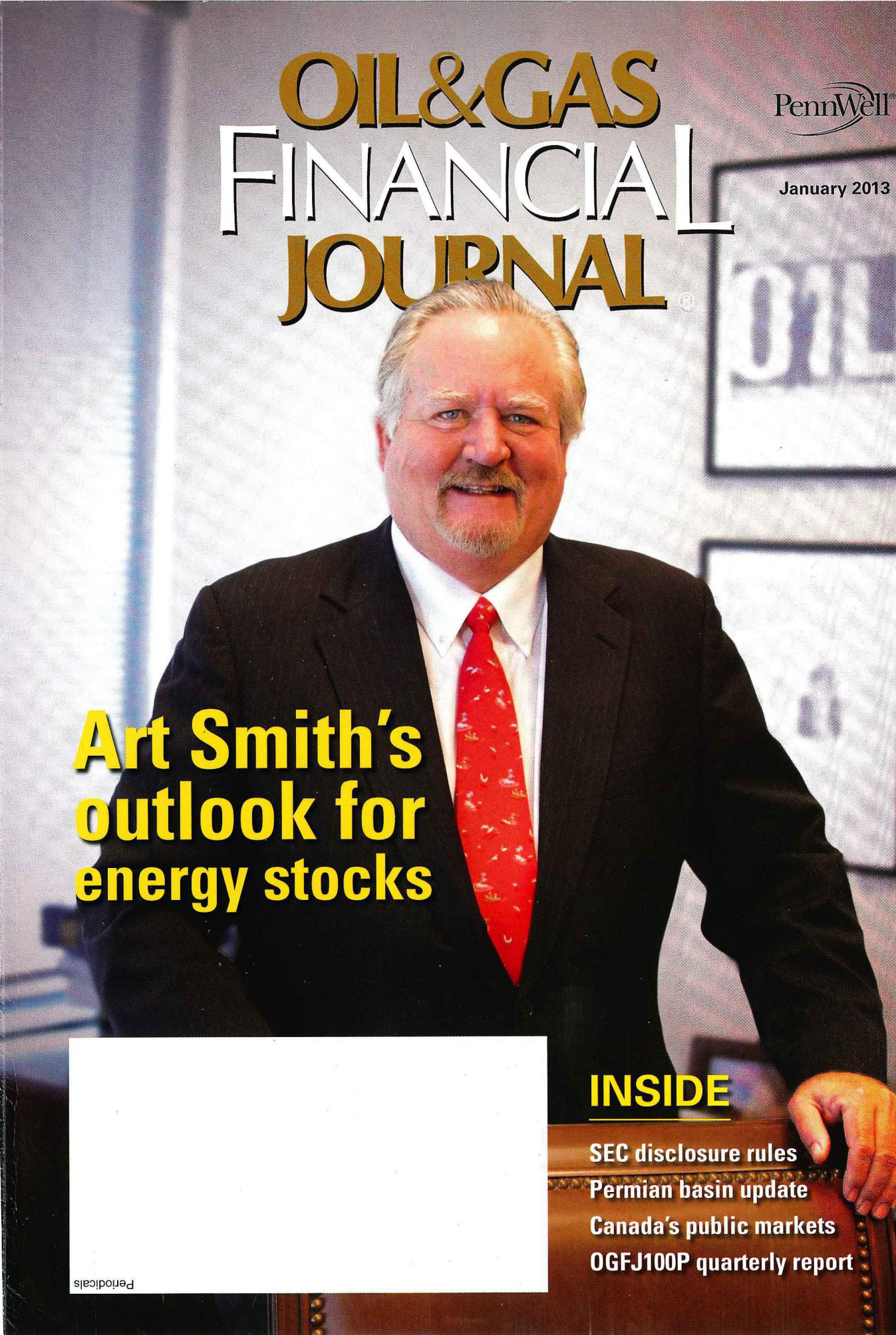


OIL & GAS FINANCIAL JOURNAL®

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January 2013



**Art Smith's
outlook for
energy stocks**

INSIDE

SEC disclosure rules
Permian basin update
Canada's public markets
OGFJ100P quarterly report

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Variety of capital options in Canadian public markets

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John Sinclair, CPA, CA, *Collins Barrow, Toronto*

Attaining and sustaining growth within the US oil and gas industry requires considerable capital. While attracting investor support within the United States may be the preferable choice, pursuing such capital within the Canadian public markets may also merit consideration because:

- Canada's economy has sufficient scale and stability to support investment activity.
- Time zone differences and other concerns associated with conducting international commerce are minimized.
- Resource-based industries comprise a large portion of the Canadian economy in general, and the Canadian stocks exchanges in particular.
- The average capitalization of a public company in Canada is lower than in the United States.
- Companies on the Canadian exchanges face lower compli-

ance and governance requirements that are applied on a graduated scale, based on company capitalizations.

- Canadian-based Foreign Asset Income Trusts (FAITs) provide an additional option for raising public capital in Canada.

Specific characteristics associated with those investment factors include:

Economic scale and stability

The World Bank cited Canada's current gross domestic product (GDP) for 2011 as \$1.736 trillion in US dollars, and various sources also cite Canada as having the lowest debt-to-GDP ratio among the world's 10 largest mature economies. The World Economic Forum's Global Competitiveness Report ranked Canada as having the world's soundest banking system for four years in a row.

The Toronto Stock Exchange (TSX) and TSX Venture Exchange (TSXV) represent most of Canada's public companies. TSX focuses on larger, more established companies, while newer, smaller entities comprise TSXV. Together, those two exchanges list 3,834 companies, with \$41.7 billion in equity raised as of Sept. 30, 2012. The exchanges cite Canada as the world's seventh-largest country for market capitalization.

While the Canadian economy and its stock exchanges are smaller than what oil and gas companies find in the United States, the country offers financial stability and public markets large enough to fund company growth.

Eased international logistical concerns

Efforts to attain greater efficiency and new investment opportunities lead companies to develop business relationships in India, Malaysia, Australia, and other distant nations. Despite ever-improving technological capabilities, though, communication and collaboration across such distances presents challenges. Because the United States and Canada share the same continent and time zones, conducting business across national borders does not present the same degrees of challenge.

Overall national impact of resource companies

Companies involved in mining or the exploration and production of oil and natural gas comprise a large portion of the Canadian economy and its stock exchanges: Canada has twice as many oil and gas companies listed on TSX and TSXV as are listed by NASDAQ and the NYSE.

In 2011, more than \$10.1 billion in equity capital for oil and gas company financing was raised by TSX and TSXV, in comparison to \$14.9 billion raised in equity capital for oil and gas companies listed with the NYSE.

The impact that oil and gas companies have on the Canadian economy is reflected by various public company stakeholders. TSX reports 90 analysts covering oil and gas companies listed on TSX and TSXV, and adds that 50% of Canadians own shares in oil and gas companies.

That industry understanding and degree of market participation fosters liquidity and promotes higher valuations for publicly-traded oil and gas companies. In 2011, liquidity for the TSX and TSXV oil and gas market equaled \$304 billion in Canadian dollars.

Market accessibility for smaller oil and gas companies

TSX and TSXV feature greater percentages of smaller companies in comparison to the US exchanges. As of Sept. 30, 2012, 34% of TSX issuers involved companies with market capitalizations of \$50 million or less; 92% of TSXV issues involved companies with market capitalizations of \$50 million or less.

With that composition of smaller companies, oil and gas companies can enter the public markets at an earlier stage than what they might be able to do in the United States.

Lower compliance and governance requirements

The principles-based International Financial Reporting Standards (IFRS) are applied for accounting and auditing requirements for publicly-traded Canadian companies. US Generally Accepted Accounting Principles (GAAP) without reconciliation may also be accepted, depending upon the issuer's reporting status in the United States.

Public companies in Canada do not face the external auditor attestation requirement that US companies face for compliance with Section 404 of the Sarbanes-Oxley Act of 2002. Companies listed on TSXV also have the benefit of complying with a basic certification, rather than the full requirements mandated for TSX companies.

To become listed on TSXV, a company must have proved developed producing reserves of at least \$500,000. TSXV listings are offered in two tiers, with three categories for a TSXV Tier 2 listing.

A listing on TSX requires proved developed producing reserves of at least \$3 million. Energy companies must report their reserves and resources in compliance with NI 51-101, a globally-recognized standard.

The relationship between TSXV and TSX itself makes it possible for smaller companies to initially become publicly-traded corporations on TSXV and then graduate to the larger TSX, based on company growth and increases in its market capitalization.

From Jan. 1, 2000, through Sept. 30, 2012, 560 companies made that transition from TSXV to TSX.

In addition to listings on TSXV and TSX, oil and gas companies in the United States may also attract investor support through Canadian stock exchanges by launching a FAIT.

FAIT characteristics

A FAIT essentially functions as a flow-through vehicle for which income from assets is passed on to shareholders in form of regular payments. FAIT payment yields are typically several times greater than what an investor would attain from a corporate bond interest payment or an equity dividend payment.

In its original form, a FAIT incurred no income tax at the corporate level. That tax savings made FAITs very attractive vehicles for raising public capital. In 2006, however, Canada's Department of Finance announced Specified Investment Flow-Through (SIFT) rules that imposed corporate income tax on non-portfolio FAIT properties, properties that include assets sited in Canada. The original FAIT tax advantages, though, still apply to trusts who assets do not include any "taxable Canadian property."

Thus, an entity whose assets consist solely of oil and gas properties in the United States can raise capital through FAIT, without having income taxed at the corporate level. Within the last two years, three FAITs – Eagle Energy Trust, Parallel Energy Trust, and Argent Energy Trust – were launched for that purpose. During that span, two other FAITs – Dundee International REIT and Crius Energy – were launched for the real estate and retail energy marketing sectors.

The Argent Energy Trust raised \$212 million when it was established in August 2012, while Parallel Energy raised \$393 million with its 2011 offering, and Eagle Energy raised \$169 million with its 2010 initial public offering.

It remains to be seen how much more FAITs will be used by US oil and gas companies as a vehicle for raising public capital. The launches of the Eagle Energy, Parallel Energy, and Argent Energy FAITs, though, indicate that the trusts do hold appeal for companies looking to raise capital.

The Canadian markets: final considerations

Companies need to evaluate a number of considerations when seeking greater capitalization. Business strategies and plans for sustainable growth must dictate all decisions for seeking additional investors through public markets. Regardless of where a company seeks to undertake an initial public offering (IPO), company leaders will face various reporting and compliance requirements, as well as need to address the concerns of analysts, investors and other stakeholders.

Canada, though, offers a number of factors that make it appealing for US oil and gas companies seeking public market investors.

Due to the importance and impact oil and gas companies have on the national economy and the public markets in particular, US companies that choose to enter the Canadian

marketplace encounter an engaged and educated investor environment.

The number of smaller companies on TSX and TSXV make Canada an attractive market for smaller US oil and gas companies. Companies listed in those exchanges face compliance requirements that are less stringent than those found in the United States.

Launching a FAIT gives oil and gas companies another means for accessing the Canadian public markets.


While seeking capital within the United States may be the preferable avenue for promoting company growth, the various options available in Canada offer appeal as well.

About the authors

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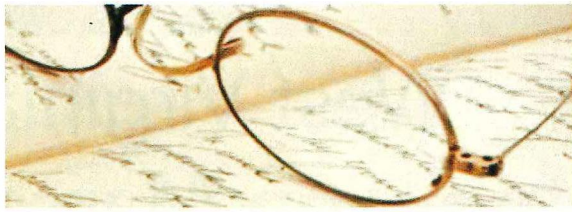
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