ANALYSIS

Sayer's Outlook For 2019 M&A Activity

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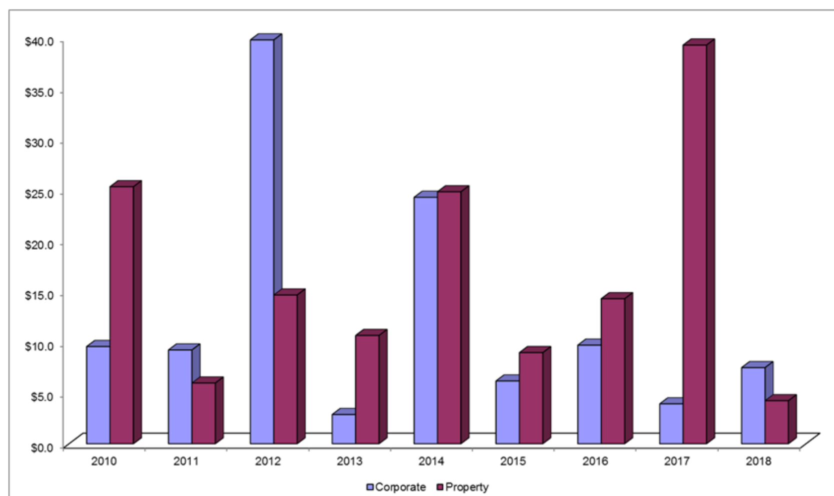
For our annual forecast of upcoming M&A activity, Sayer Energy Advisors will look back on our predictions from January 2018 to see how they stood up throughout the year, while also outlining our predictions for the upcoming year.

Following an above average year for M&A activity in the Canadian oilpatch in 2017, we predicted that the market would see significantly less M&A activity, in total dollar value, in 2018 compared to 2017. The total value of M&A activity in 2017 was approximately $43 billion, and, as predicted, the total value in 2018 came nowhere near that mark, registering approximately $12 billion.

We expected to see an increase in the percentage of the total value of M&A activity involving corporate deals, up from 8 per cent of total value in 2017 to as much as 25 per cent - 30 per cent in 2018. While we nailed the trend, we missed that mark on the percentage of value of corporate transactions by a significant amount, as the total value of corporate transactions outweighed property deals by almost two to one. Last year marked the first year since 2012 where the total value of corporate transactions outstripped the total value of property transactions.

The two biggest corporate deals in 2018 were each valued at over a billion dollars. In April, **Vermilion Energy Inc.** announced the $1.7 billion acquisition of **Spartan Energy Corp.** and in June, **Baytex Energy Corp.** acquired **Raging River Exploration Corp.** in a $2 billion deal.

Total Yearly Value of M&A Activity (2010-2018)
($billions)



There were no asset transactions valued at over a billion dollars last year, although one deal came close to that mark when **Suncor Energy Inc.** announced the $920 million acquisition of assets from **Mocal Energy Limited** in February. The second-largest asset deal was **NuVista Energy Ltd**.'s $625 million acquisition of assets from **Cenovus Energy Inc.** in August.

Similar to last year's forecast, Sayer's short term forecast shows continued frothiness in the oil and natural gas industry, which will impact and restrict M&A activity. The frothiness is caused by, among other factors, stressed balance sheets of natural gas producers due to continued low

natural gas prices, the possibility of continued robust oil shale drilling activity in the United States, continued political issues both in Canada and in the United States, an ever increasing focus on environmental and LLR issues and the ongoing pipeline debate.

We predict that 2019 will see a modest recovery in M&A activity, with the total value of all deals increasing slightly from 2018's depressed levels, but by no means reaching the level seen in 2017. We would not be surprised to see a total value of $20-$30 billion achieved this year, with corporate deals continuing to account for a high percentage of the total transaction value.

In 2016 an unprecedented number of oil and natural gas companies became insolvent, with at least 28 companies entering into receivership, bankruptcy or formal financial restructuring processes. This trend continued into 2017 with 16 insolvencies recorded. We predicted a significant decrease in the number of insolvencies in 2018, likely trending downward towards the historical average of approximately eight per year. Our prediction was correct, as we counted only six insolvencies last year. *We expect to see a minor uptick in the number of insolvencies in 2019, in part due to the effect of prolonged low oil prices on some of the junior producers.*

Companies with a strong natural gas focus continue to face the most serious balance sheet issues. Continued depressed natural gas prices combined with a gloomy outlook for short-term future prices, ongoing egress issues plaguing western Canadian natural gas and a resultant lack of market support for financing natural gas deals have significantly negatively affected short-term natural gas weighted M&A transactions.

We did not expect to see many multibillion-dollar natural gas transactions taking place in 2018 and we were correct, as there were no natural gas deals valued at over a billion dollars. The largest natural gas deal of the year was NuVista's previously-mentioned $625 million acquisition of assets from Cenovus. *Repeating last year's prediction, we do not expect to see many multibillion-dollar natural gas transactions taking place in 2019.*

On the oil front, while the recent decrease in the differential between the price of Western Canadian Select and the price of West Texas Intermediate has resulted in higher netbacks and slightly renewed interest in the Canadian energy sector, higher prices do not necessarily translate to more M&A activity. The best scenario for a robust M&A market is one with sustained steady prices. In that scenario, both buyers and sellers can generally agree on the value of an asset or a company. In scenarios with rising or falling prices, such agreement is not always possible, making it difficult for buyers and sellers to get together.

As we mentioned in our yearly forecast last January, in addition to the expected delta between buyers' and sellers' expectations, many prospective sellers may hold off on putting assets up for sale until they see stabilized prices, avoiding selling into a rising market for fear of missing the peak. This point has been emphasized by the fact that there has been an unusually slow start to the M&A year so far, with a limited number of small-sized offerings on the market. Other than the pending acquisition by **Tantalus Energy Corporation** of certain assets through the receivership of **Manitok Energy Inc.**, there has been no significant M&A activity announced to date in 2019. Compounding the lack of product, even if oil properties hit the market, many buyers may avoid transacting if prices rise significantly for fear of hitting a short-term peak.

The current economic and industry conditions have in some ways created the perfect storm for hostile takeovers; however, **Husky Energy Inc.**'s recent failed attempt at a hostile takeover of **MEG Energy Corp.** will likely temper the enthusiasm for any other such activity. *We predict that there will be very few, if any, hostile takeover attempts in 2019.*

As we predicted last year, the issue of dealing with suspended wells and other such liabilities, encompassed under the Licensee Liability Rating (LLR) umbrella of the **Alberta Energy Regulator** (AER), continued to impact M&A activity in 2018. *We see no substantial change on the horizon, so we predict that this will continue to be an issue in 2019.* Most severely impacted by these environmental issues will be junior producers, especially those with stressed balance sheets.

Last January we predicted that more mergers of junior entities should result in 2018, in part as a result of the need to get larger in order to be able to financially handle these growing regulatory and environmental issues. Increased scrutiny by the AER on officers and directors of companies

accepting well license transfers will make it increasingly more difficult to get the regulators to approve many well license transfers, increasing the attractiveness of corporate transactions as compared with asset deals. There were 26 corporate transactions valued at over $5 million last year, resulting in the previously-mentioned swing in total M&A value from property deals to corporate deals. *We predict that as 2019 progresses, more junior players will consider and conclude mergers as opposed to outright cash sales.*

We predicted that 2018 would be a slow year for oilsands transactions. Our prediction was blown out of the water shortly after it was published, with Suncor and **Teck Resources Limited** combining in the first quarter of the year to spend approximately $1.4 billion acquiring assets from Mocal (Suncor, $921 million) and **Total E&P Canada** (Suncor, $373 million; Teck, $121 million). *We will stick our necks out once more and predict that while minor oilsands assets may hit the market, we do not expect to see many multibillion-dollar transactions in this sector in 2019.*

We predict that capital markets will continue to be restricted and selective by primarily supporting larger, stronger oil-weighted public entities in 2019. Perhaps we will see an increase in capital availability after the spring election in Alberta, as we optimistically predict a change in government. Increased capital availability generally translates into more M&A activity and higher prices.

If we were to see any or all of sustained higher natural gas and oil prices, improved access to markets outside of Canada, a more sympathetic and understanding provincial government, a more sympathetic and understanding federal government, better interaction with our industry regulator and less interference and intervention from outside sources, the M&A market would take off. These same factors would also dramatically inprove all other facets of our industry as well as the provincial economy, rendering the aforementioned predictions worthless! Dare to dream!

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