Two Oil Stocks That Will Be Acquired in 2019

Description

In 2018, a report from the Bank of Montreal painted a bleak picture for Canada's oil and gas industry. "The message is clear, the report said. "Merge, innovate, or face extinction."

The industry is facing untold pressures. Oil sands production has always been politically charged, with some of the highest breakeven production costs in the world. New regulations, set to take effect over the next 24 months, could render 20% of all oil sands output economically unviable.

Plus, pipelines and terminals are at capacity. In late 2018, Canadian producers were forced to take huge discounts, sometimes below $20 per barrel, simply to transport their output. In December, the province of Alberta announced mandatory production cuts of 9% across the board. This was an unprecedented move, but as **Cenovus Energy Inc**'s CEO said at the time, "these are not ordinary circumstances."

Conditions will continue to be tough, but as the Bank of Montreal report stated, there could be opportunities for stocks to be acquired at a premium. The bank said it didn't "have a clear idea on who" will be acquired, but listed **ARC Resources Ltd** (TSX:ARX) and **Tourmaline Oil Corp** (TSX:TOU) as potential candidates considering their strong management teams, clean balance sheets, and potential synergies.

How attractive are ARC and Tourmaline?

Nearing a decade-long low, Tourmaline is clearly going through tough times. But with a $5 billion market cap, it's in a unique position, capable of financing new projects and pushing through periods of distress while still being small enough to get gobbled up by a larger competitor.

On average, the company has produced about $1 billion in cash flow each of the past three years. Additionally, net debt stands at just $1.7 billion, making Tourmaline one of the best capitalized energy companies in Canada. Financing is already getting more difficult, so not having to take on another firm's debt is a hugely attractive advantage for a potential acquirer. More than 20% of Tourmaline's shares are owned by company insiders, so you can bet they will be looking for ways to boost the stock price, rather than simply keep the business running and collect their paychecks.

Tourmaline is a clear acquisition candidate, but what about ARC?

With a $3 billion market cap, ARC is even more digestible than Tourmaline. With net debt under $700 million, it’s also one of the best capitalized energy companies in the industry.

ARC has a long runway of affordable growth. By 2021, it anticipates growing production by more than 30%. Notably, the business is getting cheaper and cheaper to maintain. Since 2019, sustaining capital requirements have fallen by 28%. Operating costs over the same time period have fallen by 46%. Other competitors, for example, need to spend billions just to keep production stable.

Both are solid acquisition candidates for 2019

In a tight market, a potential acquirer would require a buyout candidate to demonstrate a strong balance sheet, with little assumed debt and growing production without high capital requirements

Both Tourmaline and ARC are perfect candidates, so don’t be surprised to see both acquired at a premium this year, especially if Bank of Montreal is correct in its projection that acquisitions will dominate the market in 2019.

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2. TSX:TOU (Tourmaline Oil Corp.)

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