Lamphier: Oil price volatility impedes dealmaking activity

BY GARY LAMPHIER, EDMONTON JOURNAL AUGUST 31, 2015

Volatile oil prices are slowing down merger and acquisition activity.
Photograph by: Bruce Edwards, Edmonton Journal

Some sympathy, please, for the analysts who churn out oil price forecasts for a living. In today's topsy-turvy environment, it's a sure-fire recipe for insanity.

After sinking to six-year lows of $38.24 US a barrel just a week ago, U.S. light crude prices have posted their biggest three-day gain since 1990, closing Monday at $49.20 on the New York Mercantile Exchange.

To put that in context, that was the last year the Edmonton Oilers won the Stanley Cup. It was also a time when George Bush still occupied the Oval Office. Not George W. Bush, mind you, but his father, George H.W. Bush, who recently turned 91.

Yup, these are crazy times in world oil markets, with volatility at nosebleed levels.

The main spark for the latest jump in oil prices? News that the Organization of Petroleum Exporting Countries (OPEC) is ready to discuss cuts in oil output, as long as other major global players also do so in an effort to create "a level playing field" for all.

That's a big shift in OPEC's stance. In a bid to recapture market share and drive higher-cost producers out of the market, OPEC — led by cartel kingpin Saudi Arabia — had until now refused to consider production cuts despite a year-long meltdown in oil prices.

Ditto for Russia, another major producer. But the Russians are also changing their tune. Bloomberg reports that an aide to Russian President Vladimir Putin told reporters Monday that Russia is also now willing to discuss possible supply cuts.

OPEC's announcement, carried in the cartel's monthly bulletin, follows increased pressure for cuts from cash-strapped Venezuela, Algeria and other member states whose economies have been crushed by low oil prices.

Although traders quickly bid up oil prices Monday, with October futures for benchmark grade West Texas Intermediate (WTI) crude jumping nearly $4 a barrel or 8.8 per cent on the day, many expressed skepticism that any OPEC supply cuts will actually occur.

"The market is reading way too much into this," Mike Wittner, head of oil market research at Societe Generale SA in New York, told Bloomberg. "Until Saudi Arabia says something this is all meaningless."

Maybe so, but the sudden price uptick, helped along by data from the U.S. Energy Information Administration showing that U.S. production was lower than previously estimated for the first five months of 2015, offers some respite for beleaguered producers who have had precious little to cheer about this year.

At the same time, the roller-coaster ride in prices is creating havoc for asset buyers and sellers in the oilpatch, who are having a tough time agreeing on appropriate valuation levels.

The standoff is further complicated by potential changes to Alberta's royalty regime and carbon emissions levies, and the possibility that this downturn could last several more years, as some analysts predict. Add it all up, and it suggests this year's slowdown in oil and gas merger and acquisition (M&A) activity is likely to continue.

"Potentially the market is waiting for a signal or a sign or something to bring buyers and sellers together, and there is a lot of speculation as to what it will take," says Tim McMillan, president of the Canadian Association of Petroleum Producers (CAPP), who addressed the Journal's editorial board on Monday.

"I think you hear a lot of companies and analysts say this (downturn) looks a little different obviously from 2008, that it's going to be lower longer . . . (and) there is no rush to get in because if it's going to be lower longer, a more thoughtful approach (to dealmaking) is what's taking hold."

The stats back him up.

Through the first six months of this year, the total value of M&A deals in Canada's oilpatch dropped by more than half, to $9.7 billion from $20 billion a year earlier, according to data compiled by Sayer Energy Advisors.

The figures, which reflect the total enterprise value of all industry M&A transactions, also show a decline in the number of larger deals, Sayer notes.

"I think if we didn't see the decline in the oil price in July and August I think we would have seen quite a bit more M&A activity," says Tom Pavic, vice-president of the Calgary-based energy advisory services firm.

"I think the recent drop from the low $60s to the high $30s and now this bounce back to the mid-to-high $40s has increased the volatility, obviously. So I believe there is going to be a disconnect paralysis between buyers and sellers on valuations and that's going to take some time to settle out."

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