ANALYSIS

Sayer’s Outlook For 2020 M&A Activity

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Sayer Energy Advisors’ annual outlook and forecast of forthcoming mergers and acquisitions (“M&A”) activity in the oil and natural gas industry will outline our predictions for 2020. Our outlook begins with a review of our predictions from January 2019 and point to where we think things will go this year.

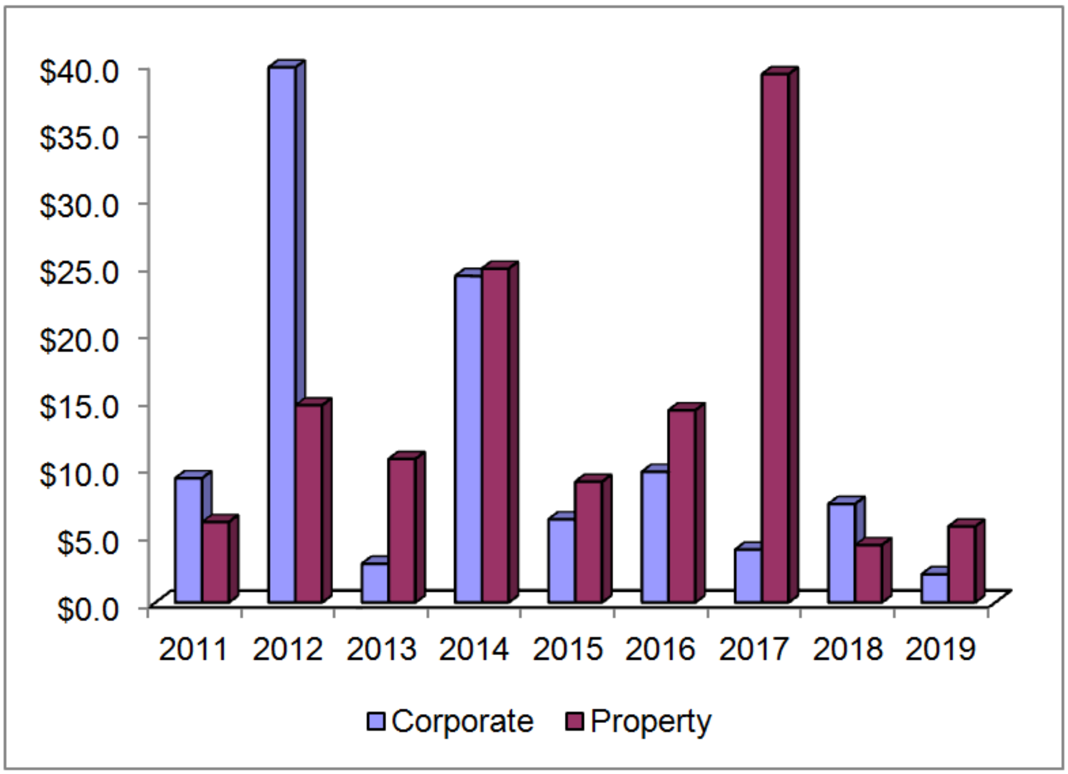
In 2018 the total value of M&A activity in the Canadian oilpatch was quite low by historical standards, totaling only approximately $12.1 billion. In January 2019, we predicted that 2019 would see a modest recovery in M&A activity, with the total value of all deals increasing slightly from 2018’s depressed levels. We predicted that corporate deals would continue to account for a high percentage of the total transaction value.

Contrary to our predictions, the total value in 2019 came in at a meagre $8.0 billion with only $2.1 billion of the value from corporate transactions. The year 2018 was an anomaly in that corporate transactions outweighed property transactions for the first time in many years. The trend reverted back to property deals dominating the M&A landscape in 2019, with nearly three quarters of the enterprise value coming from property deals.

There were only two deals in 2019 valued at over a billion dollars: one property deal and one corporate transaction. In May, **Canadian Natural Resources Limited** acquired assets from **Devon Canada Corporation** for $3.8 billion making up just under half of the total M&A value for the year. In November, **Cona Resources Ltd.** announced the $1.0 billion acquisition of **Pengrowth Energy Corporation**.

Total Yearly Value of M&A Activity (2011-2019)

($billions)



A theme in several previous forecasts has been uncertainty and frothiness in the oil and natural gas industry leading to restricted M&A activity, which Sayer expected to continue through 2020. The unease has been caused by a number for factors including: sustained low natural gas prices which lead to stressed balance sheets of natural gas producers, the continuous oil shale drilling activity in the United States, swelling environmental and Licensee Liability Rating ("LLR") issues, the enduring pipeline and egress debate and continued political issues both in Canada and in the United States.

We predict a minor recovery in M&A activity in 2020, from 2019's lower than anticipated level. We expect to see corporate deals account for a higher percentage of the transaction value than in 2019.

We were correct in not expecting to see many multibillion-dollar natural gas transactions taking place in 2019. There were no natural gas deals valued at over a billion dollars. *Echoing this prediction again, we do not expect to see many multi-billion dollar natural gas transactions taking place in 2020.*

We predicted a minor increase in the number of insolvencies in 2019, in part due to the effect of prolonged lower commodity prices on some of the junior producers. This trend began in 2016 when the number of oil and natural gas companies became insolvent shot from the historical average of approximately eight per year to at least 28 companies entering into receivership, bankruptcy or formal financial restructuring processes. This trend continued into 2017 with 16 insolvencies recorded. We correctly predicted that the number of insolvencies in 2018 would decrease when we counted only six insolvencies. In 2019 there were 12 insolvencies. *We expect to see a similar number of insolvencies in 2020, in part due to the effect of prolonged low commodity prices on certain junior producers.*

We predicted that there would be very few, if any, hostile takeover attempts in 2019 after **Husky Energy Inc.**'s failed attempt at a hostile takeover of **MEG Energy Corp**. We were correct, there were no hostile take-over attempts in 2019. *We predict the same for hostile takeover attempts in 2020.*

We predicted that 2019 would be a slow year for oilsands transactions. The previously-mentioned Canadian Natural/Devon deal involved substantially all of Devon's assets and included the Jackfish SAGD project and conventional primary heavy crude oil production. *We predict that minor oilsands assets may hit the market but we do not expect to see many multibillion-dollar transactions in this sector in 2020.*

Over the last several years there has been an issue with the amount of capital entering into the industry through financings, as well as a lack of investor interest through public markets. We predicted that capital markets would continue to be restrictive and selective by primarily supporting larger, stronger oil-weighted public entities in 2019. We also believed after the spring election in Alberta, if there was a change in provincial government, we would see an increase in capital availability.

While we did correctly predict the change in provincial government, it has yet to translate into an increase in capital availability for the industry and result in more M&A activity and higher prices. Capital raised in 2019 including equity and debt issues totaled $5.2 billion. This is down slightly from the $5.3 billion raised in 2018 and down significantly from the $22.8 billion raised in 2017.

Once more we predict that the capital markets will continue to be constrained and therefore selective but we do believe private equity will step up its presence. We have already seen the early stages of this with the Cona/Pengrowth, **Tourmaline Oil Corp./Topaz Energy Corp.** transactions and with **Altura Energy Inc.**'s recent deal with a private company.

In the public markets, a lack of capital can lead to depressed stock market valuations and 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. 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. *We expect this trend of share buy-backs to continue.*

We also predict an increase in recapitalization transactions in 2020. Recently, **Corridor Resources Inc**. announced it has entered into a definitive investment agreement with certain former executives of **Raging River Exploration Inc.** This recapitalization transaction provides for a non-brokered private placement of $20.0 million, a brokered private placement of up to $30.0 million, the appointment of a new management team and reconstitution of the board of directors of Corridor. Upon completion of the transaction, it is expected that Corridor shareholders will be asked to approve a name change to **Headwater Exploration Inc.**

Another similar transaction completed in the fourth quarter of 2019 was the recapitalization of **Return Energy Inc.** by **Spartan Delta Corp.** Return completed a reorganization and investment transaction with members of the former **Spartan Energy Corp.** management team. The recapitalization was comprised of a non-brokered private placement of up to $25.0 million and the appointment of a new management team and board of directors.

Another entity to recently announce a recapitalization transaction was **Delphi Energy Corp.** In November 2019, Delphi announced that it completed a recapitalization which included two private placements of subscription receipts raising gross proceeds of $46.5 million.

In 2019 we predicted that the issue of dealing with liabilities would continue to impact M&A activity. We thought that the struggle to get regulators to approve well license transfers might increase the attractiveness of corporate transactions as compared with asset deals. There were only six corporate transactions valued at over $5 million last year compared to 24 the prior year. In 2019 we saw several deals involving the use of shares as consideration, including **Razor Energy Corp.** purchasing **Little Rock Resources Ltd.**

and **Karve Energy Inc.**'s acquisition of **High Ground Energy Inc.** *We believe similar deal activity will pick up as year-end financial and operating results for publicly-traded companies are released.*

To date in 2020 there has already been one significant transaction. **International Petroleum Corp.** announced it has entered into an agreement to acquire **Granite Oil Corp.** for total equity and debt consideration of approximately $77.2 million. Granite's assets are located in the Milk River area of Alberta and are currently producing approximately 1,500 bbls/d. The acquisition also includes existing infrastructure, associated oil and gas processing and injection facilities. Upon completion of the acquisition, almost all of the production and infrastructure will be 100% owned and operated by International Petroleum.

We are hopeful that recent low valuations in the in the Canadian oil and natural gas industry will drive more investment in the form of recapitalization and restructuring transactions and the return of private equity. Perhaps with the recent announcement by the provincial government that it will be coming out with new guidelines pertaining to liabilities as well as completion of its review of the **Alberta Energy Regulator** and recommended changes, this may help lead to more clarity for all stakeholders in our industry, and in turn, more M&A.

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