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Asset Prices Will Fall, Companies Will Fail In New Environment

By Lynda Harrison

With the downturn in commodity prices, petroleum asset transactions now favor cash-rich buyers and difficulty securing new capital will keep it that way for some time, attendees at conference heard this week. There is also more potential for hostile takeovers as share prices have plummeted this fall along with the collapse of oil and natural gas prices.

But many potential transactions will fail because of unrealistic price expectations, **Alan Tambosso**, president of **Sayer Energy Advisors**, told The Dealmakers Symposium and A&D Forum in Calgary this week.

And asset prices are poised to fall dramatically, said Tambosso. "We think that because the price of oil and gas has fallen and access to capital has disappeared, the cost of capital has increased and obviously prices in 2009 are going to fall."

Sayer has been tracking the history of merger and acquisition prices for 22 years and 2007 witnessed the peak for the total value of merger and acquisition transactions. So far in 2008 the total value is substantially lower and it is not expected to be much higher next year, Tambosso said.

"We don't think you're going to see a lot of property packages in part because people selling assets are looking for close to their full asset value," he said.

There are currently several individual properties and packages available totalling between 50,000 and 70,000 bbls of oil equivalent per day, with the majority of the production in a few large packages such as that of **PennWest Energy Trust** and **EnCana Corporation**. There is still demand for small property packages but not many are available, he said.

Sayer expects crude oil prices may rebound while natural gas prices will remain flat. Oil deals will generally be higher priced than gas deals mostly because "there seems to be a stronger sentiment for the price of oil on the supply-demand side than for natural gas," Tambosso said.

Significant debt levels are going to make assets sales more important for some companies to improve their balance sheets, he added.

"We see a rush to sell companies that are distressed or underperforming before they have to report (2008 results) in the first quarter of 2009," he said.

Sayer expects to see more share-for-share transactions between public companies. There will also be more private company acquisitions of public companies for cash.

Nor will everyone planning to sell be successful. "Not everybody is going to find the exit door in the rush to exit," said Tambosso. Some companies will become insolvent.

With high oil and natural gas prices built into reserves reports in mid-2008 and a severe lack of liquidity, some companies are facing the prospect of a bleak winter with little to no capital to work with. "There will be some failures in 2009 ... And that, again, translates into strong companies being able to take advantage of all the opportunities that are in front of them next year."

Craig Spurn, a partner and head of the oil and gas group at **Blake, Cassels & Graydon LLP**, said expects more tension between management and shareholders, some proxy battles, a great deal of opportunities and some hostile takeovers. "You don't see a lot of those in our sector but I think that is a real possibility going forward."

Spurn also said more rules are inevitable. "You can't have gone through the cataclysmic financial events we've gone through without expecting greater regulation," he said. Cross-border regulations will also increase, he predicted.

Bill Gwozd, vice-president of gas services at **Ziff Energy Group**, told the symposium Western Canada's full cycle gas cost has risen to an estimated average of $9 per mcf in 2008 from $6.85 per mcf in 2004.

According to Ziff, based on gas well productivity, the impact of Alberta's new royalties which come into effect Jan. 1 will hit operators in the Foothills the hardest, followed by those in the Deep Basin and the west-central part of the province. Producers in the southern part of Alberta will do best under the new rules, followed by operators in central Alberta and the northern region.

The number one factor that will push the price of gas higher over the period to 2017 is gas-fired power generation growth while the biggest reason for it to go down will be increasing supply of liquefied natural gas, according to a Ziff study. Other issues that might raise the price of gas are industrial demand growth, Western Canada supply declines, residential and commercial demand growth, oilsands demand growth, production declines from the Gulf of Mexico and political and environmental policies that favour gas.

Factors driving down prices will be: growth in supply from shale and other United States basins, supply from the Rockies, and from the U.S. southwest such as the Barnett Shale. Supply from the Mackenzie region, northeast Texas and northern Louisiana will also drive down prices.

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