

# In Brief\*

Is your company built to sustain shifts in Alberta's energy sector?

It's no longer business as usual in the Alberta energy services sector. The business leaders who realize this and start building sustainability into their capital structures will be positioning their companies to make the most of the new reality that's already taking shape.

## Short-term Challenges

- Continued low natural gas prices
- Record-high natural gas inventories
- Record-low drilling and service rig utilization levels
- Increasing production and reserve base from U.S. shale gas properties

A slowdown in exploration, production and capital spending is hitting segments of the energy services sector, which benefitted from strong earnings from 2005 through mid-2008. The cash generated from those earnings is dwindling and some companies are now running out of available cash. Since lenders measure the performance of their borrowers in the most recent 12-month period, as time passes, stronger quarterly results are being replaced by weak quarterly results and that could lead to debt covenant violations and create challenges in accessing equity and debt capital markets.

A fundamental shift may be on the horizon for the Alberta economy; one that will see natural gas producers and energy service providers focus on forward-thinking technology and seeking opportunities beyond provincial borders. But only companies that have overhauled their capital structures with an eye to sustainability will be positioned to thrive in the new economic reality. The downturn is exposing a truth of the Alberta economy that often gets overlooked. Natural gas production represents a major component of the Province's economy and yet changes in oil prices dominate the headlines.

The fact is natural gas prices have been in the basement for some time and the short-term outlook for the future is not promising. The major reasons behind low natural gas prices are (i) a significant decline in industrial consumption and (ii) increasing low-cost shale gas production largely in the U.S. This is a significant concern for Albertan companies, especially those involved in energy services that have natural gas producers as their customers who are not agile and flexible enough to compete effectively. Some major gas producers have shifted most of their capital, and exploration and production spend to the U.S. shale gas play.

This is a transitional time in the energy service sector and it is critical that business leaders take the necessary steps to ensure their companies are well-capitalized so they are best placed to move forward and succeed.

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## The time to react is now

- With the declining profitability environment the banks have set more conservative risk parameters making it tougher and more costly for companies to get financing. For some highly leveraged energy service providers, developing a more sustainable capital structure will be an issue. It is time to look at existing finance models and restructure to meet the challenges of the new operating environment.
- One solution is to find alternative sources of capital, such as private equity, subordinated debt or preferred equity. Other alternatives include non-core asset sales and implementation of cost cutting initiatives.
- Manage working capital to improve liquidity. This may involve accelerating the collection of accounts receivable, accelerating the turnover of inventory by selling off obsolete inventory or stretching accounts payable.
- Create a robust financial forecast for your lenders in order to gain access to capital. This includes a base forecast for the next 12 months that has the ability to change assumptions in order to reflect a more pessimistic set of circumstances. Lenders appreciate this because it allows them to understand the business better, what the key revenue and cost drivers are and set parameters around the loan package they are providing.

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## For companies with strong balance sheets, this is the time to grow

- Diversify geographically, either through organic growth or by acquiring a local operator.
- If you have a competitor that has a weak balance sheet and may be forced into a sale by their senior lenders, it is a great opportunity to make an acquisition at an attractive price.
- This is also an opportunity for well-capitalized companies to become more lean and efficient for the upturn. Look to the future. Invest in technologies and research and development that will allow you to extract more oil/gas out of existing wells. This will be critical coming out of the downturn, when innovation will drive business.

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## Benefits of a strong Corporate Finance management strategy

- A strong balance sheet will make it possible for your company to acquire competitors who are in distress at bargain prices.
- Labour has been incredibly tight in Alberta until recently. That has changed. If your company is well capitalized, the downturn presents a good opportunity to attract top talent who want to work for more stable companies.
- Advanced drilling and fracturing technologies have allowed the shale gas play in the U.S. to prop up. Going forward, well-capitalized energy services companies that invest in or acquire such technology will be able to bring added value to producers.

# The PwC advantage: We know how to build value

| Value drivers  | PwC perspective  |
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| <b>An understanding of the markets</b>   | <p>PwC has access to M&amp;A transactions and debt refinancing transactions, which companies often don't. We track all this information and so we are able to bring business leaders up to speed on current valuations and the cost of capital.</p> <p>"We have the pulse of the market," says Brooke Valentine, a Managing Director, in PwC's Corporate Finance practice in Calgary office. "Because we deal daily with private equity firms, banks and providers of alternative capital, we know what generally is and isn't possible from a financing perspective."</p>   |
| <b>A strong and wide network</b>   | <p>PwC is a national and global corporate finance practice, which means we have a global awareness of potential sources of capital and potential buyers for Alberta-based businesses.</p> <p>"Most of our competitors are local, which means they are limited in the resources they can tap," says Stephen Mallowney, a Director with PwC's Corporate Finance practice in Calgary. "We have access to knowledge from around the globe."</p>  |
| <b>An understanding of how to work with entrepreneurial and public companies</b> | <p>PwC works with private and public companies and we understand the different dynamics involved in dealing with each.</p> <p>"Many of our competitors don't have the same level of understanding and comfort level we do with private companies," says Stephen Kent, a Managing Director with PwC Edmonton. "As a corporate finance advisor with a public company you are typically working with a board. The ownership is quite broad and diverse. In a private company there is usually no board and you are dealing directly with the owner. We have a track record of dealing with both effectively."</p>   |
| <b>Breadth and depth of experience</b>   | <p>PwC brings borrowers and lenders together to achieve the best outcome for clients.</p> <p>"If a company is having trouble with its current bank, we will work with its legal and finance teams to help them understand the financial reality and options," says Jonathan Legg, PwC's National Restructuring and Distress Strategy Group Leader. Companies in the early stages of distress need to deal with their lenders at least 3 to 6 months before they are in default of their loans—that's right about now for many energy services companies. It is critical to develop a go-forward plan, take stock of the business, assess what needs to change, consider the possibility of merging with another business and then sell the new plan to lenders. We can also produce dynamic financial forecasts that will provide lenders with a solid understanding of the key drivers of the business and the underlying assumptions and make the case for our clients in order to get the best loan package possible.</p> <p>"If a borrower decides to seek bankruptcy protection, we can help them understand the costs of operating in that situation and the prospects of successfully emerging from bankruptcy protection," says Tim Nakaska, a Partner in PwC's Corporate Advisory and Restructuring practice.</p> |

## Our team

Alberta, PwC has assembled a team with local, national and global hands-on experience in helping our clients build sustainable value. Our clients include public and private companies and leading national and international private equity funds. We invite you to connect with our Transaction Services or Banking Specialists to discuss your unique needs:

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