



## Talisman Has Struggles Ahead, but Icahn's Investment Is a Promising Signal

### Description

Renowned corporate activist Carl Icahn's recent foray into troubled **Talisman Energy** (TSX:TLM)(NYSE:TLM) has triggered a round of renewed investor interest in the company. Shares shot up on the news of Icahn's stake, and a number of analysts and market pundits have speculated there is further appreciation to come.

Whether this is overly positive speculative sentiment based on Icahn's reputation or a true appreciation of the changes that can be implemented remains to be seen.

### What have been the key drivers of Talisman's woes?

Talisman's troubles can be attributed to the company living well beyond its means. Historically, Talisman has invested significant financial resources in an attempt to grow at all costs, resulting in it acquiring a diverse global range of oil and gas assets.

But many of those assets are either of questionable quality or not a natural fit for the company, reducing the synergies available and increasing costs. Its foray into natural gas assets cost it dearly when the price of natural gas plunged to a 10-year low in April 2012.

As a result, Talisman experienced cost blowouts and was forced to maintain a high level of capital expenditures to continue funding development and exploration, even though it was seeing poor results in proportion to the investment made.

The end result: Talisman has reported four consecutive years of negative free cash flow and has a deteriorating balance sheet. For the second quarter of 2013 alone, cash and cash equivalents plunged 60% year over year, while its total asset value fell by 18% for the same period.

### Can Talisman be fixed?

Clearly, Talisman is in trouble: declining asset quality, a deteriorating balance sheet, and falling production have left the company in a severely weakened state. In an effort to turn the company around, the board appointed a new CEO and President, Hal Kvisle, in September 2012.

Since his appointment, Kvisle has implemented a turnaround strategy focused on divesting Talisman of non-core and low-quality assets with a renewed focus on core operating areas in North America, Colombia, and Asia Pacific. The aim of the divestment program is to realize \$2 to \$3 billion from asset sales.

Talisman's ailing health attracted Icahn to make his [recent acquisition](#) — a 6% stake in the company worth around \$300 million. If Icahn follows his usual activist model, he will seek a board seat and talk to management about restructuring the business. Or he may even push for an outright sale of the business, as he did with **Nexen**.

Already there have been claims by some analysts that Talisman's parts are worth more individually and that potentially \$500 million could be unlocked by Icahn. I believe this to be overly optimistic; Talisman is already well into the turnaround strategy implemented by Kvisle, having sold a 49% stake in its North Sea and U.K. assets to China's **Sinopec** for \$1.5 billion.

The company has also reduced its capital spending by 25%, implemented a strategy to reduce operational costs by \$100-\$150 million by the end of 2013, and refocused on core operations.

This leaves little, if any, low-hanging fruit for Icahn to pick in an effort to unlock value and boost Talisman's financial performance. Also, in the short term, Talisman's performance will continue to decline until the turnaround strategy gains sufficient traction.

### **What has been the impact of the turnaround strategy?**

With the turnaround strategy in its early stages, there have been few positive impacts to date. The 2012 sale of its U.K. and North Sea assets resulted in Talisman's oil reserves falling 27% year over year, and a production drop of 10% for the same period. This has had a significant impact on Talisman's cash flow, which for the second quarter 2013 was down by 36% year over year.

I expect oil reserves, production, and cash flow to continue declining over the short term as Talisman completes the sales of its troubled Norwegian assets as well as its North American Montney and North Duvernay assets. Strangely, it announced in September that it is seeking to reduce its exposure to the recent oil discovery in Kurdistan, which is in the exploration stage, despite estimating this to be a major long-life discovery.

But these assets sales will give Talisman much-needed capital to further develop its remaining North American assets, in particular the Marcellus and Eagle Ford shales. That capital will also be deployed to further develop its Colombian heavy oil assets and drilling in Kurdistan and Papua New Guinea.

But with long lead times to develop oil and gas assets into commercially viable levels of production, it will be some time before that renewed focus will have a positive impact.

### **Icahn's options**

It is difficult for me to see how Icahn could do anything different other than to force a restructure and divestment strategy that would have similar short-term impacts. I also find it difficult to believe that Icahn will force the company to sell itself to a potential suitor, because it is already well into the midst of a major restructure and asset sale process. (Also, many of its Asia Pacific assets are joint ventures with regional government interests, which could find having a Chinese partner politically unacceptable.)

And there's more. Talisman's decision to sell its 12.5% equity stake in Colombia's OCENSA pipeline is flawed, particularly when it's seeking to boost both its oil reserves and production in Colombia. Oil pipelines are the only cost-effective means of transporting crude in a country with rugged terrain that lacks basic transportation infrastructure.

With the OCENSA pipeline carrying around 60% of Colombia's total oil production, it is a particularly valuable asset. By selling its equity stake in the pipeline, Talisman is not only increasing transportation costs but forgoing a consistent income stream from its stake in the pipeline.

### **Foolish final thoughts**

Even if Icahn were to retain his golden touch with Talisman, any form of asset divestment strategy will continue to have a significant impact on the company's bottom line for the short term. I don't expect any sizable improvement in its financial performance or share price for some time yet.

While Talisman's recovery may be years away, there is another area of Canada's energy industry that might be on the verge of bouncing back much quicker. Uranium – the primary ingredient in nuclear power – has been clobbered in recent years. But there's plenty of evidence that indicates this metal is not down for the count. To get the full rundown, as well as two ways to play this potential recovery, [click here now](#) to download our special **FREE** report "**Fuel Your Portfolio With This Energetic Commodity**".

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