

Varcoe: Billion-dollar oilpatch 'survivors' grows; outlook strong

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Chris Varcoe, Calgary Herald

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Call it Canada's billion-dollar energy club.

And in the words of industry analyst Jeremy McCrea of Raymond James: "Membership has its privileges."

After a tumultuous three-year ride for oil and natural gas prices, publicly traded Canadian petroleum producers have been on an upswing over the past 12 months. The S&P/TSX Capped Energy Index is up 35 per cent during the past year, including 2.5 per cent since the end of December.

A report by McCrea this week noted 30 oil and gas companies on the Toronto Stock Exchange ended December with a market capitalization topping \$1 billion, the first time that's happened in six years.

And the total number of listed oil and gas companies has fallen 55 per cent since 2015, following a crash in oil prices.

"The number of names is down quite a bit, but the relevancy of the top billion-dollar club has actually grown here over the last couple of years," McCrea said Friday.

"They're survivors. And now, when you look at the commodity prices where they are, relative to where the average was over the last seven years, these companies are really flourishing now."

The benchmark U.S. oil price rose more than \$1 a barrel on Friday to close at US\$81.64, while U.S. natural gas prices dipped 10 cents to US\$3.16 per million British thermal units, reaching its lowest point in more than 18 months.

In Canada, the billion-dollar market cap group ranges from well-known heavyweights such as Canadian Natural Resources at more than \$89 billion and Suncor Energy at \$60 billion, down to smaller energy firms such as junior producer Headwater Exploration at \$1.5 billion and Pason Systems at \$1.3 billion.

"Why does this matter? With fewer but stronger companies in the sector, the level of interest in 2022 has picked up meaningfully with investors," the Raymond James note states.

"There may be fewer companies today, but the companies (and sector as a whole) are showing much more relevance with investors. This likely continues for 2023."

In 2013, as the oilsands boom was still going and oil prices hovered around US\$95 a barrel, there were 369 listed Canadian oil and gas companies, with 39 having a market capitalization above \$1 billion.

After oil prices crashed in 2014-15, the industry entered a painful period of retrenchment and consolidation, with more M&A activity taking place after the pandemic began.

In 2020, only 16 oil and gas companies had a market cap over \$1 billion.

Over the past 12 months, the war in Ukraine and rising global oil demand have sent commodity prices higher, and stock prices in the sector have risen.

McCrea also noted the value of trades in Canadian oil and gas stocks jumped 120 per cent to \$467 billion last year, compared to a 12-year average of \$213 billion.

According to the TMX Group, the energy sector now makes up about 18 per cent of the broader S&P/TSX Composite Index — trailing only financials — and up from 14.6 per cent a year ago.

A research note Friday from ATB Capital Markets highlighted the evolving nature of the Canadian energy capital structure. Of the 29 firms listed in the S&P/TSX Capped Energy Index, the 10 largest make up about 85 per cent of the aggregate market capitalization.

Oilpatch executives say size increasingly matters by lowering their cost of capital, making it easier to attract larger institutional investors and bolstering their ability to secure necessary services through larger capital programs.

"In order to be successfully public, you need some magnitude of size. So \$100 million of market cap probably isn't going to cut it, you're not going to get any attention," said Headwater president Jason Jaskela, stressing companies also need to differentiate themselves from their peers.

"It's not easy to raise money right now, even with the winds in our sails. There are less people investing in energy all the time ... having some size and some differentiation and having a good cost of capital are all really important."

The industry also continues to consolidate.

Sayer Energy Advisors says the value of all M&A deal-making last year in the upstream Canadian oil and gas sector hit an estimated \$16 billion, led by privately held Strathcona Resources acquiring Serafina Energy for \$2.3 billion.

Eric Nuttall, a senior portfolio manager with Ninepoint Partners, said the business model has changed for the oilpatch in recent years, making it harder for smaller petroleum producers to thrive.

"Liquidity matters for institutions where you want to be able to buy a relevant position size without being stuck in a name when you want to exit," he added.

"That's especially important now because there are vastly fewer players in this space than there were 10 years ago ... a larger market cap affords more institutions to take an interest."

As for 2023, the outlook will depend, in part, on where commodity prices are headed and how demand shapes up with a global slowdown looming.

However, chronic underinvestment globally, the easing of COVID-19 restrictions in China and less oil being released from the U.S. Strategic Petroleum Reserve should help support prices.

The International Energy Agency said earlier this week that global demand for oil is expected to reach an all-time high, increasing by 1.9 million barrels per day.

"Outside a recession, I think the fundamentals for oil and gas still look pretty good, particularly on the oil side," said Michael Clare, a senior portfolio manager with Brompton Group.

"Of course, the key risk being whether we enter a recession — and what that does to potential demand."

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