Oilpatch mergers, acquisitions expected to pick up after pandemic's dampening of demand eases

Oil price uncertainty has resulted in a quiet marketplace

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Pumpjacks are pictured in Alberta in this file photo. Observers say that as demand begins to return to normal, there will likely be a wave of Canadian energy mergers and acquisitions. (Kyle Bakx/CBC)

comments

The financial stress caused by low oil prices from plummeting fuel demand during the COVID-19 pandemic will result in a wave of Canadian energy mergers and acquisitions — but not until after the world begins to return to normal, observers say.

Benchmark U.S. oil prices so far this year have ranged from over $61 US per barrel in early January to less than zero on April 20 and the uncertainty has resulted in a very quiet marketplace, said Tom Pavic, president of M&A firm Sayer Energy Advisors in Calgary.

"Because there's so much volatility, it's very difficult to get buyers and sellers together. Times like these where commodity prices are volatile, those are the worst times for us to get deals done," he said.

"I think once you see a little bit of certainty or stability in commodity prices, especially for oil, when we know what the new normal is, that will start some activity on the M&A front."

Activity likely to fall below 2019 level

The quiet start to 2020 will likely translate into activity falling below the $8 billion in enterprise value of Canadian oil and gas transactions in 2019, a year that was 34 per cent lower than the $12.1 billion recorded in 2018, he said.

Many oil and gas producers probably wouldn't be cash flow positive at current future commodity contract prices, which makes it difficult to assess what their fair market value really is, he added.

The largest Canadian oilpatch transaction in 2019 was Canadian Natural Resources Ltd.'s acquisition of Devon Canada Corp.'s oilsands and heavy crude assets for about $3.8 billion. The company, one of the most active acquirers in recent years, bought most of Royal Dutch Shell's oilsands assets in 2017.

But president Tim McKay said on a recent earnings call that market conditions aren't ideal for striking deals.

"I think the bid-ask would be far apart at this time," he said in response to an analyst question.

"I think we're quite happy with the assets we have. We don't have any gaps."

Brad Corson, who became president and CEO of oilsands producer and fuel marketer Imperial Oil Ltd. in January, had a similar response when asked the same question on his firm's first-quarter results call.

"Obviously, there are a lot of assets that are unfortunately distressed given these economic conditions," he said.

"My experience in M&A is that at these extreme points in the cycle, it can be very difficult to transact because buyers' and sellers' expectations become very different. (Their) view of what recovery might look like and the timing for that is often very different."

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The risk of having too much debt when commodity prices crumble was brought home by the situation with Calgary oil company Delphi Energy Corp., which sought court protection under the Companies' Creditors Arrangement Act in April.

After months of trying to implement a financial restructuring, it entered CCAA as its debt-to-earnings ratio threatened to fall below what was required by its secured lenders. The company said negotiations with the lenders had failed to result in amendments to its financial covenants and its continued use of credit facilities.

In a recent update, it said it plans to use government programs to expand credit support for at-risk small- and medium-sized companies, as well as federal grants for well abandonments.

Debt that was manageable when the price of oil was $60 US per barrel might be crippling now, Pavic said. Companies that have strong balance sheets and economies of scale are the most likely to survive.

The Canadian oilpatch could look quite different after the pandemic passes as stronger companies absorb weaker ones, said CEO Grant Fagerheim of Whitecap Resources Inc.

"We believe that those companies that are the lowest cost producers and have the ability to live within cash flows will not only survive but also will provide superior returns to their shareholders into the future," he said.

"Consolidation will take place; however, we anticipate that this will be delayed until we get through this pandemic and oversupply crisis."