ANALYSIS

2018 A Weak Year For M&A

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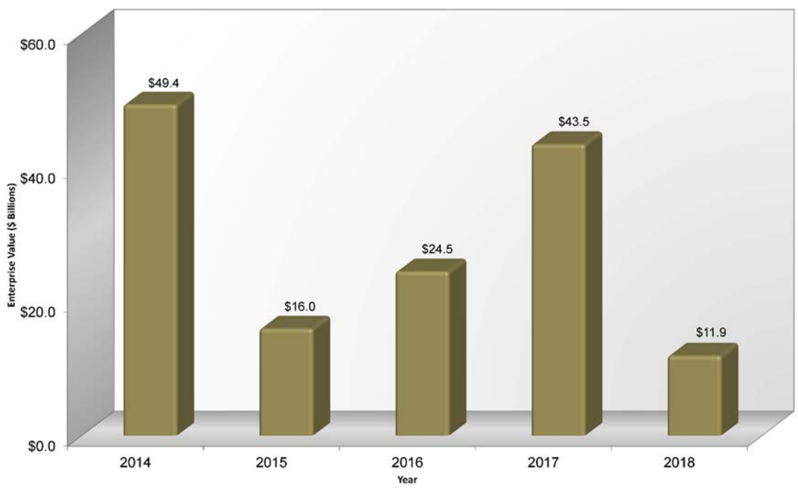
The total enterprise value of merger and acquisition ("M&A") transactions in the Canadian oil and natural gas industry in 2018 dropped 73 per cent year-over-year, plummeting to $11.9 billion. This is in stark contrast to the $43.5 billion in total M&A transaction value recorded in 2017. The $11.9 billion value recorded in 2018 represents the lowest level of M&A activity since 2003, when total M&A activity was valued at $9.1 billion.



There were two deals valued at over $1.0 billion in 2018, which accounted for approximately 31 per cent of the total M&A value. In comparison, there were five deals valued at more than $1.0 billion in 2017. The largest transaction in 2018 was **Baytex Energy Corp.**'s second quarter acquisition of **Raging River Exploration Inc.** for approximately $2.0 billion, which made up 17 per cent of the year's total M&A value. Raging River's main producing properties were located in the Dodsland, Mantario and Onward areas of Saskatchewan and in the Esther area of Alberta. In addition, Raging River was active in the East Shale Basin Duvernay play located in central Alberta. The combined company's main properties are located in the East Shale Basin Duvernay play, and the Peace River, Lloydminster and Viking areas of Alberta and Saskatchewan as well as the Eagle Ford area of Texas, with total production of approximately 94,000 boe/d (83 per cent liquids).

The year's second-largest transaction also occurred in the second quarter, with **Vermilion Energy Inc.** acquiring **Spartan Energy Corp.** for $1.7 billion. Spartan's main assets consisted of oil-focused properties located in southeastern Saskatchewan, the Waskada and Birdtail areas of Manitoba, Viking-focused assets in southwestern Saskatchewan, and a natural gas property in the Alexander area of Alberta. Vermilion identified over 1,000 development locations targeting oil in the Ratcliffe, Midale, Frobisher/Alida, Bakken and Three Forks/Torquay formations on Spartan's land.

Vermilion proved to be an active buyer in 2018 as it also acquired assets from **Canlin Energy Corporation** in the Carrot Creek and Cyn-Pem areas of Alberta in the second quarter of 2018. Prior to these two transactions, in the first quarter of 2018, Vermilion acquired **Red River Oil Inc.** for $90.8 million. Following the transactions, Vermilion reported 2018 annual average production of 87,270 boe/d, with fourth quarter 2018 production in excess of 100,000 boe/d.

Suncor Energy Inc. was also an active buyer in 2018 as it played a part in over $1.6 billion of acquisitions through several deals in the first quarter. Suncor acquired a 5 per cent interest in Syncrude from **Mocal Energy Limited** for approximately $920.0 million, increasing its share in the Syncrude joint venture to 58.74 per cent. In addition, Suncor and **Teck Resources Limited**

acquired further working interests in the Fort Hills project from **Total E&P Canada**. Suncor acquired a 2.26 per cent working interest for $308.0 million and Teck acquired a 0.89 per cent working interest for $121.0 million. Following this, Suncor purchased an additional 0.49 per cent working interest for $65.0 million and Teck increased its share by another 0.19 per cent for an undisclosed amount. Suncor's share in the project increased to 53.55 per cent and Teck's share increased to 21.08 per cent. Suncor also acquired a 37 per cent equity interest in **Canbriam Energy Inc.** in exchange for all of Suncor's northeastern British Columbia mineral land holdings and cash consideration of $52.0 million.

Corporate transactions made up 63 per cent, or $7.3 billion of the $11.6 billion in total enterprise value of large deals (over $5.0 million in value) in 2018. Property deals made up the remaining $4.2 billion. This breaks the cycle of property transactions dominating M&A activity since 2013.

A number of factors played a role in the significant drop in M&A value year-over-year but the single largest underlying factor was the lack of investment capital available to the industry. Total financings (both debt and equity) in 2018 fell to $5.0 billion from $22.4 billion in 2017. The lack of investment capital in the industry has precipitated through prolonged weak natural gas prices, widening oil differentials and production constraints in late 2018. Furthermore, persistent shale oil drilling in the United States, the enduring pipeline debate, and a greater focus on environmental and Licensee Liability Rating issues have added to the problem.

Investment capital may remain restricted through 2019, but we could see an improvement in the M&A activity level should any of the aforementioned issues be resolved, as with the recent promising improvement in oil prices. It has been a slow start to 2019 to date, as there have only been seven large transactions (over $5.0 million in size) announced in the Canadian oil and natural gas M&A marketplace. Total M&A value to this point in 2019 is just over $200.0 million.

There are a number of assets and companies that are currently on the market which may lead to increased M&A activity in 2019. Some notable offerings include **Devon Energy Corp.**, which publicly announced its intention to pursue the separation of its Canadian assets from its core business. Devon's Canadian assets consist of the Jackfish oilsands complex, with a capacity of approximately 105,000 barrels per day of bitumen, as well as conventional heavy oil wells in the Lloydminster area of Alberta which produce approximately 15,000 barrels of oil per day. Also of note is **Pengrowth Energy Corporation**, which publicly announced a formal process to explore and develop strategic alternatives with a view to strengthening its balance sheet and maximizing enterprise value. Most recently, **Return Energy Inc.** publicly announced it has initiated a formal process to review potential strategic alternatives in an effort to enhance shareholder value. Such strategic alternatives may include, but are not limited to, a sale or merger of Return or other form of business combination; a sale or joint venture involving all or a portion of the assets; a recapitalization of Return or other form of strategic investment; or the purchase of assets.

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