Canadian energy oil and gas: Top 20 of 2020 - Transactions and trends

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Part 4

Without question, the top story over the last year has been the COVID-19 pandemic and its tremendous ongoing effects felt across Canada and the world.

This time has had a significant impact on Canada's energy industry and many of the changes and developments that took place in 2020 will continue to influence trends, business decisions and the future growth of Canada's energy industry in 2021.

As we look back at 2020, we have highlighted the Top 20 industry developments and decisions made throughout the year in four key areas: Judicial decisions, regulatory decisions, legislative and policy developments, and transactions and trends. In this article, we analyze the **top five transactions and trends** of the last year and how these decisions may affect your business in 2021.

Top five transactions and trends of 2020

Events in 2020 created the perfect storm for market volatility and instability in the energy sector. Global lockdowns lead to a sharp decline in energy demand, depressed commodity prices and an oversupply of oil and gas, ultimately leading to the first time in history that oil prices traded in negative territory. Industry pioneers and contrarians took advantage of the crisis. Domestic energy players saw an opportunity to pounce on consolidation targets, creating bigger and more resilient companies to face this new economic reality while others took advantage of the ongoing restructurings and insolvencies to acquire assets at discounted prices. Environmental, Social and Corporate Governance (ESG) also became part of the lexicon of every oil and gas company while the social, economic and political controversies associated with pipelines accelerated and broadened again in 2020. Finally, east coast offshore projects continued to face uncertainty even in light of significant government support.

1. Global price volatility as COVID-19 takes hold

a) Demand impacts and OPEC+

Since January 2020, the spread of the COVID-19 virus has reversed nearly all the positive momentum in oil prices generated in 2019. The pandemic affected the oil market significantly; demand for transportation fuels fell by up to half while storage tanks filled and refineries were forced to cut output and even stop production.

On April 20, 2020, because of dramatic oversupply and insufficient storage capacity, the price of West Texas Intermediate (WTI) fell into negative territory for the first time in history, bottoming out at negative US $37.63 a barrel.[1] COVID-19 added a major layer of uncertainty to the oil market outlook and in the midst of the pandemic, the Organization of Petroleum Exporting Countries (OPEC) and its affiliates (OPEC+) sought to stabilize prices by agreeing to their largest ever cut in oil production. This resulted in the slashing of oil output by about 10 per cent globally.

The downward production trend did not persist as economies began to reopen in Q3 and with news of an arriving vaccine, oil prices recovered, climbing as high as US$43.06 in November.[2] However, the resurgence in COVID-19 cases, the re-implementation of lockdown measures and the associated negative effect on oil demand has resulted in a more conservative revaluation of the global oil outlook for 2021. Although, these new projections maintain a healthier outlook than those recorded at the earlier parts of 2020.[3]

Although the impacts of COVID-19 have permanently shifted energy-demand curves and it is unlikely that the sector will return to previous growth paths, general commodity demands are anticipated to rebound to 2019 levels in one to four years and prices will rise accordingly.

b) Natural gas and LNG

The natural gas markets were similarly affected by the pandemic and saw prices drop to multi-decade lows. However, after a 4 per cent drop in demand in 2020, as Henry Hub prices fell as low as US$1.48 in the summer, natural gas demand is expected to progressively recover in 2021 as excess supplies continue to be absorbed gradually, lifting prices as inventories edge closer to their five-year average.[4]

The liquefied natural gas (LNG) industry was experiencing low prices and oversupply long before the COVID-19 pandemic reduced demand and increased market volatility. In recent years, natural gas seems trapped between O&G companies' decarbonization strategy of focusing on low-carbon fuels and the broader impetus to replace gas with renewables for electricity generation. However, economists remain optimistic on the long-term outlook of LNG as the price discount relative to oil incentivizes consumers to switch from oil and oil products to natural gas, where practical, which may cause LNG prices to recover somewhat over the next three to five years.[5] LNG's recovery has also benefitted from the surging U.S. LNG exports that have provided an avenue of relief for domestically oversupplied markets as demands in Asia and Europe rise generally.[6]

Overall, natural gas and LNG show promise moving into 2021 as major world economies embrace pro-natural gas policies. Despite disruptions due to COVID-19 in the short term, buyers remain confident in natural gas and LNG demand for the medium and long term. In the event of sustained low prices over the coming years, 90 per cent of buyers anticipate a positive market response, particularly in the power sector as natural gas displaces other fuels such as coal.[7]

2. Consolidation and scale results in fewer players in the market after 2020

In the midst of the volatility, domestic energy players saw an opportunity to pounce on consolidation targets, creating bigger and more resilient companies. Others took advantage of the many company restructurings and insolvencies caused by the economic downturn to acquire assets at discounted prices in order to better position themselves to withstand the new economic reality anticipated in 2021 and beyond.

a) Notable mergers and acquisitions

Cenovus & Husky

On Oct. 25, 2020, Cenovus Energy Inc. (Cenovus) announced it had entered into an all-stock transaction to combine with Husky Energy Inc. (Husky) in a transaction valued at $3.8 Billion. According to Alex Pourbaix (CEO of Cenovus), the objective of the deal was to create a stronger, more resilient company able to operate with significantly reduced risk to market volatility.

Cenovus and Husky combined their pre-merger daily production rates of 475,000 BOEs and 275,000 BOEs respectively, for a total of 750,000 BOEs/d. Their combined refining and upgrading capacity is expected to total 660,000 bbls/d.[8] This transaction closed on Jan. 4, 2021 and is the largest merger in the Canadian energy sector since the start of the COVID-19 pandemic, resulting in a combined enterprise value of $23.6 Billion.

Rafi Tahmazian, partner and senior portfolio manager at Canoe Financial, explained that the investor exodus is forcing oil and gas producers to look at mergers and acquisitions in order to scale up in an attempt to attract new shareholders.[9] Ongoing consolidation in the energy sector can also lead to rounds of layoffs as energy companies begin to model themselves after low-cost manufacturing operations. On Jan. 26, 2021, Cenovus announced plans to cut over 2,000 jobs from its workforce in the next two months. This represents almost a quarter of its workforce.[10]

Whitecap & TORC

On Oct. 9, 2020, Whitecap Resources Inc. (Whitecap) continued its crusade to consolidate conventional oil and gas producers by purchasing TORC Oil & Gas Ltd. (TORC) for C$900 Million in an all-stock deal. The combination of the companies will create one of the largest pure-play Canadian conventional light oil producers and the ninth largest publicly traded oil and gas company in Canada.[11]

Before the merger, Whitecap's daily average production was 82,000 BOEs/d. This merger will grow Whitecap's daily production to over 100,000 BOEs/d and give the company an enterprise value of approximately $4 Billion. The enhanced size and scale of the company is expected to enable Whitecap's operations to better navigate commodity price volatility in the energy market. This consolidation is a result of multiple operational synergies between the companies. Both companies own and operate core assets that overlap each other in southeast Saskatchewan and central Alberta including jointly held production units.

Longshore acquires multiple entities

On June 5, 2020, Longshore Resources (Longshore) announced it had entered into an agreement to purchase all of the outstanding shares of Rifle Shot Oil Corp. (Rifle Shot), Steelhead Petroleum Ltd. (Steelhead) and Primavera Resources Corp. (Primavera). This enlarged single entity is expected to have a production capacity of 14,000 BOEs/d.[12]

The transaction closed on July 1, 2020 and brought Longshore diverse assets ranging from heavy oil, light oil and natural gas. This diverse portfolio of assets will enable Longshore to better navigate market volatility. ARC Financial Corp. (ARC) was the majority investor in the four companies pre-merger. ARC's President Brian Boulanger stated that current market conditions are forcing companies to increase in size, reduce costs and build resiliency in order to survive the current environment.[13]

b) Insolvencies

Cequence insolvency

Cequence Energy Ltd. (Cequence) along with its subsidiaries obtained protection under the Companies' Creditors Arrangement Act (CCAA) on June 11, 2020. Cequence listed approximately $113 Million in liabilities and reported operating losses for the last five years.

Cequence faced multiple challenges – a liquidity crisis, low commodity prices, declining production volumes, burdensome contractual obligations and high debt levels. The company was looking for various options to fulfill its debt obligations including "[…] the sale of all or a portion of the business and assets or shares of the company, renegotiation of certain onerous contracts, refinancing, recapitalization or other restructuring alternatives." [14]

On Aug. 24, 2020, Cequence announced a recapitalization transaction to be implemented as a plan of compromise and arrangement under the CCAA, allowing it to reduce its debt and interest costs and improve liquidity to fund future operations.[15] The plan was implemented as of Sept. 28, 2020.[16]

c) Private equity firms exiting

Tourmaline announces purchase of two private oil & gas companies

On Nov. 4, 2020, Tourmaline Oil Corp. (Tourmaline) announced that would purchase Jupiter Resources Ltd. (Jupiter) in an all-stock transaction valued at $630 Million.[17] It also announced its acquisition of Modern Resources Inc. (Modern) for $144 Million – this includes $74 Million in cash, 1.5 Million Tourmaline shares and the assumption of $44 Million in debt.[18]

Following the closing of these two transactions, Tourmaline's average production at the end of 2020 was expected to reach 400,000 BOEs/d.[19] Modern was owned by private equity (PE) firms ARC Financial Corp and EnCap Investments LP while Jupiter was an independent company, which counted Apollo Global Management as an investor.

Many factors are leading PE firms to exit the oil and gas sector.[20] The pandemic, the growing supply surpluss and geopolitical price wars are wreaking havoc on commodity prices and energy PE firms.[21] PE portfolios are also undergoing a green shift in that they are playing a role in global initiatives to reduce carbon emissions and to promote renewable energy. For example, the Canada Pension Plan Investment Board, Canada's largest investor in PE, promised to weigh every significant transaction according to climate risks and opportunities, and to boost deployments to renewables. ESG policies and commitments are impacting PE firms' investment decisions. Political pressure continues to grow on PE firms to reduce their fossil-fuel investments. Consequently, oil and gas fundraisings have steadily declined since 2014 and continue to undermine investor confidence.

3. ESG – top of mind

In 2020, ESG became part of the lexicon of virtually every oil and gas producer. A quick refresher: ESG is a shorthand way for investors to assess performance in terms of societal values, rather than only using financial metrics to determine how a company has performed relative to its peers.

Some of the factors that can affect ESG performance are set out below:

Environmental	Social	Governance
• GHG Emissions • Methane Emissions • Water Management • Spill/ Release Frequency & Management • Abandonment & Reclamation • Land Use/Minimal Impact • Water use	• Employees: Diversity • Health and Safety • Community Relations • Indigenous Relations • Anti-bribery and corruption	• Board Committee Structure & Independence • Ethical Business Conduct – Board Supervision • Climate Risk

The issue for many investors is benchmarking. If disclosure of these factors is incomplete or inconsistent, it is difficult to compare company performance. In 2020, eight large Canadian pension funds (including Ontario Teachers and AIMCo) united to call for standardized ESG disclosure. It was not clear whether this was to be part of annual financial statements or as part of their annual securities filings - but it is clear is that there is a push from investors for clarity and transparency.

Some of the largest funds have also indicated their intention to include ESG in investment decisions: Brookfield Asset Management hired Mark Carney (former Bank of Canada and Bank of England Governor) to lead ESG and impact fund investing. This, combined with the announcements by supermajors BP and Shell of "net-zero" impact of operations by an identified date, shows the global market for energy will be driven in part by the values of the producer – producers that are cavalier about these issues can expect to see funding dry up.

Given that operations of Canadian oil and gas producers are strictly regulated, it may be that the emphasis on ESG is a positive for the Canadian energy market generally – if oil and gas is part of the energy mix, it may as well come from Canada, where producers hold themselves to very high standards of ESG performance.

4. Pipeline politics take centre stage

The social, economic and political controversies associated with pipelines accelerated and broadened in 2020. For a sector that rarely warranted media mention a decade ago, pipeline companies found themselves, again, at the centre of a litany of socio-political debates.

The year commenced with demonstrations by Wet’suwet’en protesters and their supporters, against the further development of the 640 km Coastal GasLink natural gas pipeline, stemming from Indigenous groups’ land title disputes, internal governance matters and environmental concerns. The $12 Billion TransMountain crude oil pipeline expansion project also highlighted the adequacy of Indigenous consultation in June when the Supreme Court denied leave to hear a years-long challenge. Alignment around the Pipeline debates intensified in April as the Alberta Government invested $1.5 Billion in equity and $6 Billion in loan guarantees to support the construction of the $8 Billion, 1,947-kilometer Keystone XL crude oil export pipeline to Nebraska. Followed by the announcement in November that Indigenous groups backed Natural Law Energy had agreed to invest up to $1 Billion in Keystone XL. The momentum of these investments was stopped cold in January 2021, however, when the previously granted U.S. Presidential Permit for Keystone XL to cross the U.S. border was revoked by the new Biden administration.

The pipeline debates also aggravated constitutional, interprovincial and international jurisdictional tensions in 2020. In January, the Supreme Court of Canada rejected British Columbia’s attempt to regulate shipments through interprovincial pipelines, affirming federal constitutional authority to approve and regulate interprovincial pipelines. However, the pipeline debates were not only domestic. Before the revocation of Keystone XL’s presidential permit in early 2021, the governor of Michigan threatened to revoke a 1953 easement allowing Enbridge’s Line 5 to cross the straits of Mackinac, potentially cutting off propane and light crude oil supplies into Detroit, Toledo and Sarnia. Similarly, despite receiving final permits to construct the $2.9 Billion U.S. portion of the Line 3 crude pipeline replacement project after more than six years of legal proceedings, Enbridge continues to encounter protests and debates, particularly in Minnesota.

Pipeline debates also percolated amongst owners and customers seeking to balance commercial certainty with access to transportation capacity. In April, the Canadian Energy Regulator approved TransCanada’s natural gas mainline tolling and services settlement for the 2021 to 2026 period, providing a measure of toll and revenue certainty for the stakeholders. In May, the Canadian Energy Regulator commenced hearings to consider a controversial proposal by Enbridge to reserve approximately 90 per cent of its crude mainline pipeline capacity to long term contracts (versus monthly access) in a bid to provide revenue and toll certainty, raising the ire of many of its spot market shippers.

In 2020, both proposed and operating pipelines, continued to be lightning rods for a range of social, economic and political debates. These public controversies, and the associated delays, increased costs and escalated uncertainties, are expected to persist in the near term.

5. Uncertainty in East Coast offshore projects

The global crash of oil prices during the COVID-19 pandemic has disrupted the oil and gas dependent economy of Canada’s east coast and created uncertainty for its many offshore projects near Newfoundland and Labrador. In response, companies have curtailed operations, drastically reduced spending and laid off workers from these facilities. In September 2020, the Federal government announced a $320 Million Oil and Gas Recovery Fund to support Canada’s offshore oil and gas industry workers during the economic downturn. The majority of this has gone into restarting or maintaining operations at offshore facilities, creating hundreds of jobs in the process. In addition, the Newfoundland and Labrador government has contributed money from a contingency fund in its budget into offshore projects as well. However, despite significant government funding, the future remains uncertain for many of these projects, their workers as market conditions fluctuate, as the pandemic stretches into 2021. An update on some key projects will provide helpful insight into the issue:

a) Hibernia

Drilling was halted at the Hibernia offshore platform in early 2020 in response to plummeting oil prices, but the facility has continued to produce. At the end of December, the Federal government announced its contribution of $38 Million from the Oil and Gas Recovery Fund into this platform, to be used to create or maintain 150 jobs over the next 18 months. Hibernia Management Development Corporation, which manages the facility, agreed to make its own $56 Million contribution, to restart work needed for future drilling operations. The combined investment is intended to ensure Newfoundland and Labrador is well positioned when demand for the commodity returns.

b) Come by chance refinery

The Newfoundland and Labrador government pledged $16.6 Million to North Atlantic Refinery Limited to keep its Come-by-Chance refinery alive while it seeks a new owner after Irving Oil backed out of a deal to acquire the refinery in October 2020. The refinery has been idle since April, employing only 100 of the 400 full-time workers it employed prior to the shutdown. The funding will help keep the refinery in a warm state in preparation for future restart, employing about 200 workers and hopefully keeping it alive long enough to attract a new buyer.

c) West White Rose expansion

In December 2020, the Federal government pledged $41.5 Million into Husky Energy to keep the idled West White Rose Offshore project afloat, creating jobs for more than 300 people. While the investment will keep the 60 per cent complete project breathing, there is no guarantee it will restart. Cenovus purchased Husky Energy on Jan. 1, 2021, creating further uncertainty for the expansion. On Jan. 28, 2021, Cenovus announced that it plans to spend between $200 and $250 Million on its offshore segment in 2021.[22] The capital spend includes baseline preservation capital for the West White Rose Project, which has been deferred for 2021 while the company continues to evaluate its options.[23] In early January, Suncor Energy announced that it would take a $425 Million impairment charge on its share of the existing White Rose oil field assets, further signalling an uncertain future for the project.

Looking forward to 2021

While there is uncertainty, and large assets are distressed, there is significant production potential in Canada's east coast offshore projects that should not be overlooked. 2021 holds potential for Canada's Atlantic oil and gas industry and many are hopeful that the government support can see these projects through until the demand for oil returns.

[1] BBC News, "US oil prices turn negative as demand dries up".

[2] CBC, "Oil prices surge on vaccine hopes – and then ebb on pandemic realities"

[3] TD, "Canadian Quarterly Economic Forecast"

[4] TD, "Commodity price report"

[5] McKinsey and Company, "The future of liquefied natural gas: Opportunities for growth"

[6] TD, "Commodity price report"

[7] McKinsey and Company, "COVID-19 and market changes are shaping LNG buyer preferences"

[8] Cenovus closes transaction to combine with Husky.

[9] Financial Post, Cenovus to buy Husky for $3.8 billion to create Canada's No.3 energy company.

[10] CTV News, Calgary-based Cenovus Energy to lay off upward of 2,000 workers.

[11] Whitecap Resources Inc.

[12] Longshore Resources Ltd. announces transformational transaction and creation of a premier oil weighted entity.

[13] BNN Bloomberg, 'Hope is not a strategy': M&A heats up as new era rattles oil patch.

[14] CBC, More Canadian oilpatch companies seek CCAA protection to restructure.

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[16] Global News Wire Cequence Energy Announces Conclusion of CCAA Proceedings.

[17] Tourmaline Oil Group.

[18] Tourmaline Q3 2020 Press Release.

[19] Calgary Herald, Varcoe: 'The trend will continue,' says Tourmaline CEO as company unveils twin takeovers.

[20] S&P Global, Oil and gas private equity sector shrinks amid bankruptcies, lack of funds.

[21] Buyouts Insider, The greening of private equity: the watt and the why.

[22] Cenovus Energy, News Release, "2021 budget to achieve nearly $1 of synergies in first year" (28 January 2021),.

[23] *Ibid.*

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