Varcoe: Biggest oilpatch deal of year gets bumpy reception from investors

CHRIS VARCOE, CALGARY HERALD (HTTP://CALGARYHERALD.COM/AUTHOR/CHRISVARCOE) Updated: June 19, 2018

Pumpjacks at a Baytex Energy well site near Crosby, North Dakota.

It's the biggest union in the oilpatch this year, but the merger of Baytex Energy Corp. and Raging River Exploration Inc. received a rough initial reception from shareholders on Monday.

The question is whether the sentiment will turn around — and if the creation of a larger Canadian oil producer is a harbinger for more mergers and acquisitions going forward or a warning for others contemplating a deal.

Baytex, an intermediate oil producer, announced Monday it will acquire Raging River (http://calgaryherald.com/commodities/energy/update-1-canadas-baytex-to-buy-oil-producer-raging-river-for-c2-8-bln/wcm/239fd9c4-4ac8-486d-afb2-9b5de389b8c6) in an all-stock transaction valued at $2.8 billion.

If approved by shareholders, the combined companies would produce 93,600 barrels of oil equivalent (boe) per day in Western Canada and the United States, with an enterprise value of almost $5 billion.

Baytex chief executive Ed LaFehr will remain as CEO and president of the combined companies, while Raging River CEO Neil Roszell will become chairman.

In an interview, LaFehr said Baytex had been evaluating potential opportunities for the past year and wanted to remain focused on North American oil plays.

He believes the merger will be transformative, giving Baytex a stronger balance sheet with new growth opportunities.

“If you look historically, the junior companies have all but evaporated and the large-scale, major companies have all been undergoing a consolidation over the last five years. . . What we haven’t seen is much consolation in the intermediate space,” LaFehr said.

“Scale does matter and we want to be competitive with the U.S.; we want to have assets that attract capital and investor attention.”

The Canadian oilpatch is facing challenges today gaining the interest of investors.

Raging River was spun off in 2012 by Roszell to develop some assets in Saskatchewan’s Viking formation after his previous company, Wild Stream Exploration, was sold to Crescent Point Energy.

The new firm was named the industry’s top junior producer in 2014 and 2016 by the Explorers and Producers Association of Canada, but Raging River announced in March it was examining a strategic repositioning, saying its share price didn’t “adequately reflect” the value of the firm.

Roszell told a conference call Monday that the strategic fit with Baytex is compelling, and the combined companies can be “much greater than the sum of its parts.”

With the move, LaFehr pointed out the company will have core producing properties in the Viking, Peace River and Lloydminster areas, as well as the Eagle Ford play in Texas.

The producer has growth plans for Raging River’s East Duvernay shale oil play, where it holds 260,000 acres of land.

Both stocks fell sharply after the announcement (http://calgaryherald.com/business/energy/baytex-energy-shares-tumble-following-1-2-billion-raging-river-deal) , with Baytex closing down 12 per cent, while Raging River was off 10 per cent.

“Bigger is not always better here. And you can see shareholders speaking with their feet here in terms of how they’re selling off Baytex and Raging River,” said analyst Jeremy McCrea of Raymond James.

The merger comes as benchmark U.S. oil prices have strengthened this year into the US$65-a-barrel range.

Yet, there’s widespread consternation about the Canadian industry’s ability to attract capital due to pipeline constraints, a steeper heavy oil discount and feeble natural gas prices.

After $43.5 billion in M&A activity occurred in the oilpatch last year — driven by the sale of oilsands assets by international majors to Canadian companies — the pace of deal-making slowed to $2.6 billion during the first quarter, and roughly the same amount since April, according to data from Sayer Energy Advisors.

Prior to Monday’s announcement, the largest takeover this year was Vermilion Energy’s $1.4 billion acquisition of Spartan Energy Corp.

“There hasn’t been a lot of M&A because there hasn’t been a lot of cash in the system,” said Alan Tambosso, president of Sayer Energy Advisors. “You’d start to see things pick up if you saw a further strengthening of oil prices.”

Tambosso expects there will be a slow pickup in acquisitions through the rest of the year as more companies look to consolidate.

But the reaction by investors to Monday’s deal could make potential sellers cautious until more acquirers enter the picture and offers improve.

“There are fewer buyers and they are more conscious about the potential impacts about . . . doing acquisitions that raise their debt too high, or that dilute their own equity values,” said Mike Tims, vice-chairman of Matco Investments.

“Other producers may be looking at this and saying why would I merge or sell – especially if you’re the seller — if I’m not going to get a lift in my pricing?” added Martin Pelletier, a portfolio manager at TriVest Wealth Counsel.

Looming in the background is the inattention toward the Canadian energy sector this year by global investors, while the U.S. oilpatch is booming.

Rafi Tahmazian, a senior portfolio manager at Canoe Financial, believes there are positive signs around oil prices, but Canadian producers are facing turbulence, including pipeline constraints and ongoing regulatory uncertainties, that don’t exist south of the border.

“We’re in an environment of, ‘Show me,’” he said.

“The sector is under extreme negative sentiment pressure, so it has to be a fairly prolific type of transaction for the market to recognize it positively in this day and age.”

LaFehr said he was a bit surprised by the initial investor reaction and believes the headwinds facing Canadian oil and gas producers are a factor. But there is also an opportunity for buyers to be countercyclical and “poised to move up when those headwinds turn into tailwinds,” he added.

There are many currents blowing across the Canadian energy sector today, and progress on pipelines would make for a smoother ride. But on the deal-making front, the initial gust toward the Baytex-Raging River marriage is decidedly bumpy.

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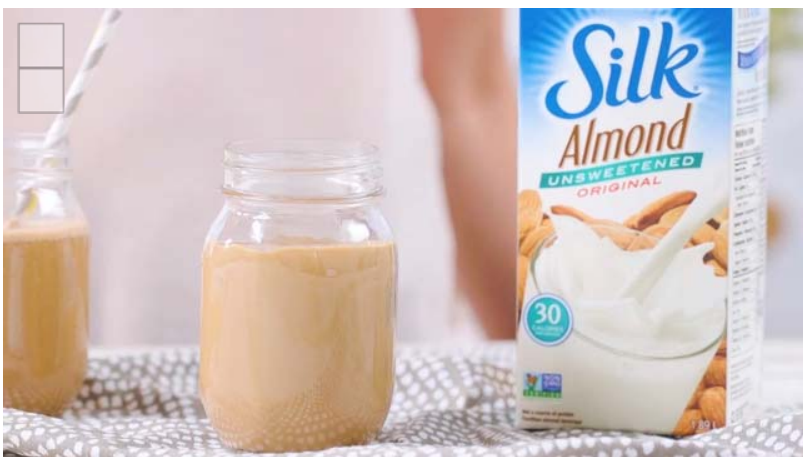

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