that many of the deals have been based on the quality of the assets, with corporate

acquisitions being accomplished through the issuance of shares. Sayer's view is shared by analysts with Barclays, who said in recent months that M&A deals among smaller companies "could do share-for-share deals so long as the buyer's stock is richly priced." The banking giant added that large independents in North America as a whole were more likely to look for tactical acquisitions, as opposed to more expensive corporate deals. Another factor holding back US M&A activity has been wide open capital markets, which have allowed even distressed companies to hold off on selling their best assets.

In Canada, some firms are using capital markets for opportunistic acquisitions rather shoring up weak balance sheets. Torc Oil & Gas issued 16 million shares worth \$128 million earlier this year to finance its purchase of conventional producing assets in Saskatchewan, and later said it would pay \$430 million in cash for more assets and production in the province. Kelt Exploration, meanwhile, acquired Artek Exploration, which it had previously worked alongside in the Inga-Fireweed-Stoddart area of British Columbia. Kelt paid for the assets by issuing 26.9 million shares, raising C\$309 million.

While larger Canadian oil and gas firms have remained mostly on the sideline this year, Cenovus Energy said recently it was in advanced discussions to offload its royalty interest and mineral fee title lands in Western Canada. The timing of the negotiations, which could be worth as much as C\$3 billion, comes as a mild surprise. Barclays analyst Paul Cheng noted in late April that while the Calgary-based company had been marketing the assets, a deal "will not be executed in the near-term given current market conditions."

There is some further reason for hope in the M&A marketplace this year, as Sayer has said it sees deal flow picking up significantly in Canada this fall. Tambasso confirmed the advisory firm's view that despite the slow start to M&A this year, activity in the country should pick up as the year moves on with oil prices improving and becoming more predictable. He added that concerns do linger, however, about any regulatory changes brought forth by Alberta's new provincial government and federal elections scheduled in October could bring another wave of change and uncertainty.

Canada's Top 10 M&A Deals 2015		
Announce Date	Transaction	Value (\$ million)
May 26 '15	Crescent Point Energy acquires debt-burdened Legacy Oil+Gas	\$1,258.0
Apr 22 '15	Privately held Aspenleaf Energy buys Arcan Resources	477.5
Mar 18 '15	Light oil producer Whitecap Resources buys Beaumont Energy	430.5
Jun 11 '15	Trinidad Drilling snaps up CanElson Drilling	413.2
Feb 2 '15	Midwestern Oil & Gas buys fellow African-focused explorer Mart Resources	405.6
Apr 27 '15	Torc Oil & Gas buys light oil assets in Saskatchewan, Manitoba	353.0
Feb 23 '15	Western Canada-focused Kelt Exploration acquires Artek Exploration	237.5
Mar 12 '15	Tourmaline Oil buys oil and gas assets in Alberta	203.6
May 26 '15	New Star Energy acquired by undisclosed Chinese company	174.8
Jun 9 '15	Montney, Duvernay player Black Swan acquires Carmel Bay	\$160.8

Source: Dealogic, Derek PLS