ANALYSIS

Are Share Buy-Backs Impeding M&A Activity?

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Wednesday, September 25, 2019, 9:53 AM MDT

Print

Suncor's Fort Hills operations. Suncor is one of several companies pursuing share buy-backs this year.

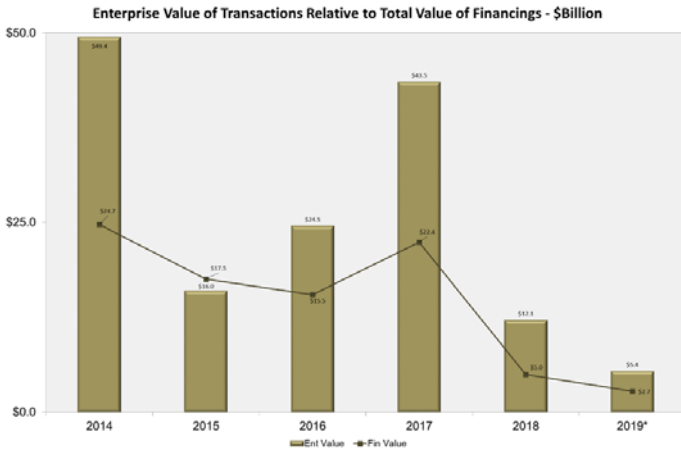
There has been a recent wave of announcements made by publicly-traded oil and natural gas companies related to share buy-backs. This is unusual, in that until recently, buying back stock has not been a significant use of capital in the Canadian energy industry.

Over the last several years there has been a dishearteningly low amount of capital entering into the industry through financings, as well as a lack of investor interest through public markets, leading to depressed stock market valuations. If a company's management team views the current stock price as undervalued by the public market, capital may be best utilized by being invested back into the company by re-purchasing shares.

In terms of financing, a total of $2.7 billion in capital was raised by the Canadian oil and natural gas industry in the first six months of 2019, down 18 per cent from the $3.3 billion recorded over the same time period in 2018. For the second year in a row, this is the lowest amount of total capital raised in the first six months since 2001, when there was only $2.3 billion in capital raised. These totals are dismally low compared to historical averages. For example, as recently as 2017 there was a whopping $22.4 billion of capital raised.

The oil and natural gas industry is a huge consumer of capital. This capital is primarily used for developing oil and natural gas properties. Companies which wish to expand their oil and natural gas property portfolios use outside capital to acquire properties from other companies, or even to acquire other companies corporately, which has historically led to a robust merger and acquisition ("M&A") market.

The recent lack of capital coming into the industry has led to a significant drop off in M&A activity. In the first half of 2019, there was approximately $5.4 billion worth of assets and companies changing hands, down 29 per cent from the $7.6 billion recorded in the first six months of 2018. The first six months of the year had the lowest first half total M&A value in the Canadian oil and natural gas industry since 2013 when only $4.3 billion in total M&A value was recorded. By comparison, in 2017 the total value of M&A activity topped $43.5 billion, with $36.1 billion in transactions in the first half.



In 2018, 30 publicly-traded exploration and production companies announced the intention to make a normal course issuer bid ("NCIB") or the renewal of existing programs to buy back shares. Similarly, during the first six months of 2019, 24 publicly-traded exploration and production companies announced the repurchase of common shares, NCIBs or the renewal of existing programs to buy back shares.

In the first half of 2019, **Imperial Oil Limited** announced a new one-year program to repurchase up to 38,211,086 common shares, or five per cent of its outstanding shares. This maximum will be reduced by the number of shares purchased by Imperial's majority shareholder, **Exxon Mobil Corporation**. Exxon Mobil will be permitted to sell its shares to Imperial in order to maintain its proportionate share ownership at approximately 69.6 per cent. The 12-month NCIB program that was in place during the first half of 2019 came into effect in June 27, 2018. Imperial has been an active re-purchaser, and this new NCIB represents an extension of its continuing share repurchase program. Under this share repurchase program Imperial has purchased 12,035,859 shares on the open market and 27,550,825 shares from Exxon Mobil for a total cost of approximately $1.55 billion, averaging $39.11 per share. Imperial has also established an automatic share purchase plan.

Canadian Natural Resources Limited initiated an automatic securities purchase plan to purchase shares which it has been using in connection with a NCIB to buy back common shares. Canadian Natural has purchased for cancellation five per cent of its issued and outstanding common shares, or 42,155,027 common shares at an average price of $40.37 under its current NCIB which authorized the purchase for cancellation of up to 61,424,856 common shares. Canadian Natural also contributed 70 per cent of the total M&A value in the first six months of 2019 with its acquisition of substantially all of the assets of Devon Canada Corporation for approximately $3.8 billion.

In the second quarter of 2019, **Suncor Energy Inc.** repurchased approximately $552.0 million of its own shares for cancellation under its NCIB, and returned $658.0 million of cash to shareholders through dividends. Between May 1, 2017, and April 30, 2018, and pursuant to Suncor's previous NCIB, Suncor repurchased 43,213,523 shares on the open market for approximately $1.85 billion, at a weighted average price of $42.83 per share.

Crescent Point Energy Corp. announced a NCIB in the first half of 2019. Crescent Point intends to acquire up to seven per cent of its public float, or up to 38,424,678 common shares. At the same time, Crescent Point announced a reduction to its quarterly dividend paid to shareholders. This strategy is intended to offer a more accretive way to return capital and provide a permanent benefit to shareholders. The share repurchase will be funded within cash flow. Crescent Point's current strategy is to allocate excess cash flow to debt reduction and share repurchases. In connection with the normal course issuer bid, Crescent Point announced an automatic share purchase plan.

In the first quarter of 2019, **Encana Corporation** announced its intention to buy back $1.25 billion worth of common shares. Encana renewed its NCIB through which it may purchase up to 149,425,839 common shares, or 10 per cent of its public float, during the 12-month period commencing March 4, 2019, and ending March 3, 2020. As at June 10, 2019, Encana had repurchased $1.037 billion, or approximately 149.4 million common shares at an average price of $6.94 per common share. Limited by a restriction of 10 per cent of its outstanding public float, Encana completed a substantial issuer bid to purchase US$213.0 million in common shares in order to fulfill its initial pledge to repurchase $1.25 billion. The substantial issuer bid was completed as a "modified Dutch Auction" which resulted in the purchase of 47,333,333 shares at a purchase price of US$4.50 per share. Prior to this, Encana had an existing NCIB that expired on February 27, 2019, under which it was authorized to purchase for cancellation 35,000,000 common shares, and during the last 12 months, Encana has purchased for cancellation 20,685,000 common shares. Encana believes that "*depending on the trading price of its common shares and other relevant factors, purchasing its own shares represents an attractive opportunity that is in the best interests of the company and its shareholders."*

Enerplus Corporation renewed its NCIB in 2019 whereby it may purchase up to 16,673,015 common shares, being seven per cent of the public float of Enerplus. Under its prior NCIB and up to March 19, 2019, Enerplus repurchased an aggregate of 7,311,297 common shares at a weighted-average price of $12.96 per share, Enerplus returned over $100 million to shareholders in 2018 through dividends and share repurchases. Enerplus repurchased $79.0 million (5.9 million shares) in 2018.

In the first quarter of 2019, **Peyto Exploration & Development Corp.** announced approval of a NCIB for up to 12,400,000 common shares, or 10 per cent of the public float. In 2018, Peyto had also announced an issuer bid for 10 per cent of the public float at that time, however; Peyto did not purchase any common shares under its previous NCIB.

PrairieSky Royalty Ltd. announced a one-year extension to its existing NCIB whereby it could purchase up to 2,700,000 common shares, or 1.4 per cent of the public float. Under the previous NCIB PrairieSky previously purchased an aggregate of 1,750,000 common shares at a weighted average price per share of $22.12. The extension carries the NCIB forward to May 12, 2020, and PrairieSky intends to use a maximum of $50.0 million for NCIB purchases during this period.

Subsequent to the end of the first half of 2019, we continue to see several companies announcing share buy-back programs. Nine companies, including **Cardinal Energy Ltd.**, **Razor Energy Corp.** and **Vermilion Energy Inc.** have announced share buy-back plans. Most recently, **Gear Energy Ltd.** announced that is has been granted approval to commence a NCIB for up to 10,954,673 common shares, representing approximately five per cent of its issued and outstanding shares.

We recognize the relationship between the injection of capital and M&A activity in the industry. The large number of share buy-backs we have been seeing in the Canadian oil and natural gas industry is an indicator of the recent lack of outside investment and low investor sentiment. We believe this trend will continue to be pervasive as long as oil and gas companies' share prices are undervalued and a limited amount of capital is coming into the industry. We also believe that M&A activity will be languid as long as this is taking place.

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