

## Small oil players strive to survive as big producers eye bargains

**JEFFREY JONES** > MERGERS AND ACQUISITIONS REPORTER

**EMMA GRANNEY** > ENERGY REPORTER

+ FOLLOW JEFFREY

+ FOLLOW EMMA

PUBLISHED SEPTEMBER 8, 2020

UPDATED 7 HOURS AGO

8 COMMENTS

SHARE

- A

A +

TEXT SIZE

BOOKMARK



FILE PHOTO: An oil pump jack pumps oil in a field near Calgary, Alberta, July 21, 2014. Pump jacks are used to pump crude oil out of the ground after an oil well has been drilled.  
REUTERS/Todd Korol/File Photo

TODD KOROL/REUTERS

A wave of consolidation is bearing down on Canada's oil patch as smaller companies exhaust their survival options and large players see bargains.

Several deals have already been announced following a lengthy drought, including two last week. Investment bankers say industry financial woes made worse by the COVID-19 contagion are prompting virtually all corporate boards to run the numbers on potential transactions to either satisfy lenders or beef up to become relevant to institutional investors.

Many that have scraped through the worst of the price collapse that began in March now face a reckoning with their banks. In some cases lending syndicates kept producers on short leases, reassessing credit capacity month-by-month, but did not take the drastic step of pushing them into bankruptcy processes.

Oil prices have been stuck in a tight range that affords little room to fund capital-spending increases, making the odds of more deals high, especially in the industry's lower tiers. Crude took a major hit Tuesday, with the West Texas Intermediate futures contract sliding 7.6 per cent to US\$36.76 a barrel.

**Andrew Willis: Will energy giant Shell quit Sarnia and oil sands?**

**Globe editorial: The oil sands have a future, and it includes polluter pays**

“Lenders need to assert their priority in their capital structures to preserve their stake after what I have to imagine looked like the vapourization of significant investments in the business,” said Robert Fitzmartyn, head of energy institutional research at Stifel FirstEnergy. That means pressure to

sell, or look for other ways to recoup losses. Meanwhile, large producers are bargain-hunting.

Last week, Obsidian Energy Ltd. launched an unsolicited offer for Bonterra Energy Corp., a proposal that exposed both mid-sized companies' main weakness – limited access to new sources of capital. Following a year of on-and-off talks, Obsidian made the bid official on Tuesday, offering two of its shares for each Bonterra share, even though the exchange is worth less than Bonterra's price in the market.

Bonterra shares are down almost 70 cent in the past year, as the company slashed its capital spending and suspended its dividend. Obsidian, the former Penn West Petroleum, began a formal search for strategic alternatives a year ago, and the market remains wary of its high debt and large obligations for cleanup of spent well sites.

Also last week, Whitecap Resources Ltd. announced a \$155-million deal to buy NAL Resources Ltd. from its owner, Manulife Financial Corp. That helps Whitecap consolidate properties across four-fifths of its portfolio of assets in Saskatchewan and Alberta. Stronger players that have long since graduated to senior producer status, such as Whitecap and Tourmaline Oil Corp., are seen as consolidators.

Meanwhile, some value-focused private equity investors are also jumping in.

“You’re seeing some parties that are thinking that this is a bottom, and it would be a good time to dip their toe in and acquire some oil and natural gas assets,” said Tom Pavic, president of Sayer Energy Advisors in Calgary.

Valuations for most publicly traded companies are a fraction of what they were even at the beginning of 2020, which has had a bearing on that activity, he said.

In the first six months of this year, merger and acquisition activity in the industry rang in at just \$750-million compared with \$5.4-billion in the first half of 2019. But a small flurry kicked off mid-July after Kelt Exploration Ltd. announced it was selling natural gas assets in the British Columbia Montney basin to ConocoPhillips for \$510-million, in an effort to bolster its balance sheet.

Aroon Sequeira, chairman of Edmonton-based investment bank Sequeira Partners, says selling off non-core assets has become a more attractive prospect in a tough economy where companies are starved of capital but want to live to fight another day. “I think there is a lot of overcapacity in the system, and that usually means rationalization, consolidation and takeovers,” he said.

Shortly after Kelt’s sale, Canadian Natural Resources Ltd. made a friendly \$111-million bid for Painted Pony Energy Ltd. to beef up its own Montney holdings.

Crude is stuck at a price that crimps returns for many oil producers and relegates them to looking for savings in overhead costs rather than plowing capital into new wells. Since U.S. benchmark oil crashed to below zero dollars a barrel in April, prices had recovered and were hovering on either side of US\$40 until Tuesday’s selloff. That compares with about US\$56 a year ago. In late August, just 10 per cent of Western Canada’s rig fleet was drilling, according to industry figures.

Alberta natural gas prices, meanwhile, have strengthened considerably, selling for \$2.47 a gigajoule on Monday, compared with \$1.61 a year earlier. The 12-month forward price, known as the strip, is even more bullish at \$3.11 a GJ.

The current strength in gas prices could help boost the deal flow into the fall, Mr. Pavic said. Larger producers are expected to take the opportunity to add assets in their core areas such as the Montney, or are looking to buy out their partners to build economies of scale.

Tourmaline, for instance, acquired two producers, Chinook Energy Inc. and Polar Star Canadian Oil and Gas Inc., just before the lockdown. The company, run by chief executive Mike Rose, is expected shortly to announce the initial public offering of its royalty and energy infrastructure spinoff, Topaz Energy Corp. Tourmaline has earmarked proceeds for funding for future acquisitions.

Some of the targets – including producers and oil field service providers – were limping before the pandemic took its toll on energy prices. Indeed, many large institutional investors had long since turned their attentions away from Canadian energy amid years of delays in adding export pipeline capacity. Instead, U.S. shale producers attracted billions of dollars.

Now, as U.S. producers struggle to generate returns and even undergo insolvency, some rival energy companies and fund managers see Canada's small oil and gas producers as the ultimate deep value play.

Adam Waterous, founder of Waterous Energy Fund (WEF), has done a series of acquisitions starting well before the lockdown, acquiring companies that had run out of funding options. Early this year it closed its \$28-million acquisition of debt-hobbled Pengrowth Energy Corp.

In August, WEF merged its natural gas and heavy oil companies, Strath Resources Ltd. and Cona Resources Ltd., to form Strathcona Resources Ltd. – and bought a large stake in producer Osum Oil Sands Corp. to help maintain access to capital through size.

Mr. Waterous is looking to take advantage of what he calls the “oil tech-wreck.” That is, despite major advances in drilling and well-completion technology, with oil below US\$50 a barrel the industry cannot come close to achieving the profitability it enjoyed when crude was double the price.

“The industry’s returns have been horrendously poor in North America for the last six years now,” he says. As a result, capital available to many companies, especially the smaller ones with production at around 20,000 barrels of oil equivalent a day, has dried up.

One investor betting big on Canada’s oil patch is Halifax-based George Armoyan, founder of Armco Capital Inc. The investment arm of that group, G2S2 Capital Inc., stands to pick up \$18-million worth of lien notes in the recapitalization of oil field service stalwart Calfrac Well Services Ltd., itself the target of a hostile bid from a major U.S. shareholder.

His company already owns about 20-per-cent each of Trican Well Service Ltd. and Western Energy Services Corp., and last year it acquired 16 per cent of Bonavista Energy Corp. and was a key part of Bonavista’s recent recapitalization.

“I am somewhat long-term bullish, in that I do believe fossil fuel will still be here in my lifetime because it is a global commodity and the world is still growing,” Mr. Armoyan told The Globe and Mail in a recent interview. “When I looked the last few years at buying something cheap, the only

thing that seemed cheap to me – and I’ve been wrong the last few years, so I’m down a lot – has been oil and gas.

“Ask me in three to five years and I’m either going to be a visionary or a jackass. I just haven’t figured out which one it is.”

*Your time is valuable. Have the Top Business Headlines newsletter conveniently delivered to your inbox in the morning or evening. [Sign up today.](#)*

---

© Copyright 2020 The Globe and Mail Inc. All rights reserved.

351 King Street East, Suite 1600, Toronto, ON Canada, M5A 0N1

Phillip Crawley, Publisher