


## Long-shot Obsidian talks up consolidation in beaten-down Canadian oilpatch

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CALGARY — Despite depressed commodity prices, disinterested capital markets and huge short interest in its own stock, Obsidian Energy Ltd. believes there are consolidation opportunities in parts of the Canadian oilpatch.

The Calgary-based company's interim president and chief executive officer Stephen Loukas said his company is the largest oil producer in Alberta's light-oil producing Cardium formation, which is also home to more than a dozen competitors.

"There are a significant amount of operators. There are 15-plus companies that have a not-inconsequential amount of their production profile in the Cardium," Loukas said, adding the fragmented concentration in the play in western Alberta, fallen valuations and a lack of scale means that many of these producers, including Obsidian, are "just no longer relevant in today's capital markets."

In September 2019, Obsidian launched a strategic alternative process and Loukas said it has now "looked at a number of potential transactions." But it's unclear whether the indebted company is capable of buying competitors, or whether it would be an attractive takeover target itself, or even if its competitors are willing to merge.

"We're open minded in regards to what creates the most amount of value for all stakeholders," he said. "When this is all said and done, there should probably be two players in the Cardium — three at most. Certainly not 15."

There are also lingering questions of how Obsidian would fund a deal. Its most recent financial results show \$4 million in cash on its balance sheet and \$474 million in long-term debt, though the company announced earlier this year it renegotiated its credit facility and pushed out some maturities by 18 months.

Once a fertile ground for mergers and acquisitions activity, the oilpatch has seen a dearth of deals as COVID-19 pandemic has led to a catastrophic collapse in oil prices this year, pressuring business models of oil and gas producers. This has led, in turn, to capital markets being less willing to lend to the energy sector or finance deals.

Financial Post Data shows 17 M&A deals valued at \$822 million in the oil, gas & consumable fuels sector took place in the first six months of the year, compared to 26 such deals valued at \$6.88 billion during the same period last year — an 88 per cent drop in terms of values.

Sayer Energy Advisors president Tom Pavic said the vast majority of his M&A advisory firm's work is currently in assets involved in insolvency or The Companies' Creditors Arrangement Act, or CCAA, processes.

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Tom Pavic, Sayer Energy Advisors

"It's really tough for buyers and sellers to come together right now unless it's an insolvency process," Pavic said. "The valuations are so far off. There's not really a happy medium."

Since the coronavirus pandemic hit, company valuations have plummeted along with oil prices, and companies that are going concerns are not looking to sell in the current market, Pavic said.

There have been a few small deals. Last week, Tamarack Valley Energy Ltd. announced a \$4.25 million acquisition of assets that produce 2,500 barrels of oil equivalent per day in West Central Alberta, as well as 105,000 acres of land.

Pavic said that deal shows how far asset valuations have fallen. "You can see the metrics on that were pretty low and pretty surprising," he said.

Tamarack Valley is a small oil and gas producer focused on the Cardium and Viking plays, but analysts say it was able to buy a small number of assets because it has relatively low debt levels in comparison with Obsidian and other players.

There could be very little equity value (in Obsidian) at the current strip prices

Jeremy McCrea, Raymond James

"Despite the terms of (Obsidian's) loans pushed out 18 months, the company still has large (environmental remediation) liability and in the context of recent M&A transactions, we believe there could be very little equity value at the current strip prices today," Raymond James analyst Jeremy McCrea said in a research note after the company announced financial results in May.

Obsidian announced a \$746 million net loss for the first quarter compared with a \$54 million loss in the same quarter a year earlier. That equates to a loss of \$10.22 per share for Obsidian stockholders.

Short sellers have been aggressively betting against the company, which had the highest short interest ratio in the Canadian exploration and production industry on May 1, according to AltaCorp Capital research.

It's a far cry from the company's pre-financial crisis heyday when it was known as Penn West Petroleum Ltd. and shares traded at 200 times today's prices. The company's share price plunged after the company was mired in an accounting scandal in 2014 and then as a result of the oil price crash that year.

Since that time, many Canadian oil and gas companies, including Obsidian, have seen their stock prices plunge. Loukas said the drop should be a signal to other companies that they should be looking at consolidation to reduce costs.

"I do think it's fair to say that we're in an environment now where every board has to think through their strategic options. The banks are looking at their exposures. I need to be mindful of my exposures," Loukas said.

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