Canadian oil and gas

Transactions and trends: 2012–13

Interest in Canada's oil and gas industry continues to grow around the world. Over the last year, the Canadian transactions market has been very active. While much of the activity can be attributed to the focus by well-capitalized players on technology-enabled oil and liquid plays, and for others a very challenging natural gas price environment which resulted in distressed M&A, the year's most significant trend is the increased interest from Asian investors and the high-profile deliberations by the Canadian government about the implications of foreign investment in Canada's oil and gas industry.

But Canadian transactions will look different in the future – influenced by macro factors, including the growth of US unconventional oil and natural gas production, transportation and infrastructure constraints, increased environmental regulations, continued interest from Asian investors (both state-owned enterprises and private investors), and new clarity on the rules governing foreign investment.

Looking back

Over a decade ago, in late 2000 and early 2001, news headlines described record levels of M&A transactions in the Canadian oil and gas sector. US buyers raced to take over the Canadian industry as natural gas prices surged. Concern about the “Americanization” of the Canadian energy business abounded.

Fast forward to today, and what a different story has played out in the past year. CNOOC Limited’s acquisition of Nexen Inc. and Petronas’s acquisition of Progress Energy Resources received considerable attention from regulators, policy makers, media and the public. The debate about how best to fund the Canadian oil and gas industry and what qualifies as “net benefit to Canada” took centre stage.

Canadian transaction activity in 2012 compared closely to 2011 but was dramatically more robust in relation to deal values, led predominantly by the upstream sector. Deal value increased by 318% year over year, from $15.2 billion to $48.4 billion. However, deal value is somewhat skewed due to the $15.1-billion CNOOC and $5.8-billion Petronas deals.

There was also Mitsubishi Corporation’s $2.9-billion transaction with Encana Corporation for a 40% stake in the Cutbank Ridge gas assets, PetroChina Company Limited’s $665.8-million purchase of the remaining 40% interest in MacKay River Oil Sands project from Athabasca Oil Corporation, and Toyota Tsusho Corporation’s $608-million royalty interest acquisition in Alberta coal bed methane production from Encana.
Overall, there were nine blockbuster transactions in 2012 with a deal value of over $1 billion, compared to only five in 2011. Asian investment into Canada accounted for $25.1 billion of total deal value, compared to $6.1 billion in 2011 and $9.2 billion in 2010. The total number of deals year over year, on the other hand, remained relatively consistent, from 138 in 2011 to 148 in 2012.

The mix of deals between asset packages and corporate acquisitions shifted towards corporate transactions, which comprised 75% of total deals in 2012 compared to 56% in 2011. In part, this reflects the nature of buyers, as portfolio rationalization activities by Canadian producers were restricted by capital constraints faced by the traditional Canadian domestic buyers.

Significant corporate transactions in 2012 included Exxon Mobil Corporation’s $3.2-billion acquisition of Celtic Exploration Ltd. for its Western Canadian gas weighted producing assets in the Montney and Duvernay basins, and Pengrowth Energy Corporation’s $2.1-billion acquisition of NAL Energy Corporation and its related light oil properties in Alberta and Saskatchewan, and gas properties in British Columbia and Ontario.

Many of the asset packages that did change hands were focused on the tight gas/shale gas plays in British Columbia and northwestern Alberta, including Mitsubishi’s partnering with Encana in the Cutbank Ridge assets and Penn West Exploration’s sale of producing properties to an undisclosed buyer for $1.3 billion. In addition, Royal Dutch Shell Plc acquired deepwater exploratory licences in Nova Scotia with a work commitment of $956.4 million.

Domestic transactions were led by Crescent Point Energy Corp., which acquired Wildstream Exploration Inc. and their Saskatchewan and Alberta light oil properties for $616.1 million, Cutpick Energy Inc. and their Alberta light oil assets for $431.1 million, and the acquisition of Saskatchewan Bakken light oil assets from PetroBakken Energy Ltd. for $426.8 million. Interestingly, Crescent Point completed six acquisitions alone in 2012 with a total value of approximately $2 billion.

On the midstream/downstream front, there were two transactions of significance, with Pembina Pipeline Corporation’s acquisition of Provident Energy Ltd. and its transportation, extraction, marketing and storage businesses in North America for $3.8 billion, and Enbridge Income Fund Holdings Inc.’s $1.2-billion deal for Alberta oil storage capacity and Ontario wind and solar-powered electricity generation from Enbridge Incorporated.

While there was only one material transaction (in global terms) in the oilfield services space – URS Corporation’s $1-billion acquisition of Flint Energy Services Ltd. – there continued to be significant consolidation of a highly fragmented Canadian market, resulting in very robust interest from both private equity and strategic acquirers.

**Looking ahead**

Transaction activity in Canada is set to continue in the year ahead. Domestic players need to achieve scale to manage the risks of unconventional resource development, along with ongoing cost pressures. These pressures are resulting in part from low natural gas prices, large negative price differentials on Canadian oil given transportation constraints, general inflationary pressures, and the need to generate yield for investors.

Foreign interest remains strong, but foreign entities will have to become more creative in structuring future transactions. Complete control transactions will be far more infrequent. Instead, expect to see a renewed emphasis on the part of foreign investors to enter into strategic alliances and joint ventures, with Canadian domestic partners retaining some form of control. These partnerships will enable companies to share risk and pool Canadian expertise with foreign financial strength. Canadian companies also stand to benefit by gaining access to foreign markets where demand appetite and the economic return is higher due to the commodity pricing environment.
What else can companies expect in 2013?

- **Back to business basics.** The findings of our seventh bi-annual global Capital Confidence Barometer indicate a decline in companies’ appetite to transact, with many respondents noting they will refocus on business fundamentals. Cost reduction, performance improvement, capital allocation and targeted organic growth initiatives will dominate the boardroom agenda.

- **Unconventionals have changed the energy dynamic.** Shale gas, tight oil and the oilsands are seen as fundamentally changing the global supply/demand picture, including influencing where companies deploy their capital. North American unconventionals, in particular, continue to attract more attention, especially in light of ongoing global geopolitical concerns.

- **Technology is the name of the game.** Whether operating in East Africa, Iraq or Alberta, technology now plays a critical role in accessing reserves in increasingly difficult and challenging geological formations. Technological advances have made the unconventional resource boom possible and are what will allow for advances in critical environmental efficiencies, such as reductions in water usage and greenhouse gas emissions.

- **People are everything.** Part of the interest in Canada by national oil companies (NOCs) is to gain access to and to learn from Canadian expertise. The NOCs can buy the latest technologies, but they stand to benefit more from the business acumen and know-how developed by Canadians and applied in the Canadian energy sector.

- **Assets will be priced with a far greater appreciation of underlying risks.** This is especially true given the geopolitical environment in certain asset locations. Expect to see an increased discount applied to assets in these challenging jurisdictions.

Interest in Canada’s oil and gas industry will remain high as foreign investors continue to be attracted to long-life reserves, the stable economic, regulatory and political environment, as well as the transparency and sophistication of the Canadian industry.

Canada will also continue to lay the groundwork for the exportation of liquid natural gas (LNG) as the shale gas revolution unfolds. Not surprisingly, there is very strong interest in this initiative from Asia, which would be the beneficiary of this new supply chain.

But with continued foreign investment in Western Canada comes a number of unique challenges and complexities in the form of cultural and business differences. These factors must be considered and properly managed in order for all parties involved to succeed in the execution of their business strategy.

NOCs are eager to implement global best practices to further improve operational performance. Real value can be realized by excelling at post-transaction integration. There is a growing recognition that the value of a deal is really obtained through the effective integration of the business post close, as opposed to the purchase price.

There is a new horizon ahead, and all of these trends will enable those in the Canadian oil and gas industry to proactively pursue new areas of sustainability – including in areas like the oilsands, tight shale oil and gas and LNG projects – and continue building and strengthening strategic relationships and alliances with key global players that were so prevalent in 2012.