Daily Oil Bulletin

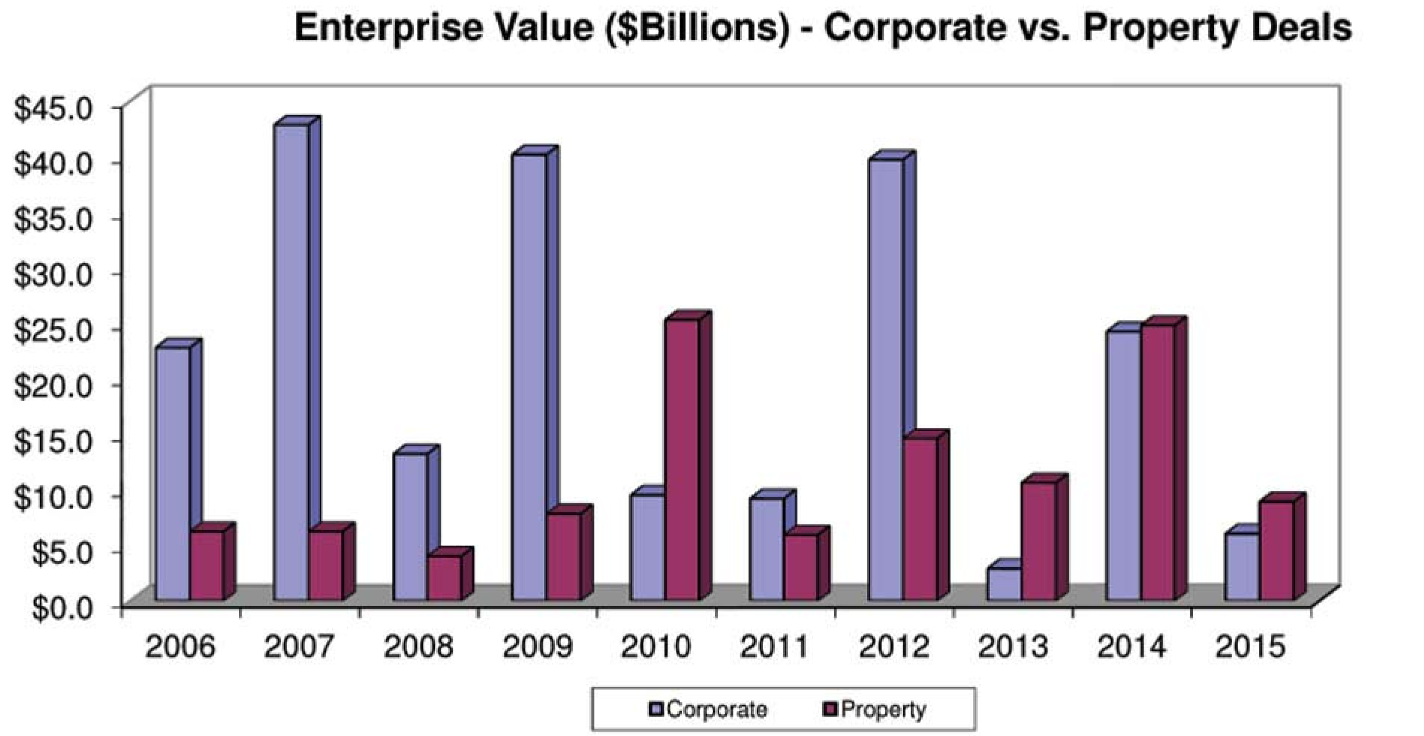
Sayer's Outlook For 2016 M&A Activity

JAN. 27, 2016 – VIEW ISSUE (/HEADLINES/2016-01-27)

By Tom Pavic, CFA
Vice-President, Sayer Energy Advisors

The past year was relatively quiet for merger and acquisition ("M&A") activity in the Canadian oil and natural gas industry with a total of $15.0 billion of transactions. In comparison, there was a total of $49.0 billion in M&A activity in 2014. Throughout the past year, the industry has been dealing with anemic commodity prices, which continue to deteriorate further in early 2016, especially in the case of oil.

We forecast that feeble commodity prices, coupled with uncertainty over government policies — most notably not knowing what the provincial government of Alberta will do to the royalty framework — will lead to a slow start for M&A activity in the early part of 2016. Once commodity prices settle to a "new norm" and the industry knows what the royalties will be, this should then lead to more activity on the M&A front in 2016.



In 2015, property deals, as illustrated in the graph, made up the bulk of the M&A value. There was approximately $9.0 billion in property transactions, or 66% of the total value. This is the third straight year that property transactions were higher in value than corporate transactions. The sale of royalty interests by both **Canadian Natural Resources Limited** and **Cenovus Energy Inc.** to **PrairieSky Royalty Ltd.** and **Ontario Teachers' Pension Plan** for $1.8 billion and $3.3 billion, respectively, led to the higher value for property transactions in 2015.

We forecast that royalty interests will continue to garner strong interest in the M&A market in 2016 and companies looking to raise capital from asset sales will deliberately spin royalty interests out into separate offerings. **Husky Energy Inc.** has done this with its recently announced non-core asset sale offering, having one process for its conventional oil and natural gas assets and a separate one for its royalty interests.

Another trend which was prevalent in 2015 and unfortunately we believe will continue in 2016 is the growing number of companies which will be placed into receivership. According to our statistics, there were 20 oil and natural gas exploration and production ("E&P") companies which went into receivership in 2015. Some of the notable publicly traded E&P companies which went into receivership in 2015 were: **Exall Energy Corporation**, **Palliser Oil & Gas Corporation**, **Shoreline Energy Corp.**, **Southern Pacific Resource Corp.**, **Spyglass Resources Corp.** and **Waldron Energy Corporation**.

The increasing number of receiverships has drawn further attention to the updated Licensee Liability Rating ("LLR") program that was instituted by the **Alberta Energy Regulator** ("AER") a number of years ago. The AER's handling of LLR for insolvent companies has affected the sale of assets and the distribution of proceeds to creditors, which has led to **Alberta Treasury Branches** formally challenging the AER in court, in the case of **Redwater Energy Corp**. No matter the outcome of this case, it will have a dramatic impact for both solvent and insolvent junior E&P companies going forward.

In 2016 we will continue to see more companies entering into *"strategic alternatives processes to maximize shareholder value"* either quietly or publicly. A number of companies, such as **Cequence Energy Ltd.**, **Rock Energy Inc.**, **Tuscany Energy Ltd.** and **Twin Butte Energy Ltd.**, announced in late 2015 that they were entering into strategic alternatives processes.

These strategic alternative processes could also lead to more corporate transactions being done on a share-for-share basis in 2016. **Suncor Energy Inc.**'s pending acquisition of **Canadian Oil Sands Limited** is the most recent example, wherein Suncor is using its shares as currency. Other notable corporate transactions completed in 2015 in a similar fashion were **Crescent Point Energy Corp.**'s purchase of **Legacy Oil + Gas Inc.**, **Kelt Exploration Ltd.**'s takeover of **Artek Exploration Ltd.**, **Raging River Exploration Inc.**'s acquisition of **Anegada Energy Corp.** and **Tourmaline Oil Corp.** buying **Mapan Energy Ltd.**

We believe that foreign interest in Canadian oil and natural gas will also continue in 2016 as evidenced by **Long Run Exploration Ltd.**'s pending sale to a group of investors based in the People's Republic of China. Other active foreign buyers in 2015 were **Orlen Upstream Canada Ltd.** and **Sinoenergy Pacific Corp.** with their purchases of **Kicking Horse Energy Inc.** and **New Star Energy Ltd.**, respectively.

Another catalyst which will need to occur for M&A activity to start to pick up is an increase in financings. With the fall in commodity prices and uncertainty relating to government policies there has been little to no capital raised. In the last quarter of 2015, approximately $1.3 billion in equity was raised by Canadian based oil and natural gas companies. More than 50% of that equity was raised by PrairieSky alone, to partially fund the aforementioned purchase of royalty interests from Canadian Natural Resources.

The difficulties the Canadian oil and natural gas industry went through in 2015 seem to have gotten worse in the first few weeks of 2016 with deteriorating global economic conditions. Once oil prices stabilize and industry understands *"the hand they will be dealt"* from the provincial government of Alberta, there will be more certainty for all stakeholders involved. Greater certainty should then translate into increased M&A activity in 2016.

ARTICLE SECTIONS: MARKET INTELLIGENCE (/SECTION/MARKET-INTELLIGENCE/), PRODUCER NEWS (/SECTION/PRODUCER-NEWS/)
ARTICLE CATEGORY: MERGERS AND ACQUISITIONS (/CATEGORY/MERGERS-AND-ACQUISITIONS/)