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Juniors Facing Tough Decisions On Asset Sales

by James Mahony

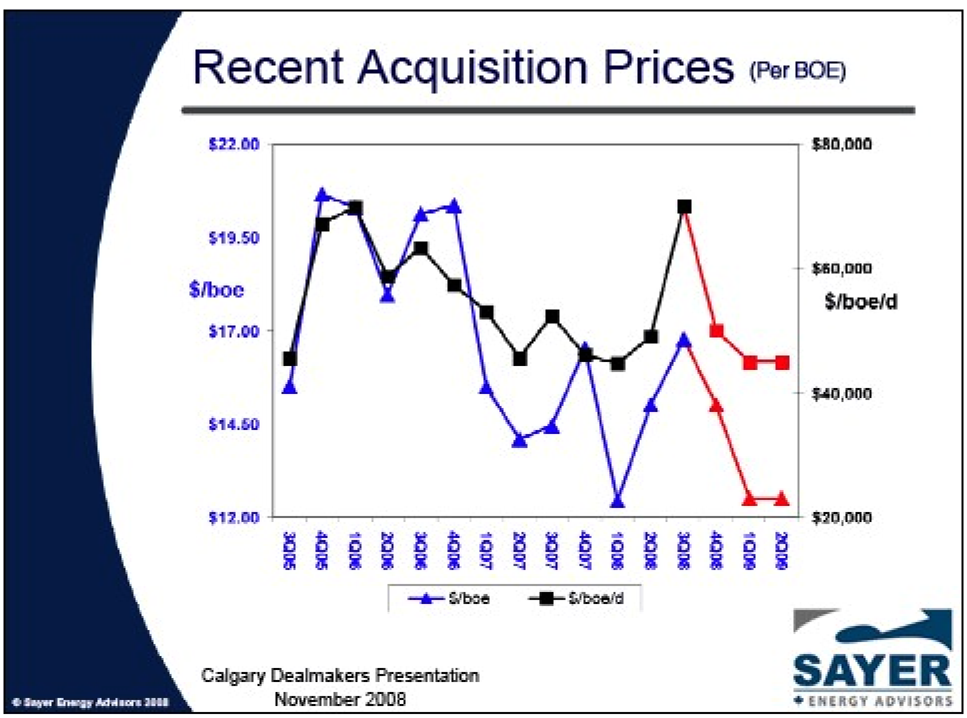
While companies able to buy assets see opportunities in the current market crisis, whether or not to sell is a tough decision for struggling juniors, speakers said at this week's **Canadian Dealmakers' Symposium** in Calgary. And the outcome may well be a Western Canadian basin with fewer junior players.

The number of M&A transactions (and their total value) is down sharply this year, possibly because of the extreme volatility in commodity prices. In the first nine months, $14.52 billion in M&A deals were announced in Canada's oilpatch, down 64% from the $39.47 billion booked in the first nine months of 2007, according to Calgary-based **Sayer Energy Advisors**.

Last year's roster showed four deals valued at over $5 billion, including **Royal Dutch Shell plc**'s $9.7 billion acquisition of the rest of **Shell Canada Limited** and **Marathon Oil Corporation's** $6.7 billion scoop of **Western Oil Sands Inc.** So far this year, the only megadeal is Royal Dutch Shell's acquisition of **Duvernay Oil Corp**. for $5.9 billion.

At **Daylight Resources Trust**, Executive Vice-president **Ted Hanbury** admitted he does not know what the juniors are thinking these days, but is pretty sure they are worried about being able to finance next year's capital budgets.

"They're not sure about the advantages of doing a deal now, but they're worried about the risk of doing one later," he said. Pricing is another issue, with some juniors debating whether to sell assets and at what price. Recent market volatility is behind much of the confusion, and it may explain the gap between buyers and sellers in the M&A market, he told the conference.



"We believe the M&A market will be quiet until equilibrium is reached. As we move into (the first quarter of 2009 and) people start to get their engineering and year-end reports, we think we'll begin to see more alignment, and with luck, a bit of stability in commodity prices and equity markets."

While the prospect of scoring a deal in the M&A market is making some producers eager, it's making others re-assess their strategies and goals. The unspoken view behind many of this week's presentations was the expectation that challenged juniors with weak balance sheets will start unloading assets, sooner rather than later.

Like others addressing the conference, a **PennWest Energy Trust** executive believes oil and gas assets coming to market in the New Year will be priced competitively. At the same time, she suggested potential buyers entering the fray should apply a basic lesson from the supermarket.

"It's what I refer to as the Costco analysis," explained **Hilary Foulkes**, senior vice-president of A&D for **Penn West Energy Trust**. "Sometimes you go (there) and see all these great deals, but you can spend a lot and forget what you actually went in for. That's the caution I have: it may be a great time to buy things, but make sure you're buying the right thing," she added.

Apart from knowing what to shop for, buyers in the market should know what doesn't fit. At PennWest, management does not see conventional oil and gas assets sustaining the trust over the long term. That means turning away from conventional properties and toward resource plays and properties outside the Western Canadian Sedimentary Basin (WCSB), Foulkes said.

Like its peers, Penn West uses M&A as a tool in portfolio management. "If you have (a property) but don't have the scalability or resources, you have some tough choices to make," she said. "It's either go or grow. You find partners, grow or you say 'this is not going to fit our portfolio' and move on."

At **Enerplus Resources Fund**, the view was that hard times in the current market will have long-term implications for juniors. "The junior model will continue to be viable, (but) on a smaller scale," said **Ian Dundas**, the trust's senior vice-president of business development.

"I think the market is going to be permanently affected. Running small public companies in Canada is more expensive than it used to be (and) going forward, I think you're going to have fewer junior public companies. Probably (it will) look a little bit more like it does in the U.S.," he said.

While one third of Enerplus' business is conventional, the trust increasingly focuses on resource plays, tight gas and tight oil. Acquisitions remain a key part of its portfolio management, but the trust does not strive for a high deal count, aiming instead for a smaller number of "significant" transactions, such as the **Focus Energy Trust** deal.

As for properties coming onto the market in the near term, Dundas was blunt. "You're going to see assets look a lot cheaper than they did in the past," he said.

More than one speaker said juniors that are reluctant to sell into a declining market still have other options.

Acknowledging that shares of small-cap juniors have fallen harder than those of larger producers, Ted Hanbury said there are nonetheless opportunities for juniors to cut deals -- for example, through share exchanges -- with other companies whose stocks are also down. That way, neither party need use cash, yet they still get a chance to share in the upside --- when it returns.

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