2014 Set to Be a Monster Year for Canada's Oil Patch

Description

Canada is in the midst of an energy infrastructure super cycle, with the oil patch caught up in a frenzy of activity that will only continue to heat up through 2014. Not only is the market awash with Canadian oil and gas assets for sale, with a number of companies restructuring their operations, but a wave of initial public offerings is expected to engulf the industry throughout the year. Merger and acquisition activity is also expected to outpace 2013.

2014 deal activity is expected to surpass 2013
Already there has been a flurry of deal activity since the start of 2014. In March, **Whitecap Resources** (TSX: WCP) acquired a number of Western Canadian light oil assets from Imperial Oil in a transaction valued at $885 million, while Vermilion Energy completed the purchase of Elkhorn Resources for $400 million. Even bigger was **Canadian Natural Resources'** (TSX: CNQ)(NYSE: CNQ) acquisition of Devon Energy's Canadian conventional and heavy oil assets for over $3 billion.

This flurry of activity has led to Calgary-based Sayer Energy Advisors estimating that based on the current pace of deal activity, total 2014 mergers and acquisition activity will easily surpass the $14 billion completed in 2013.

There is also a significant volume of Canadian oil and gas assets for sale in the patch. Between them, **Lightstream Resources** (TSX: LTS) and **Penn West Petroleum** (TSX: PWT)(NTSE: PWE) have indicated they are seeking to divest around $1.6 billion worth of non-core assets over the current year. But it isn't solely restricted to mergers and acquisitions or asset sales, there are also a number of initial public offerings in the works.

The first of these is expected to be the much touted IPO of **Encana's** (TSX: ECA)(NYSE: ECA) PraireSky royalty business as early as next month, which will be the biggest IPO in the patch since 2010. Encana expects to raise around $700 million from the IPO and will retain a majority interest in the company.

Canadian Natural Resources has also the flagged the possibility of an IPO of a royalty business this year, as it packages together its own royalty properties with those it purchased from U.S. energy company Devon.

What is driving this growing activity in the patch?
A key driver of increased deal activity, asset sales, and investment activity in the patch is higher crude and natural gas prices coupled with narrowing price differentials between West Texas Intermediate and key Canadian crude blends.

For the year to date, the price of West Texas Intermediate is up 9% to well over $100 per barrel, whereas natural gas is up 12%. Over the same period Canadian light oil (Edmonton Par) has seen its price differential to WTI close by around 14% and Canadian heavy oil's (West Canadian Select) price differential has narrowed by 12%.

What does this mean for investors?
The key takeaway for investors is that this growing level of activity indicates a number of industry participants have high expectations for 2014 and are confident of a strong year. That signifies that many participants are expecting stronger operational and financial performances during 2014, which should see further value unlocked for investors.

Light oil producers such as Whitecap, Lightstream, Crescent Point Energy, and Penn West Petroleum will be able to take advantage of the narrowing price differential between Edmonton Par and WTI. But the biggest threat they are facing is surging U.S. light oil production from the shale oil boom, potentially driving lower demand for Canadian light crude.

However, this surge in activity will assist Lightstream and Penn West in successfully implementing their turnaround programs. These programs are primarily focused on restoring balance sheets and reducing leverage through the sale of non-core assets, the proceeds of which are earmarked to pay down debt.

The successful implementation of those programs is under threat because of the sheer volume of Canadian oil and gas assets on the market, making it a buyers' market and preventing the realization of the full value of those assets. But growing investment and deal making activity in the patch mitigates much of this risk by increasing the demand for Canadian oil and gas assets.

However, it is heavy oil companies that may offer the best value for investors when the increased M&A and investment activity is taken into account. This because players in this sector fell into disfavor with investors because of high development costs coupled with low heavy oil prices.

For all of the reasons discussed and more, Canadian Natural Resources stands out as an investment opportunity offering considerable value for investors. Not only has management flagged that it is looking to unlock additional shareholder value through the IPO of its royalty business, but the company is well positioned to capitalize on firmer crude prices and the narrowing differential between Canadian heavy crude and WTI.

It also continues to remain attractively priced despite its share price spiking 23% for the year to date, trading with an enterprise-value of seven times EBITDA and six times its oil reserves.

Foolish bottom line
If the first few months of 2014 is any indication, it is going to be a big year for the patch, with significant growth in deal-making activity and increased investment. This certainly makes it a hotspot for investors as many of the players continue to unlock value and see their share prices grow.

CATEGORY

1. Investing

TICKERS GLOBAL

1. TSX:CNQ (Canadian Natural Resources Limited)
2. TSX:WCP (Whitecap Resources Inc.)

Category

1. Investing

Date
2025/09/11
Date Created
2014/04/21
Author
mattdsmith