Calgary

Oilpatch buyers expected to stay on the sidelines in 2020, analysts say

'Canadian guys are facing more country risk and currency risk and regulatory risk'

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Pumpjacks at work pumping crude oil near Halkirk, Alta., in this stock image from 2007. A recent spate of consolidation of producers in prolific Texas oilfields has some investors wondering when the same thing will happen in Canada, but the answer is likely not, said analyst Jordan McNiven with Tudor Pickering Holt & Co. (Larry MacDougal/Canadian Press)

comments

A mindset of "hunkering down" in the face of persistent headwinds means mergers and acquisitions activity in Canada's oilpatch will likely remain at low ebb in 2020, analysts say.

A recent spate of consolidation of producers in prolific Texas oilfields — WPX Energy announced the US$2.5-billion purchase of Felix Energy last week — has some investors wondering when the same thing will happen in Canada, particularly in the rich Montney resource play on the northern Alberta-B.C. border, said analyst Jordan McNiven with Tudor Pickering Holt & Co.

But the Canadian M&A situation is quite different, he said. Factors including declining share prices, low stock-market trading volumes, poor access to capital and industry pessimism over export pipeline constraints mean companies are more interested in surviving than growing.

"It certainly makes it more challenging. Canadian guys are facing more country risk and currency risk and regulatory risk, and then you layer on top of that liquidity risk," said McNiven.

"(Investors) have to have a compelling reason to accept all of those risk factors and invest in Canada instead of the U.S."

Companies more likely to buy back shares, pay down debt

He explained low trading volumes discourage large investors from buying oilpatch stock in Canada because their trades could have too much impact on share prices.

Statistics from Evaluate Energy show that year-to-date upstream transactions in Canada in 2019 add up to about $4.6 billion US ($6 billion Cdn), down from $11.2 billion US in all of 2018 and $32.2 billion US in 2017.

In contrast, upstream deals in the United States are up this year to $94.1 billion US from $81.5 billion US last year and $66.7 billion US in 2017.

"I think a lot of what we've seen in 2019 (in Canada) will continue into 2020," said Tom Pavic, senior vice-president with Calgary-based Sayer Energy Advisors.

"It's a lack of capital. We're seeing very little in the way of financings being done in the upstream oil and gas industry. Whatever excess capital companies do have, they're not using it on M&A, they're using it for share buybacks and payback of debt."

Tourmaline Oil Corp.'s rare move

In its 2020 production guidance news release this month, Calgary-based producer Tourmaline Oil Corp. said it expects to have access to over $800 million for "select acquisition activity" next year.

The news is remarkable because it's so rare, analysts agreed, adding the company has had to employ a unique solution to raise the money.

The acquisition pool is expected to be freed up through the company's creation of subsidiary Topaz Energy Corp., which will take ownership of its midstream and royalty assets in exchange for the expansion cash.

Companies that merge often justify it by citing cost synergies, the ability to do more with fewer people and resources.

There's less to gain in Canada where years of cutting costs and exploration budgets have reduced expected administration costs to an average of about six per cent of cash flow in 2020, compared with U.S. peers at 13 per cent, McNiven pointed out.

Husky Energy Inc. recently confirmed it had reduced its ranks by 370 employees this year because it is spending less on growth.

The S&P/TSX Capped Energy Index, which tracks share prices of major producers, has dropped by more than a third in the past three years, suggesting there are plenty of bargain-priced publicly traded companies for buyers to look at.

But "turning over the keys at the bottom of the market is a tough pill to swallow," noted McNiven.