Provided Courtesy Of
URISH POPECK
accountants and consultants

WINTER 2014
www.bdo.com

THE NEWSLETTER OF THE BDO NATURAL RESOURCES PRACTICE

NATURAL RESOURCES RECORD

THE NORTH AMERICAN ENERGY RENAISSANCE AND GLOBAL OPPORTUNITY

By Charles Dewhurst, BDO USA and Lorraine Walker, BDO Canada

With North American exploration and production flourishing and demand exploding worldwide, the global oil and gas sector is in the midst of a reorientation. Over the past decade, the United States and Canada have leveraged new technologies to more efficiently exploit their oil and gas reserves and bring new sources of supply online for countries hungry for energy resources. Meanwhile, traditional power players are losing market share: OPEC, which as of 2011 believed that the North American energy revolution would be short-lived and only provide a small contribution to global oil output, now acknowledges that North American oil is changing industry dynamics. In its recent World Oil Outlook, OPEC projects that the United States and Canada could supply up to 4.9 billion barrels of oil a day by 2018, up from last year's projection of only 1.7 billion barrels per day over the same time period. And these projections don't take into account the significant natural gas output also flowing from North American shale formations. This evolving landscape isn't only changing the global economic balance of power, though; it is also impacting how dollars flow internationally and how companies align themselves to adjust to the new dynamic.

The United States is leading this market reorientation, having spent the past decade refining hydraulic fracturing and horizontal drilling technology in order to tap its vast shale resources. In October 2013, U.S. energy consultancy PIRA reported that the United States had officially outpaced Saudi Arabia as the world's largest oil producer—ahead

Read more

DID YOU KNOW...

While the ***International Energy Agency*** reports that Canadian oil production could rise to 5.7 million barrels per day by 2030, the Canadian Association of Petroleum Producers predicts production will increase by an additional 1 million barrels per day, 6.7MM bpd, respectively.

In 2013, 80 North American big energy companies spent a combined $50.6 billion more than they brought in from their operations, according to data from ***S&P Capital IQ***. That deficit was twice as high as in 2011 and four times as high as in 2010.

According to the ***BDO IPO Outlook Survey***, capital markets executives at leading investment banks attributed the high rate of IPOs in 2013 to continued low interest rates increasing investor demand for higher yielding assets (27 percent), increased confidence in the U.S. economy (26 percent) and positive IPO performance encouraging more businesses to make offerings (24 percent).

The U.S. Energy Information Administration says Mexico's technically recoverable shale gas reserves are the world's sixth largest, not far behind Canada and the U.S., and that it has the world's eighth-largest shale oil deposits.

Natural Resources executives overwhelmingly cite "value" as the most important factor influencing customer acquisition, according to BDO International's recent ***Service 2020: Return on Service*** study.

On Dec. 12, 2013, Mexico's Congress voted and passed legislation to open the country's oil and gas sector to private investment in the biggest overhaul of the industry since it was nationalized in 1938, according to ***Reuters***.

Canadian oil sands are predicted to become a key source of global supply growth, accounting for 16 percent of all new oil production by 2030, according to a report from ***IHS Cera***.

CONTINUED FROM PAGE 1

THE NORTH AMERICAN ENERGY RENAISSANCE

of the timeline initially projected by the International Energy Agency in late 2012, which anticipated that the United States would surpass Saudi Arabia by 2020. At the same time, the United States is well on its way toward outranking Russia as the top combined oil and gas producer worldwide. While some industry observers have expressed concern that this growth bubble will burst soon, others are optimistic that we've only scratched the surface of the U.S. shale boom. The Energy Information Administration (EIA) notes that, as of October 2013, the production from new U.S. gas wells has been outpacing declines in existing wells, suggesting that there is still plenty of shale to exploit.

Meanwhile, Canada is experiencing its own renaissance in the form of not only its shale resources, but the ongoing development of its oil sands. Oil from the oil sands, obtained through surface mining and in-situ techniques, accounted for more than half of Canada's oil production in 2012, and that proportion only continues to grow. With oil production exploding and Canada seeking new ways to bring its oil to market, it also has begun work on the Keystone XL pipeline which, once completed, will pump Canadian crude to U.S. refineries and broaden Canada's access to global oil markets. Canada, like the United States, is set to become a net energy exporter: though U.S. imports of foreign crude overall dropped 16 percent since 2005, its imports of Canadian crude grew by nearly 50 percent, according to the EIA.

As the global oil and gas markets continue to evolve in light of these developments, the transactions space has seen significant fluctuations in both deal size and flow, as well as in who is buying and who is selling. While overall global merger and acquisition activity has remained relatively consistent since 2007, North America continues to see the lion's share of deal activity.

2012 was a blockbuster year for global oil and gas transactions, with energy industry research group and listing service PLS, Inc. recording 679 deals totaling $254 billion. This exceeds the previous record set in 2010 by nearly 20 percent, and is 50 percent higher than total deal value in 2011. The United States was the leader in transactions activity in this space, seeing 299 deals valued at $83 billion, accounting for just shy of a third of total deal value last year. Canada, thanks to the oil sands boom, had the second largest number of deals, 194, valued at $50 billion, with more than a third of the value attributable to CNOOC's acquisition of Nexen (the acquisition itself was worth $15.1 billion; with Nexen's debt included, the total deal value rises to about $18 billion). Overall, nearly three-quarters of 2012's M&A deals occurred in North America, and accounted for more than half the total value of all deals globally.

This activity was rather atypical. Across multiple industries, including the natural resources sector, many companies raced to close deals before the beginning of President Obama's second term, concerned that new regulations could create a less favorable deal environment. Furthermore, while the majority of oil and gas deals in 2012 fell in line with annual average values since 2007, three major deals—acquisitions by Rosneft and Freeport-McMoRan Copper & Gold, as well as the CNOOC/Nexen deal—accounted for more than a third of total deal volume last year, according to PLS, Inc.'s data.

2013, then, saw a comparatively slow start. PLS reported that global deal count totaled only 304 with a value of approximately $49 billion for the first half of the year, the slowest pace since 2009 (a year that suffered from a lack of confidence following the financial crisis). While deal flow did pick up slightly in Q3, with 150 deals valued at nearly $42 billion, the current pace indicates that this year is unlikely to match 2012.

However, despite this slowing of global activity, the North American deal environment continues to thrive. In the first half of 2013, PLS recorded 220 North American deals with a total value of $24.8 billion. This accounts for more than three-quarters of global deals closed, and 52 percent of global deal value. The United States led the activity, with PLS reporting 157 transactions totaling more than $22 billion in value, just shy of half of all activity worldwide. The third quarter was similarly prosperous for North America. The continent saw 105 deals valued at nearly $16 billion, or 37 percent of total global deal value. While the number of deals was down from Q2's totals, the value of the deals grew by 45

Read more

▶CONTINUED FROM PAGE 2

THE NORTH AMERICAN ENERGY RENAISSANCE

percent. The United States continued to lead in deal flow, posting 68 deals valued at about $12 billion.

Much of the deal flow seen in the North American oil and gas markets has been driven by foreign investors looking to identify and secure energy resources to satiate burgeoning demand in their countries. For example, in 2012, Malaysia's Petronas acquired Canada's Progress Energy Resources Corp. in an effort to gain access to shale gas; in October 2013, Petronas announced plans to develop liquefied natural gas export facilities to move the product to Asian markets. However, such mergers and acquisitions aren't the only way foreign entities are getting a foot in the door. Instead, joint ventures allow foreign investors—many of whom are national oil companies (NOCs)—to benefit from the tremendous output of North American companies without assuming the full burden of associated liabilities and risks. An April 2013 EIA report found that the U.S. shale sector has seen 21 international joint ventures since 2008, highlighting the growing significance of these relationships. Joint ventures are also a strategy for foreign investment in Canadian oil and gas companies, although not nearly to the extent seen in the United States.

Asian countries, particularly China, have been keen to invest in North American assets. According to *Reuters*, China already has $5.5 billion invested in U.S. natural gas assets alone, while Canada's *Globe and Mail* reports that between 2005 and 2012, Chinese NOCs invested around $33 billion in Canadian companies. Notable deals include Sinochem's $1.7 billion stake in the West Texas Wolfcamp shale formation, Sinopec's recent purchase of a $1 billion stake from Chesapeake Energy Corp. in the Mississippi Lime shale formation and PetroChina's $2.2 billion investment in Canada's Encana Corp. Japanese utilities companies have similarly been exploring investments in the North American energy sector—from upstream to downstream—in an effort to secure low-cost fuel for electricity generation while they explore domestic alternatives to nuclear energy.

Private equity also remains a relatively secure way for foreign investors to make their way into the North American oil and gas industry. These investments are a low-risk opportunity for foreign investors to capitalize on a strong return on investment without the challenges associated with acquiring a company or attempting to secure energy resources simultaneously. However, this is an avenue that decidedly favors the United States over Canada. Between 2010 and 2013, U.S.-based private equity funds investing in the oil and gas sector (both upstream and midstream) saw 295 commitments from limited partners, according to PitchBook. About 19 percent of these commitments came from international investors. Private equity activity has been slightly less robust in Canada; in its *Canadian Oil & Gas 2013 Outlook*, international law firm Torys reported only five private equity deals overall in Canada through 2012, though it did expect private equity activity to pick up in 2013 as a result of decreased access to traditional equity. As of June 2013, however, this had not come to pass. Torys reports that the first half of the year saw only about $600 million in private equity in the Canadian oil and gas sector, with much of that activity focused on public companies going private in the face of capital market uncertainty. Nevertheless, some foreign investors still find this an attractive place to play, with promising funds (such as Camcor Energy Fund VII) featuring substantial foreign contributions.

Finally, initial public offerings (IPOs) posted a mixed showing in North America. Activity in the United States is robust. As of November 2013, the United States has seen 18 power and energy IPOs this year, according to Thomson Reuters. Though this is slightly down from last year's number—21—the overall value of these offerings has increased by more than 50 percent. Investors are particularly interested in companies focused solely on shale plays. For example, since its 2006 IPO, shares of Kodiak Oil & Gas have more than doubled in value; the company focuses the majority of its E&P activity in the Bakken shale formation in North Dakota. Meanwhile, this year's IPO of Antero Resources Corp., which operates primarily in the Marcellus and Utica shales, saw the company initially valued at approximately $11 billion. By November, its value had grown by about 27 percent to $14 billion. According to *Reuters*, IPO activity also seems to be driven by the sell-side, as private equity firms seek to cash in on their investment while the U.S. energy sector is booming. This may in part explain the overall decline in M&A activity in this space, with sellers seeking greater returns than can be offered by private buyers.

In Canada, however, uncertainty in the markets and a less favorable price differential between Canadian crude and global benchmarks is putting a crimp on IPO activity. The oil and gas sector in Canada has seen only one IPO so far this year. Oryx Petroleum Corp. Ltd. went public in May, raising about C$250 million. However, the offering did not yield the gains Oryx had hoped for: according to *Bloomberg,* the company had originally sought to raise about C$350 million, and though shares were marketed at around C$20-23 dollars, they ultimately sold for about C$15 each.

The global oil and gas sector is clearly undergoing major changes as supply and demand dynamics continue to shift away from the traditional power players in the Middle East to up-and-coming resource plays in North America. The United States is leading the pack overall now, but Canada is close behind with its own growing industry. However, this evolving landscape stands to benefit the international industry as a whole: advances in Canadian and U.S. oil and gas production provide opportunities with the potential to deliver a strong ROI for investors worldwide, as well as a new avenue to satisfy demand at a reasonable cost.

This article originally appeared in the Oil Council's Drillers & Dealers *magazine – www.oilcouncil.com/content/drillers-and-dealers*.

Charles Dewhurst is the leader of the Natural Resources practice at BDO USA, LLP, and he can be reached at cdewhurst@bdo.com. Lorraine Walker is the Canadian Oil & Gas leader with BDO Canada, LLP, and she can be reached at lwalker@bdo.ca.

▶ Read more

BDO SPOTLIGHT:

Executive Q&A with Michael Madsen

What do you see as some of the biggest challenges facing the North American natural resources industry today?

Access to capital markets and debt financing has become tight, especially for mining companies. Many junior and mid-sized mining companies listed on the Toronto Stock Exchange saw negative returns in 2013, and it has become increasingly difficult for them to secure adequate capital to fund further activities. Declining commodity prices combined with increasing production costs have led to a buildup of project delays. Globally, China's demand for mining and metals has been waning, putting a dent in demand levels overall. Moreover, many companies face the challenge of navigating the interaction between foreign governments. As more North American companies open and operate mines abroad, the burden of navigating foreign government regulation and project involvement has grown.

The outlook for the oil and gas industry is more optimistic. These companies can find financing with relative ease, but projects may still hit the twin roadblocks of rising production costs and skilled labor shortages. The labor shortage issue is a real concern for the industry moving forward, with a diminishing supply of young, technically capable workers available.

Environmental and safety matters remain sources of tension in both the oil and gas and mining industries. Finding a safe means of transport for resource deposits around Canada and the United States is a top priority and will continue to have a major impact on the global industry. Canada's oil needs to be moved to markets where it can be shipped and moved to U.S. production and refining facilities, as opposed to offshore. Talk of the Enbridge Northern Gateway pipeline project across Canada has been going on for years, but like the Keystone XL pipeline in the United States, it faces some opposition from environmental groups.

What are some of the biggest growth opportunities for the industry?

These same challenges also present the industry's biggest growth opportunities. The significant global demand for oil, gas, mining and metals necessitates a constant means for harvesting these resources. The International Energy Agency reports almost half of international oil demand will come from China over the next five years, a trend that is predicted to continue until 2035 due to strong transportation sector growth in Asia. Economic recovery in developed countries has also caused global oil demand to climb over the last 18 months, and the industry expects this to continue throughout 2014.

Liquefied natural gas (LNG) presents the biggest opportunity for North America to capitalize on this global momentum, as there are massive deposits in our north that remain largely untapped. To realize this potential, though, billions of dollars in new infrastructure are required to safely extract and transport LNG to ports on the West Coast, where it could fulfill the needs that exist in Asia. There is still a great mountain to climb, but great possibilities lie ahead as a result.

Finally, there may be opportunities for North American companies to team up with competitors, colleagues and even foreign governments to find cost-effective ways to adapt the industry to ongoing technological innovations.

What led you to focus your accounting work in the natural resources industry?

I've been with BDO in Vancouver for 23 years. Vancouver is a vibrant venture capital city where many junior mining head offices are based; they are backed by a community that supports public companies and understands this industry. I began my career in public practice here, which eventually, inevitably, pointed me in the direction of mining. I started with clients who were raising large sums of money to develop properties in the United States and Mexico, and soon decided to establish a niche in mining specifically. I've always found the work in this space to be interesting; visiting a site, watching its transformation year-to-year and navigating the production issues associated with the process are all exciting and informative challenges.

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

As a national leader, I oversee and facilitate the sharing of ideas among our team. Our practice is dispersed across three key markets, as well as a host of smaller, but thriving, centers around Canada. This structure, combined with continuous communication among BDO offices, allows us to provide services to clients throughout the country, regardless of where they operate or are headquartered.

We aim to provide our clients customizable solutions that they may not be able to find elsewhere in the market. We offer a full suite of services, including tax, assurance, audit, risk management, financial advisory, technology solutions and transaction advisory, specifically geared toward providing value to mid-tier

▶ Read more

CONTINUED FROM PAGE 4

BDO SPOTLIGHT

companies. Few auditing and consulting firms tailor their service offerings to mid-sized companies, and we believe we are well-positioned to fill this gap.

What lies ahead for BDO Canada's Natural Resources practice?

The natural resources sector is seeing more growth surrounding Channel 2 activities, such as international tax planning and compliance, business modeling and valuation, IT solutions, risk advisory services and advisory services around R&D. As such, BDO Canada plans to continue enhancing its service capabilities in these areas. Diversifying within the non-audit sector of our practice enables us to create stronger value-added relations and promote a “one firm” approach. Ultimately, we want to bring a comprehensive, yet concise, set of abilities to the market. We regularly collaborate with BDO Canada’s other industry groups to facilitate idea sharing and to advance our offerings, a key component to enhancing this aspect of our business.

As the world continues to shrink, global opportunities only increase. We’ve created a cross-border exchange of ideas and staff between BDO USA and BDO Canada in order to synergize our respective knowledge bases and capabilities. Moreover, both our firms maintain active leadership roles within BDO’s International Natural Resources group. These valuable partnerships allow us to demonstrate the strength of the global BDO network and how we are well-equipped to help the international natural resources industry. The North American practices have had great discussions facilitating this movement, and we’re looking forward to collaborating on future initiatives.

Michael Madsen is leader of the Energy & Natural Resources practice at BDO Canada, LLP. He can be reached at mmadsen@bdo.ca.

PErspective in Natural Resources

The mining sector is facing its third year of downturn. Hit by lower commodity prices and other economic drivers, miners are losing funding from traditional investors, such as institutions and retail, and are under pressure to cut spending and streamline operations. As the sector continues to be under duress, countercyclical buyers, including private equity firms, are raising considerable capital for investment.

According to *Prequin*, private equity groups raised $10.2 billion in the past five years for funds that target mining assets, which is nearly five times more than in the five years prior to 2007 – the height of the private equity boom.

Currently, gold mines are one of the primary targets within the sector. Many gold mines have become distressed due to the collapse of gold prices, the result of an improved economy and tapering stimulus efforts by the Federal Reserve, as well as the European and Japanese central banks. Additionally, many mining companies are overleveraged and face high operating costs. Despite these obstacles, private equity investors view gold mine companies as attractive “bargains” with valuable assets. According to *Gold Investing News*, private equity firms are anticipating returns up to 18 percent on their gold mining investments.

Private equity firms, which have a longer investment horizon and greater ability to withstand volatility in metal prices, are developing innovative financing solutions to engage with mining companies. Such solutions include royalty streams, joint ventures with strategic partners and debt financings. Given the unstable equity markets and lack of traditional financing, the trend for mining companies to engage in alternative financing arrangements with private equity firms is expected to continue, according to Resource Intelligence.

Private equity’s investment in this sector may not heal the mining industry completely, but it is a stepping stone to encourage traditional investors, such as institutions and retail, to revisit opportunities in the mining industry.

PErspective in Natural Resources is a feature examining the role of private equity in the Natural Resources Industry.

Read more

MARK YOUR CALENDARS

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

FEBRUARY 2014

February 12
Cleantech Innovation Summit
Island Hotel
Newport Beach, Calif.

February 18-19
The Oil & Services Conference
Omni San Francisco
San Francisco, Calif.

February 26-28
SPE's International Symposium & Exhibition on Formation Damage Control
Lafayette Hilton
Lafayette, La.

MARCH 2014

March 3-7
CERAWeek*
The Hilton-Americas
Houston, Texas

March 2-5
Prospectors & Developers Association of Canada Annual Convention*
Metro Toronto Convention Centre
Toronto, Canada

March 23-25
American Fuel and Petroleum Manufacturers 2014 Annual Meeting
Hyatt Regency Orlando
Orlando, Fla.

March 30 – April 1
International Petrochemical Conference
Grand Hyatt San Antonio
San Antonio, Texas

APRIL 2014

April 3-4
IEEE Green Technologies Conference
Omni Corpus Christi Hotel
Corpus Christi, Texas

April 7-9
IPAA Oil & Gas Investment Symposium
Sheraton NY Hotel & Towers
New York, N.Y.

April 9-11
NAPE East
David L. Lawrence Convention Center
Pittsburgh, Pa.

April 22
International Geothermal Energy Forum
Ronald Reagan Building and International Trade Center
Washington, D.C.

MAY 2014

May 5-8
Offshore Technology Conference
Reliant Park
Houston, Texas

May 7-8
Asia Assembly hosted by the Oil Council
Grand Hyatt Hotel
Hong Kong Island, Hong Kong SAR

** Indicates that BDO representatives will be present at conference.*

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

CONTACT:

CHARLES DEWHURST, Houston
713-986-3127
cdewhurst@bdo.com

KEVIN HUBBARD, Houston
713-986-3149
khubbard@bdo.com

CARLOS ANCIRA, Austin
512-391-3510
cancira@bdo.com

LANCE FROELICH, Houston
713-986-3186
lfroelich@bdo.com

ROCKY HORVATH, Houston
713-986-3150
rhorvath@bdo.com

JIM JOHNSON, Dallas
214-665-0614
jwjohnson@bdo.com

CLARK SACKSCHEWSKY, Houston
713-986-3101
csackschewsky@bdo.com

CHRIS SMITH, Los Angeles
310-557-8549
chsmith@bdo.com

ALAN STEVENS, Dallas
214-665-0786
astevens@bdo.com

BDO'S NATURAL RESOURCES INDUSTRY PRACTICE

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 1,264 offices in 144 countries, allowing us to provide a consistently high level of service wherever our clients do business.

ABOUT BDO USA

BDO is the brand name for BDO USA, LLP, a U.S. professional services firm providing assurance, tax, financial advisory and consulting services to a wide range of publicly traded and privately held companies. For more than 100 years, BDO has provided quality service through the active involvement of experienced and committed professionals. The firm serves clients through 49 offices and over 400 independent alliance firm locations nationwide. As an independent Member Firm of BDO International Limited, BDO serves multinational clients through a global network of 1,264 offices in 144 countries.

BDO USA, LLP, a Delaware limited liability partnership, is the U.S. member of BDO International Limited, a UK company limited by guarantee, and forms part of the international BDO network of independent member firms. BDO is the brand name for the BDO network and for each of the BDO Member Firms. For more information, please visit www.bdo.com.

Material discussed is meant to provide general information and should not be acted on without professional advice tailored to your firm's individual needs.