

THE NEWSLETTER OF THE BDO NATURAL RESOURCES PRACTICE

NATURAL RESOURCES RECORD



2013 OIL COUNCIL NORTH AMERICA ASSEMBLY: THE ECONOMIC PROMISE OF NATURAL GAS

By Charles Dewhurst

I recently attended this year's Oil Council North America Assembly, where I participated in a panel focused on how natural gas exploration and production (E&P) can help support our economy by driving change across multiple industries, increasing liquefied natural gas (LNG) exports and fueling gas-to-liquids (GTL) technology investments. The conversation also explored how the market and regulatory environment has and will continue to change in response to a shifting global energy landscape. With the Energy Information Administration (EIA) predicting that the United States will become the world's largest producer of natural gas this year and that prices will remain steady through 2014, we are already in a

strong position to capitalize on this critical resource. However, while natural gas may be a strong vehicle for the United States' economic growth, we can only maximize its potential if the government, industry and stakeholders align and work together toward a comprehensive, cohesive energy policy.

►GROWTH IN U.S. GAS MARKETS

Domestic demand for natural gas is high in the United States. According to the International Energy Agency, U.S. production is expected to continue rising into next year, with output increasing 17 percent between 2012 and 2018.

►DID YOU KNOW...

The *Energy Information Administration* projects that this year's domestic oil production is on track to achieve the biggest annual growth increase in U.S. history—a predicted jump of 15.1 percent to 7.47 million barrels per day this year.

The amount of oil transported by rail rose 2,361 percent between 2008 and 2012, according to the *American Association of Railroads*.

The Wall Street Journal reports that the U.S. is importing approximately the same number of barrels of oil as it was 20 years ago, but net imports have declined 7 percent since the beginning of 1993.

According to *Fortune*, U.S. oil production is up 50 percent from its 2008 levels, natural gas production has risen 33 percent since 2005 and shale gas alone accounts for roughly 45 percent of total natural gas production.

The Gulf Coast deepwater oil reserves are believed to contain 48 billion barrels of oil, compared to the 13 billion barrels estimated for onshore and coastal oilfields, reports *Bloomberg*.

In May 2013, Alaska ranked fourth among U.S. states in oil production, up from second in 2011, according to the *Institute for Energy Research*.

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This abundant and relatively affordable resource is spurring changes across many industries, including the manufacturing, electricity generation and transportation sectors. Between 2006 and 2010, natural gas prices for manufacturers fell by 36 percent, according to the EIA, and many companies are building new factories to take advantage of low costs. In turn, this is creating millions of new jobs in the industry. A less expensive alternative to standard gasoline fuel, natural gas is also transforming the transportation sector, powering automobiles, trucks, public transit and potentially even trains. The industry has already taken note: Shell is planning a nationwide LNG gas fueling network for trucks and other commercial vehicles, and many city bus fleets now run entirely on natural gas. And, being 20 percent cheaper than coal, natural gas is boosting its share of U.S. electricity generation, as well.

The LNG exports sector has also been expanding as a result of our increased natural gas supply. The Congressional Research Service reports that LNG exports are on the rise in the United States, and proposed export projects could encompass up to 41.4 percent of our current natural gas production. Pipeline exports to Canada and Mexico have doubled since 2006 and 2010, respectively.

▶EXPLORATION & PRODUCTION COMPANIES RESPOND TO LOWER GAS PRICES

As abundant supplies of natural gas drive down prices, E&P companies are repositioning their focus from gas to oil production. While U.S. oil production has outpaced natural gas production in recent years, natural gas production has also increased. However, in an effort to improve profitability and take advantage of the historic price differential between the two resources, companies like ExxonMobil and Chesapeake Energy have begun to focus their drilling efforts on oil.

▶NAVIGATING THE LNG EXPORTS LANDSCAPE

The panel addressed the opportunity for LNG export growth and the current permitting environment. Natural gas costs approximately



\$3/MCF in the United States, compared to \$10/MCF in Europe and \$15-\$20/MCF in Asia. Paired with burgeoning demand (particularly in Asia), the considerable price differential makes LNG exports very profitable for the United States. However, the price gap will likely narrow as more players enter the marketplace, increasing supply and driving down international prices. Thus, LNG exports may only remain an economically attractive proposition in the near term while the United States still maintains its upper hand.

Furthermore, the U.S. Department of Energy's permitting process for LNG exports moves at a snail's pace. Only four LNG export facilities have received licenses in the United States to date, and more than 25 are waiting for approval. Cheniere's Houston-based Sabine Pass facility was the first to be approved in 2011, and has since prospered in a relatively open marketplace with little competition. There are varying views on whether additional LNG permits should be granted. Oregon Senator Ron Wyden has suggested that increasing the number of permits will diminish our supply and raise domestic prices. Others, including President Obama, are in favor of increasing the number of permits to create

a more global market and avoid monopoly exporters.

▶CONSIDERING GTL TECHNOLOGY'S ADVANTAGES

Amid a growing supply of natural gas, conversations surrounding the future of GTL technology have amplified. GTL technology, which converts gas into high-value liquids like diesel and gasoline, offers an additional outlet for natural gas resources. Due to GTL's high operation costs, there are currently only a handful of plants in the world. However, this may change as more companies begin to explore a potential investment in this space.

Though it offers considerable benefits, there are costs associated with pursuing GTL technology. If natural gas prices rise in the future, for example, they may drive up GTL technology's already high operational costs to a point where production is no longer economically viable. Conversely, if GTL technology becomes more prolific, it will likely increase the demand for natural gas, and, consequently, drive up prices. This would in turn raise the prices of our LNG exports,

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making us less competitive in the global market. Yet because the LNG permit approval process is slow, there may be some value in investing in GTL technology in the near term.

►REALIZING THE FULL POTENTIAL OF NORTH AMERICAN GAS RESERVES

In order to capitalize on our natural gas reserves, the U.S. government and the industry should work together to develop a cohesive, updated energy policy that encourages the exploration and production of many resources while encouraging participation in global markets. Our natural resources sector has developed tremendously over recent years, and revising our current regulations to galvanize our advancements will help us harness our current momentum.

As we do this, it is crucial for us to continue addressing public concerns about hydraulic fracturing (fracking). Transparency about water usage and the chemicals used in the process is vital to maintaining government, stakeholder and public support. A balance of government and industry self-regulation may be a smart way to proceed. Additionally, determining whether regulation should be decided at the federal or state level should be a priority. Advocates of federal regulation are concerned that states may not be able to effectively manage fracking's potential environmental impact. Others argue that fracking's effects are mainly felt at the local level, and policy should be determined by those most directly affected. Either way, agreeing upon an energy policy that reconciles public and private priorities is essential to maximizing the economic potential of natural gas.

The Oil Council Assembly underscored the optimism surrounding the United States' natural gas sector. Natural gas is transforming multiple industries and boosting the energy industry overall, making it one of our economy's most promising—and most complicated—products.

Perspective in Natural Resources



Following technological advances and new discoveries in the U.S., a resulting abundance of natural gas coupled with the strong demand for energy in other areas of the world, especially Asia, has positioned the U.S. as a major energy exporter. While private equity has played a significant role fueling capital across the natural gas supply chain, the latest trend seems to be focusing on investments in liquefied natural gas (LNG) projects for export to Asia, where according to Bloomberg, LNG costs are more than four times higher than U.S. gas prices.

One of the most notable LNG projects to date is Cheniere Energy, a natural gas company backed by Blackstone. Cheniere's Sabine Pass Liquefaction Project in Cameron Parish, La., was the first LNG export project to receive approval from the U.S. Department of Energy to export LNG to countries without a free trade agreement (which include Japan, India, China, Korea and most of Europe).

Following Cheniere's U.S. Department of Energy (DOE) approval, other projects have emerged, including most recently, Freeport LNG, which owns facilities to convert imported LNG to natural gas. Freeport is now raising capital (both equity and debt) to convert its existing facilities into LNG plants. According to Infrastructure Journal, as of June 2013, this project received interest from more than one dozen potential equity investors in response to the first round of requests for bid submissions.

While the trend for LNG export seems to be picking up pace, it is not without risks. The U.S. DOE has selected certain projects with permits to export to non-free trade agreement (FTA) countries, but the question remains as to how many more permits they will award, given the political implications of driving up the domestic cost of natural gas if the U.S. continues to export it and the demand for fuel increases. Additionally, new projects may become less economical as competition increases, with several other projects currently in the pipeline across both the U.S. and Canada. A decline in demand from countries such as China, where economic growth has weakened, could also hurt the economics of new projects.

PEerspective in Natural Resources is a feature examining the role of private equity in the natural resources industry.

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BDO SPOTLIGHT:

Executive Q&A with Jim Hasle

How did you become interested in accounting? What areas have you focused on thus far, and what other areas are you hoping to explore?

I began college wanting to study business. Back then, they called accounting “the language of business,” so I began taking accounting courses. As it turned out, the content fascinated me and I excelled in my courses. Following graduation, I went on to earn my CPA certification and worked on the audit side for many years. Now, after working in the field for nearly three decades, I have a broad base of experience and have focused on areas including government contracting, manufacturing, construction and utilities. I have also worked with for-profit specialized companies and Alaska Native Corporations. My clients have ranged from larger entities to smaller, closely held corporations. Looking forward, I am eager to leverage BDO’s experience in the natural resources and energy sector and focus more in those industries.

Which industries are ripe for growth in Alaska? Where do you see the most opportunity?

Many of Alaska’s industries are thriving today. The state’s oil and gas sector, a major driver of the economy due to its natural reserves, is extremely active. The tourism and convention industry also continues to make a big impact on the state’s economy and will likely continue to do so. Alaska Native Corporations also have an important role to play in our economy. Today’s ANCs are more diversified than ever before, cover many sectors and are evolving at a rapid pace. Other sectors include the transportation, healthcare and construction sectors.

What are some of the most common business challenges facing Alaskan companies? Which industries are particularly impacted?

Alaskan companies face two major challenges. The first is attracting and retaining talent. Alaska’s distance from major metropolitan centers and often harsh environment are certainly not for everyone. It can be difficult to find new employees and get them settled in place. As a result, labor shortages are not uncommon. The medical and service sectors are particularly affected by the limited talent. Oil companies are slightly less impacted due to the rotational nature of their operations, which naturally creates a flow of employees coming and going.

The state’s seasonal changes can also negatively impact many Alaskan companies. Certain industries’ revenue is directly linked to a certain season, like tourism in the summer or crab fishing in the fall. Because of the drastic seasonal changes, many companies essentially face making a year’s worth of profit in one season. That can prove to be very challenging.

What’s ahead for BDO’s new Anchorage office? What are the implications for the Natural Resources practice?

We are already off to an exciting start. We are looking to broaden and build upon our consulting practice, as well as expand our work in the energy, healthcare and financial institutions sectors. As we grow, we are also looking to serve larger entities, including Alaskan Native enterprises. Backed by BDO’s national reputation and resources, we are enhancing our services and reaching a wider client base than ever before.

BDO’s new Anchorage office also provides the Natural Resources practice with many opportunities for growth. We are the largest firm in the state and the resources of the national Natural Resources practice, coupled



with Alaska’s extensive involvement with the natural resources and energy industries, put us in the ideal position to best serve our clients in this sector. The Natural Resources practice is also exploring opportunities for expansion in the midstream, downstream and utilities industries.

How would you characterize the impact of the work you do?

We measure our impact by the value we provide our clients. We aim to deliver the best results at a reasonable cost. Our consulting work is an important complement to the assurance and tax services we provide, as well. By working with our clients to find real, practical and holistic solutions to their unique financial challenges and to help them contract new business opportunities, I believe we have a great impact on every client, industry and region we touch.

Jim Hasle is an Office Managing Partner in BDO’s Anchorage, Alaska office. He can be reached at jhasle@bdo.com.

MARK YOUR CALENDARS

The following is a list of upcoming conferences and seminars of interest for natural resources executives:

NOVEMBER 2013

Nov. 12-14

POWER-GEN International

Orange County Convention Center
Orlando, Fla.

Nov. 13-15

5th Annual DUG East Conference & Exhibition

David L. Lawrence Convention Center
Pittsburgh, Pa.

Nov. 18-20

Oil Council's 2013 World Assembly

Old Billingsgate
London, U.K.

DECEMBER 2013

Dec. 2-5

PIRA Understanding Natural Gas Markets PIRA Understanding Global Oil Markets

Hilton New York
New York, N.Y.

Dec. 4-5

12th Annual Oil Sands Symposium

Marriott Downtown
Calgary, Canada

Dec. 9-10

12th Annual Coal Trading Conference

Millennium Broadway Hotel
New York, N.Y.

Dec. 12

Platt's 7th Annual Global Energy Outlook Forum

Waldorf Astoria
New York, N.Y.

JANUARY 2014

Jan. 13-14

Platt's 12th Annual Gas Storage Outlook

JW Marriot Houston
Houston, Texas

Jan. 23-24

5th Annual Pipe Tech Americas Summit 2013

The Woodlands Waterway Marriott Hotel & Convention Center
Woodlands, Texas

Jan. 28-30

5th Annual Marcellus-Utica Midstream Conference & Exhibition

David L. Lawrence Convention Center
Pittsburgh, Pa.

For more information on BDO USA's service offerings to this industry, please contact one of the following regional practice leaders:

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BDO's Natural Resources industry practice provides assurance, tax and advisory services to emerging and established businesses in the United States and all over the world who are involved in both the traditional and alternative energy industries. Our clients often operate across borders either raising capital or making acquisitions abroad. Our extensive industry knowledge is supported by our international network of 1,204 offices in 138 countries, allowing us to provide a consistently high level of service wherever our clients do business.

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