DAILY OIL BULLETIN

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The Federal Government Has Spoken - What Next?

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Canada is a country that is rich in natural resources which require significant capital investment to exploit. This is a factor that affects the Canadian oil and natural gas industry which relies heavily on access to capital, as without capital, the industry would languish. Since the third quarter of 2010 foreign investment has had investors cheer the sizable joint ventures that have occurred; however, continued foreign investment may be in jeopardy due to the transactions having to meet the "net benefit test" of the Investment Canada Act.

Companies that are heavily natural gas-weighted have fallen on hard times for the most part as their share prices have slid along with the price of the commodity. The investment community has shunned these companies, resulting in a higher cost of capital and limited access to capital; however, some companies with significant undeveloped assets have been fortunate enough to garner the interest of foreign entities that have a positive long term view on the commodity.

Over the past two years, there has been significant foreign investment in Canada's oil and natural gas industry, with joint ventures totaling approximately $9.3 billion involving natural gas deposits. The transactions have been structured mainly as cash up front with significant carrying interests for a non-operating interest in the project.

Malaysian state owned company **PETRONAS International Corporation Ltd.** entered into such a transaction in the second quarter of 2011 with **Progress Energy Resources Corp.** when it agreed to purchase a 50% working interest in Progress' Montney shale gas assets in the Altares, Lily and Kahta areas of northeastern British Columbia, in a deal valued at nearly $1.1 billion. A year later, in June of 2012, PETRONAS entered into an agreement to acquire Progress for $20.45 per share and later increased the consideration to $22.00 per share in July.

On October 19th, 2012 the Canadian government temporarily blocked PETRONAS from acquiring Progress for nearly $6.0 billion based on the deal failing the "net benefit test" as set by the Investment Canada Act. The shares of Progress fell 9% from $21.65 to $19.64 the following trading day. Under the Investment Canada Act, PETRONAS has been given up to 30 days from the decision to make any additional representations and submit any further undertakings. PETRONAS and Progress have met with officials of Industry Canada to understand the basis for the October 19, 2012 announcement by the Minister of Industry. PETRONAS intends to make further submissions to the Minister in order to obtain approval of the proposed transaction.

Nexen Inc., which is in a similar situation with Chinese state oil company, **China National Offshore Oil Corporation** or "CNOOC", felt the impact of the Progress decision, with its shares falling 4% from $25.15 to $24.04 following the Progress announcement. There was already apparently some doubt by investors that the deal would be approved prior to the Progress deal being blocked as Nexen was trading below the offer price of $27.50 USD or $27.84 CDN per share.

Celtic Exploration Ltd., which announced an agreement to sell to U.S. based **ExxonMobil Corp.** days before the Progress ruling, saw its share price decline initially but has recovered since. Talisman Energy Inc. felt the shock of the announcement, falling 7% since it was announced. There was life revived into Talisman's stock price in early September when a new CEO took the realm and it was brought to light that **Ontario Teachers' Pension Plan** and **West Face Capital Inc.** are now among Talisman's biggest shareholders which might spark a transaction.

The most recent corporate acquisition by a state-owned oil company was **Sinopec International Petroleum Exploration and Production Corporation**'s $3.2 billion takeover of **Daylight Energy Ltd.** in the fourth quarter of 2011. Previous to that CNOOC was successful in acquiring **OPTI Canada Inc.** for $2.1 billion in the third quarter of 2011. OPTI had a 35% working interest in the Long Lake SAGD project operated by Nexen.

Chinese investment in the Canadian oil and natural gas sector has been steady since the third quarter of 2009 when **PetroChina International Investment Company Limited** purchased a 60% interest in **Athabasca Oil Sands Corp.** assets in the Athabasca Oil Sands' MacKay River and Dover oilsands projects for $1.9 billion. Since that time Chinese companies have purchased assets from **Penn West Energy Trust** (now **Penn West Petroleum Ltd.**) for $817 million, acquired **ConocoPhillips**' 9.03% interest in the Syncrude mining operation for approximately $4.7 billion, secured an additional 40% interest in the MacKay River oilsands project from Athabasca for $680 million and purchased a 20% interest in **Royal Dutch Shell plc**'s 100% owned Groundbirch lands and assets in northeastern British Columbia.

There is speculation that there are additional foreign state owned oil companies on the sidelines eager to enter into transactions with Canadian companies; however, the recent decision by the federal government may hamper continued M&A activity if the perception that there is some political risk associated with Canada continues. The test will be how the PETRONAS-Progress deal unfolds and if there are additional headwinds to the CNOOC-Nexen transaction. It is evident that we require foreign investment to extract certain resources in Canada but it is important to make sure the rules for a transaction to be accepted by the Canada Investment Act's "net benefit test" are clear to entities abroad.