

Oilpatch primed for more consolidation in wake of Cenovus-Husky deal

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The merger of Cenovus Energy Inc. and Husky Energy Inc. may prove to be a catalyst that sets off a wave of M&A activity leading to much-needed consolidation in the oil-and-gas space, according to analysts who watch the sector.

On Sunday, the two companies announced a \$3.8 billion, all-stock merger that will see Cenovus pay a 23 per cent premium for Husky. The combined entity will become Canada's third-largest oil producer if the deal clears as expected in the first quarter of 2021 and boost Cenovus' output to 750,000 barrels per day.

The merger follows on the heels of a few smaller moves in the Canadian sector, including Whitecap Resources Inc. buying NAL Resources Limited for \$155 million in an all-stock deal and Canadian Natural Resources Ltd.'s \$111 million purchase of Painted Pony Energy Ltd. Whether it's a case of two smaller companies combining to form a larger entity like the former or one of the sector's leaders plucking up a junior for its assets like the latter, analysts expect there's more to come.

This could likely be the catalyst we need to set off a merger wave

Veritas Investment Research analyst Jeffrey Craig

"Everyone was waiting for the first shoe to drop and this could be it," said Veritas Investment Research analyst Jeffrey Craig. "I would say this could likely be the catalyst we need to set off a merger wave."

Analysts and critics alike have long called for consolidation in Canada's oil-and-gas sector. The problem was that due to the years-long bear market in energy, there was little capital to throw around and even less space available on balance sheets for additional debt.

According to Craig, the Cenovus-Husky deal may have done two things to accelerate M&A in the sector. For one, Cenovus may have to divest from some of the non-core assets it acquired in the transaction. Merging with Husky gives the company new asset types it didn't possess before in retail, midstream and offshore Atlantic Canada. Cenovus CEO Alex Pourbaix has already hinted that the company may look at unloading some of these assets.

Secondly, the deal provides a blueprint for others to follow. Prior to COVID-19, a merger of this sort would've simply been seen as dilutive to shareholders, he said. (And perhaps it still is after Cenovus' stock closed down nearly nine per cent on Monday.) Without cash or room for additional debt, all-stock deals may be the best solution. Better still if unlike the Cenovus-Husky merger, they don't involve premiums and are simply seen as a "merger of equals," he said.

"Given where we're at now, investors and management teams are starting to see deals have to happen to make these companies stronger, even if they're dilutive in the short-term," Craig said.

"(Before COVID-19) if you tried to sell for a tiny premium or no premium, your shareholders might

say 'What the heck (is going on),' but I think you're going to start to see them realize it's pure survival at this point."

Mergers like these may in fact be the only solution for some smaller producers, who may soon be called into action. If two of the largest companies in the sector realized they had to merge in order to continue to thrive, then what does that mean for the junior producers or even for the Crescent Point Energy Inc.'s or Vermilion Energy Inc.'s?

"Before, no one would've been willing to merge on a non-premium deal but as they see their big brothers throwing in the towel and merging, the bar for a deal has dropped," Craig said.

Eight Capital analyst Phil Skolnick also foresees more mergers and acquisitions, but not just among the space's smallest players. The Cenovus-Husky merger has left four clear-cut companies at the top of Canada's oil and gas sector: Canadian Natural Resources, Suncor Energy Inc., Cenovus and Imperial Oil Ltd. In a move that could be similar to the Newmont Mining Corp and Goldcorp Inc. mega-merger of 2019, Skolnick can see two of those heavyweights merging.

The prospect of a Suncor and Canadian Natural Resources merger is what intrigues Skolnick most.

"If they were to merge, it would be a massive powerhouse of an energy company on a global level," said Skolnick, adding that while this proposed super-entity might seem light on downstream assets, the few that it would have would be among North America's best.

As far as some of the smaller players in the sector, Skolnick highlights MEG Energy Corp. as a potential target.

Like Skolnick, Tom Pavic, the CEO of Sayer Energy Advisors, an expert in M&A activity in the oil-and-gas sector, also expects more consolidation going forward, but he offered a warning. The Cenovus-Husky deal made sense for both parties, he said. Anyone following in their footsteps should ensure that a merger or acquisition reaps the same benefits.

"You can't just consolidate for the sake of consolidating," he said.

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