

Is The SpinCo Returning?

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A recent trend we have witnessed in the Canadian oil and natural gas industry is the return of the SpinCo structure as part of a transaction involving the sale of all of the issued and outstanding shares of an oil and natural gas company. The SpinCo structure involves the seller spinning out certain lands and production into a separate entity concurrent with the sale of all of the issued and outstanding shares of the company.

The SpinCo structure was very common in the early to mid-2000s when oil and natural gas royalty income trusts (“RITS”) were very active on the merger and acquisition (“M&A”) front. At that time, RITS were focused on acquiring producing properties with low-risk development potential and the exploration and production companies would then sell their producing properties to RITS in a corporate sale and concurrently “spin out” these growth type assets into a separate entity.

In addition, a number of oil and natural gas companies which previously converted into RITS in the early 2000s also created SpinCo’s as part of these reorganizations. Companies such as **Crew Energy Inc.** and **NuVista Energy Ltd.** were the resulting SpinCo’s created out of the reorganizations of **Baytex Energy Ltd.** and **Bonavista Petroleum Ltd.**, respectively, into RITS in 2003.

Late last week, **Tamarack Valley Energy Ltd.** announced that it had entered into an agreement to acquire all of the issued and outstanding shares of privately-held **Rolling Hills Energy Ltd.** for total consideration of approximately \$93.0 million consisting of \$46.5 million in cash and the issuance of 9,276,623 common shares of Tamarack Valley. Rolling Hills’ main producing properties are located in the Jarvie area of Alberta and are producing from the Clearwater formation. As part of the transaction, shareholders of Rolling Hills will also receive 0.387 of one common share in a newly created Clearwater growth focused company (“NewCo”). NewCo will operate as a private company and will be led by existing members of the Rolling Hills management team. NewCo will retain certain of Rolling Hills’ Clearwater lands totalling approximately 193,000 net acres and estimated production of 700 bbls/d of oil.

In late March, **Leucrotta Exploration Inc.** announced that it had entered into an arrangement agreement with **Vermilion Energy Inc.** pursuant to which Vermilion will acquire all of the issued and outstanding shares of Leucrotta for total consideration of approximately \$477.0 million excluding value assigned to the newly formed Montney company (“ExploreCo”). As part of the transaction, the shareholders of Leucrotta will receive \$1.73 in cash per Leucrotta share held, plus 1.0 common share of ExploreCo and 0.1917 of one ExploreCo common share purchase warrant. Each ExploreCo warrant will entitle the holder to acquire one ExploreCo share at an exercise price of \$0.27 per share at any time on or before 30 days following the closing of the transaction.

ExploreCo is anticipated to be a new junior energy company led by **Robert Zakresky** as president and CEO and certain members of Leucrotta’s current management team. ExploreCo will be a growth-oriented entity with assets focused in the Montney formation in the Two Rivers area of northeastern British Columbia. At the time of closing, ExploreCo is forecast to have approximately 400 boe/d of production, over 140 net sections of Montney land and approximately \$80.0 million in cash (subject to the completion of certain equity financings and the exercise of ExploreCo warrants mentioned above).

It should be noted that Leucrotta was formed through a SpinCo structure back in 2014 when **Crocotta Energy Inc.** was acquired by **Long Run Exploration Ltd.** for approximately \$394.0 million. As part of the transaction, each common share of Crocotta was exchanged for 0.415 of a common share of Long Run, 1.0

common share of Leucrotta and 0.2 of a Leucrotta common share purchase warrant. Each whole Leucrotta warrant entitled the holder to acquire one common share of Leucrotta at an exercise price of \$1.70 per share at any time on or before 30 days following the closing of the transaction.

The Crocotta assets that were spun out to Leucrotta were focused in the Montney formation in the Dawson-Sunrise area of northeastern British Columbia. At the time of the transaction, Leucrotta had approximately 2,300 boe/d of production, over 60 net sections of Montney land and approximately \$67.0 million in cash.

We expect this recent trend with the SpinCo type transaction to continue as it is a structure that could be used in the current M&A market to bridge a value gap between buyer and seller and provide additional returns to shareholders. In addition, this structure also allows existing management teams such as Rolling Hills and Leucrotta a platform to start over again in popular plays such as the Clearwater and Montney, rather than starting from scratch.

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