

Recipe for a SUCCESSFUL MERGER?

Be prepared and have a good strategy

In today's economic climate, oil and mining companies are bracing for mergers, acquisitions and divestitures. Find ways to ensure your company is prepared - if not, expect to manage significant risks.

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Up to a year ago, Canadian oil and mining companies saw historically high stock market valuations and significant revenue increases. Then the global economy slowed down, decreasing the demand for commodities which, in turn, led to reduced prices. This decline, together with a correlated

drop in the Canadian dollar exchange rate and a global credit crunch led to an evaporation of capital, increased operating costs and an uncertain outlook for energy companies.

This uncertainty has brought unique risks and opportunities for oil and mining

companies based on how strong or weak they were going into the economic crisis. These companies are bracing for an impending wave of acquisitions and consolidations as the strong absorb the vulnerable and equals join forces to strategically position themselves for the future recovery in commodity prices.

At the front of the wave are energy giants Suncor and Petro-Canada. In March 2009, the companies announced their plans to merge. The merger was an opportunity to create a stronger company that will see an increase in reserves and revenues as well as a decrease in operating costs and risks





Before planning to acquire a weaker company or merge with an equal, develop a clear understanding of your organization's strengths weaknesses, opportunities and threats and create your plan accordingly:

- Factor in undesirable assets into assumptions around value.
- Do not rely on past transaction ratios for setting prices and improbably forecasts – it may lead to overpayment for acquisitions.
- Develop pre-emptive plans about how to deal with unsolicited offers to acquire your firm.

while it continues to create value even in an economic downturn.

We know that mergers, acquisitions and divestitures in the energy sector will continue to happen – and happen more frequently. This will lead to tremendous opportunities for those who are well-prepared and significant risks for those who are not. There are no silver bullets to successful mergers, takeovers or divestitures. We all know the saying 'luck equals preparedness plus opportunity' – to be lucky in the M&A space is to be prepared and armed with a strategy to be executed by the right people in the right circumstance. That forethought

will make a huge difference in how your company manages and prospers in these volatile times.

Merger and acquisition opportunities

Currently, the market is favourable for increased consolidation because it is a cost-effective way of growing and maintaining oil and mineral reserves. It's also a way to enhance access to capital through an increased scale of operation and balance sheet strength.

Proven oil reserves have grown by more than 15% since 2005. Today, oil production companies can be

purchased for same price as in mid-2005, but are yielding significantly greater reserves. Thanks to previously high oil prices, oil companies saw their revenues and cash flows increase, putting them in a position of strength in terms of flexibility to acquire or expand operations. By growing their oil producing assets, producers will enjoy more flexibility in terms of matching the resources they exploit to the economic conditions at any given time. They can temporarily shift from high incremental cost production to more favourable economic resources and can choose the most advantageous mix of oil and gas. The current contango – the future

delivery price for oil exceeding today's prices – is around \$10 a barrel, showing that a well-planned and executed acquisition can strategically position a firm to capitalize on an anticipated rebound in oil prices.

In the mining sector, gold reserves have grown by more than 25% while other metals and minerals have grown by 15%. These high commodity prices, however, did not equal a build up in cash reserves. Costs at mining firms skyrocketed because of expensive acquisitions at the peak of the commodity price cycle, putting many firms at a disadvantage. Mining firms –



and their reserves – can be purchased for the same price as in mid-2007 but, like with oil producers, these companies are yielding significantly greater reserves. Mergers and acquisitions offer an opportunity to unlock cash in sector where the current cash burn rate implies urgency for firms to access additional capital. Like oil companies, mining firms with larger scale of operations have more flexibility and can choose to operate mines that have lower production costs. A mining firm that successfully merges or acquires another firm will see the same positives as oil companies: increased flexibility and reserves that will allow them to position themselves well to endure the current global situation as well as ensuring that they are well-placed when the economy rebounds. Investors, equity markets and lenders are not looking to make risky investments on floundering firms or struggling companies.

They are looking for organizations that have producing assets and proven reserves. A merger or acquisition that

creates a consolidated company with a strong balance sheet will find it easier to get credit than smaller companies, especially exploration-based juniors with riskier assets. If there is a well-developed and designed strategy in place, a merger or acquisition can create value for all parties.

Creating a solid plan

Energy companies that are doing well are in a position to acquire ones that are faltering, and weaker companies can make themselves more attractive to be acquired. If you haven't already, now is the time to create your organization's merger or acquisition strategy – but know that the wrong company, the wrong advice or the wrong strategy can destroy your organization's value.

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Few energy firms have the full-time internal resources and/or expertise to develop and execute M&A strategies in their entirety, so they normally work with knowledgeable outside advisors. Having unbiased third-party advisors, who can support a tactical framework around the advantageous conditions for a deal and how those conditions would be achieved, is a necessity. When choosing advisors to work with your organization, ensure that your incentives and objectives are aligned and that your advisors know what your goals are and are in agreement to achieve them. Work with advisors who can provide the breadth of services that your organization needs and are able to look beyond the transaction

itself and understand how integration or divestiture will occur and affect your business. Most importantly, find someone who has the experience and industry knowledge to help you successfully complete the transaction.

A merger or acquisition strategy is a tool that can help your organization achieve its corporate strategic objectives. If you are unprepared, you'll be in position of weakness – no matter how stable your company is. Avoid common pitfalls by developing a strategy that will allow you to respond to the opportunities and threats in the marketplace. Having a plan and seeking opportunities that align with your objectives, while at the same time being ready to ward off the threats, is the first step to being successful in these volatile times.

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