

BULLETIN #139 – OCTOBER 15, 2013

MACRO ENTERPRISES INC. –

MCR-TSXV; MCESF-PINK

Over the next decade, the energy services sector will be one of the best places for investors to make money. Western Canada has the oilsands, it has the Montney liquid-rich gas formation and it's now getting ready for ANOTHER tidal wave of spending to make ready for LNG exports in northwest British Columbia.

Billions of dollars in new pipeline construction, maintenance, drilling, pressure pumping, facilities construction etc. will generate big cash flows for OFS companies driving their shares higher.

I picked Macro Enterprises as my vehicle for exposure to the pipeline construction business. The company handles a variety of jobs from (mostly) gathering small pipes at the wellhead to the big pipes running thousands of miles towards the LNG export facilities. They also handle pipeline integrity work and infrastructure construction at well sites.

The company's client list includes several blue chip names including Enbridge, Talisman, TransCanada, Cenovus, Nexen, Spectra, Altagas and Pembina. Yet it is riskier than my typical LNG focused pick due to customer concentration. In 2012, four customers represented 64% of overall sales.

The stock is tightly held so it can move up or down pretty quickly; volatility is to be expected. This is a small company with an excellent balance sheet, positive cash flow and proven organic growth over the past 4 years. Management is aligned with shareholders as they own about 11 million shares or some 38% of the shares.

Macro reported its best quarter ever in Q2. A feat that won't be very hard to repeat as massive LNG spending begins to unfold.

QUICK FACTS:

Trading Symbols:	MCR-TSXV
Share Price:	\$5.40 (my price \$2.21)
Shares Outstanding:	29.9 million shares
Market Cap:	\$161.5 million
Net Debt:	\$9 million
Enterprise Value:	\$170.5 million

POSITIVES

- ✓ Call option on a recovery in the price of natural gas
- ✓ Call option on major pipeline projects
- ✓ Call option on upcoming LNG related infrastructure & drilling spending

NEGATIVES

- ✓ No geographic diversification, this is a pure play on Canada
- ✓ Natural gas drilling dependent on LNG industry starting up—any delay could lower rig count/well count
- ✓ If the price of oil drops under \$70 for a sustained period oilfield services activity declines as projects get cancelled or pushed out.

COMPANY OVERVIEW

Frank Miles, president & CEO, founded Macro in 1994 to provide pipeline and facilities construction services. He has 25 years of field construction and maintenance experience in the northeast B.C. and northwest Alberta region. He started his career in various positions related to pipeline and facilities construction prior to Macro and has been in this field ever since.

The company went public in 2006 on the TSX Venture exchange with \$12 million in cash and 2.6M shares valued at \$1.75. The Company made a transformative acquisition in late 2012 when it purchased the assets of North American Pipeline. This was essentially a large purchase of heavy equipment as Macro acquired a significant amount of specialty pipeline equipment including pipe laying machinery.

Macro, headquartered in Fort St. John, B.C., built up an expertise with work in mountainous terrain and harsh climates. This strength strategically positions the company to many planned gas pipelines connecting Northeast BC to the Pacific coast. Four major mountain ranges are located in BC and Alberta and any one of these ranges can be between oil and gas production and urban centres or LNG export terminals.

Business Overview:

Macro offers 3 specialized services across the Western Canadian Sedimentary Basin:

- Pipeline construction
- Facilities construction
- Pipeline integrity and maintenance of facilities

Pipeline Construction

Macro provides construction for 3 major types of pipelines:

1. Small diameter pipe gathering systems: The gathering system consists of low pressure, small diameter pipelines that transport raw natural gas or oil from the wellhead to oil batteries or natural gas processing facilities.
2. Small transmission pipeline systems: These are feeder lines that move products from batteries, processing facilities and storage tanks in the field to the transmission pipelines for long-distance hauling.
3. Major transmission pipeline systems: the energy-highways for transporting oil and natural gas within a province and across provincial or international boundaries. But they mostly do smaller pipelines.

Pipeline construction is much more than just attaching segments of pipe. The project goes through several stages from initial concept to the in-service date. Here's a quick summary of the services Macro performs for pipeline construction project:

- The pipeline lifecycle begins with a pre-construction survey. The proposed site is surveyed to locate utility lines to prevent accidental damage during the construction phase. After staking the area and identifying the exterior

right of way boundaries, the company starts clearing trees and vegetation. This is followed with excavating the pipeline trench by removing the soil.

- On the working side of the trench, separate joints of pipe are laid to be bended using specialized equipment. After bending according to the contour of the trench, the pipe sections are aligned and welded together. Sidebooms (see figure) suspend the pipes in the air for visual and electronic inspection following coating and recoating to ensure there are no faults along the pipeline.
- The pipe assembly is lowered into the trench by the sidebooms and the trench is backfilled using bulldozers. Once installation is complete, the pipeline is tested by sealing a section of the pipe and filling it with pressurized water. If no leaks are revealed, the section is emptied of water, dried and becomes ready to be placed in service.



Facilities Construction

Processing facilities are important building blocks in oil and gas production. Think of them as central collection points where multiple wells meet through small pipelines. Production at the well-head needs to be processed before it can travel via major transmission pipelines. Oil and gas have to meet strict quality guidelines before going into pipes.

Oil wells are typically connected to treating facilities (oil batteries) to remove natural gas and water from the oil stream prior to transport.

Natural gas requires several steps of processing in order to remove contaminants (acid gases like hydrogen sulfide and carbon dioxide). If water is present, it is removed from the gas stream and disposed of.

Processing facilities require the construction of multiple components like storage tanks, high pressure flare stacks, pumps, “pigging” closures and separators are installed as well.

Once the product is processed, it is moved into larger transmission pipelines. These energy highways require specialized facilities like pump stations for liquids and compressor stations for natural gas.



Macro's work starts with site preparation and continues with pipe fabrication, pipe installation and testing services. Except for subcontracting electrical/instrumentation installation, Macro pretty much does the whole thing from A to Z.

Pipeline Integrity

Canada has more than 110,000 km of pipelines with a total replacement cost of over \$100 billion. These are federally regulated and must be regularly inspected and repaired in order to reduce failures and spills.

The federal government is planning to revamp the allocation of liability for this sector. The legislation that will be introduced this fall includes the following changes:

- Pipeline operators will be expected to have a minimum financial capability to deal with spills of at least \$1 billion (That's a stark contrast to the \$30 million liability limit in clean-up costs when no fault is proven.)
- Fines will be increased
- Clarifying the right of the National Energy Board to conduct compliance audits

This bodes well for Macro as it also specializes in pipeline integrity work. This involves the inspection and maintenance of existing pipeline infrastructure in order to prevent pipe failures. Pipeline operators use Macro's services to dig up and repair any pipeline deficiencies that were detected.

According to Macro, pipeline operators have been ramping up investment in pipeline integrity expenditures. For instance Enbridge, a client of Macro, tripled its annual spending on integrity digs from \$150M to \$450M.

FINANCES & VALUATION

Macro has demonstrated a strong growth rate in the past 4 years. Annual revenue grew from \$48.5 million to \$148.3M in 2012, that's close to 20% in compounded annual growth rate.

The company has little debt, less than \$10M at the end of Q2-2013 (Cash \$12.8M – debt of \$21.8M). This results in a net debt to EBITDA ratio of 0.2x. Add to that a healthy balance sheet with a strong growth rate and you get a market darling.

The stock has been a top performer in the oilfield services sector. It returned more than 320% so far this year!

There's an important reason behind this market revaluation, the revenue growth rate has been largely organic. Macro had only one acquisition over the past 4 years, it acquired pipeline construction assets from North American Pipeline in the fall of 2012 for a little over \$16M. The company had equipment for about \$50M at the time, it currently stands at over \$70M. The deal also included a master service agreement with Enbridge.

Analysts expect Macro to generate over \$200M in 2013, up from \$148M in 2012. This comes out to \$0.77 per share for a P/E (Price divided by Earnings per share) ratio of 7.6x. I used a share price of \$5.85 compared to the date price used in the table below of \$3.88.

Peer comparables (source: IQ Capital)

Canadian Peer Group	Symbol	Price	MC	Revenue			EBITDA			EPS			EV/	
				FY12	FY13	FY14	FY12	FY13	FY14	FY12	FY13	FY14	EBITDA FY13	P/E FY13
Enterprise Group, Inc.	TSX:E	\$ 0.63	45.3	18.5	41.2	58.9	4.5	15.6	23.4	0.04	0.14	0.15	3.5x	4.7x
ENTREC Corporation	TSXV:ENT	\$ 1.54	178.1	132.5	241.6	295.1	31.6	63.9	80.9	0.17	0.23	0.28	4.1x	6.8x
Enerflex Ltd.	TSX:EFX	\$ 13.88	1,081.4	1,501.7	1,446.5	1,572.9	155.5	149.8	166.8	0.93	1.05	1.20	6.9x	13.3x
Petrowest Corporation	TSX:PRW	\$ 0.75	92.8	196.5	214.8	236.8	33.8	38.6	45.3	0.04	0.07	0.11	4.3x	11.5x
Average													4.7x	9.1x
US Peer Group														
Layne Christensen Co.	NASDAQGS:	\$ 20.92	409.0	1,112.8	1,075.6	1,013.0	89.5	45.8	35.1	(2.88)	(1.88)	(1.29)	10.5x	na
Orion Marine Group, Inc	NYSE:ORN	\$ 13.29	362.1	292.0	344.8	384.5	7.4	26.5	37.4	(0.44)	0.14	0.37	12.3x	na
Quanta Services, Inc.	NYSE:PWR	\$ 28.27	6,020.9	5,920.3	6,340.8	6,881.7	623.1	655.4	769.9	1.44	1.46	1.77	8.6x	19.4x
Vectren Corporation	NYSE:VVC	\$ 36.38	2,993.1	2,232.8	2,353.2	2,435.1	607.1	599.2	640.5	1.94	1.98	2.15	8.1x	18.4x
Willbros Group Inc.	NYSE:WG	\$ 7.14	354.4	2,004.2	2,057.4	2,206.9	76.2	78.5	118.9	(0.63)	(0.24)	0.72	7.6x	na
North American Energy Partners Inc.	NYSE:NOA	\$ 5.07	183.8	670.7	544.6	563.2	35.4	30.4	55.9	(0.58)	(0.04)	0.03	16.3x	na
Average													10.6x	18.9x
Canadian Peer Group Average													4.7x	9.1x
US Peer Group Average													10.6x	18.9x
Macro Enterprises Inc.	TSXV:MCR	\$ 3.88	128.8	148.3	203.1	250.7	30.6	42.1	53.0	0.58	0.77	0.98	2.9x	5.0x

Even after the recent run-up in price, Macro is still trading at a discount to its peer group in Canada. If I apply the same multiple of 9.1x, I get a target share price of $\$0.77 \times 9.1 = \7.00 per share. That's only a 20% upside! BUT remember this is based on the earnings for 2013, a year that only has less than 3 months left!

I believe the upside is much higher than 20% if we're looking well into 2014. If I use the analyst earning per share estimate of \$0.98, the target price is bumped close to \$9.00 for potentially more than 50% in upside.

Before I get too excited at the upside, are the revenue estimates realistic?

For the first 6 months of 2013, Macro reported \$98 million in revenue. Hitting the \$200M mark should not be difficult at all given Q2 is typically the weakest quarter of the year. For Q3, the company has already guided for higher revenue than in 2012 in its Q2 report.

Last year, Macro generated its revenue largely from oil related projects. Recall natural gas visited the \$1 handle in Canada following a mild winter and record production in the US.

In the short and medium term, there are significant prospects for an increase in drilling and pipeline infrastructure projects in B.C. and Alberta. This could only translate into more contracts and higher revenues supporting the \$9.00 target.

The real kick is yet to come from the spending in anticipation of the LNG (Liquefied Natural Gas) export facilities planned on the coast of British Columbia.

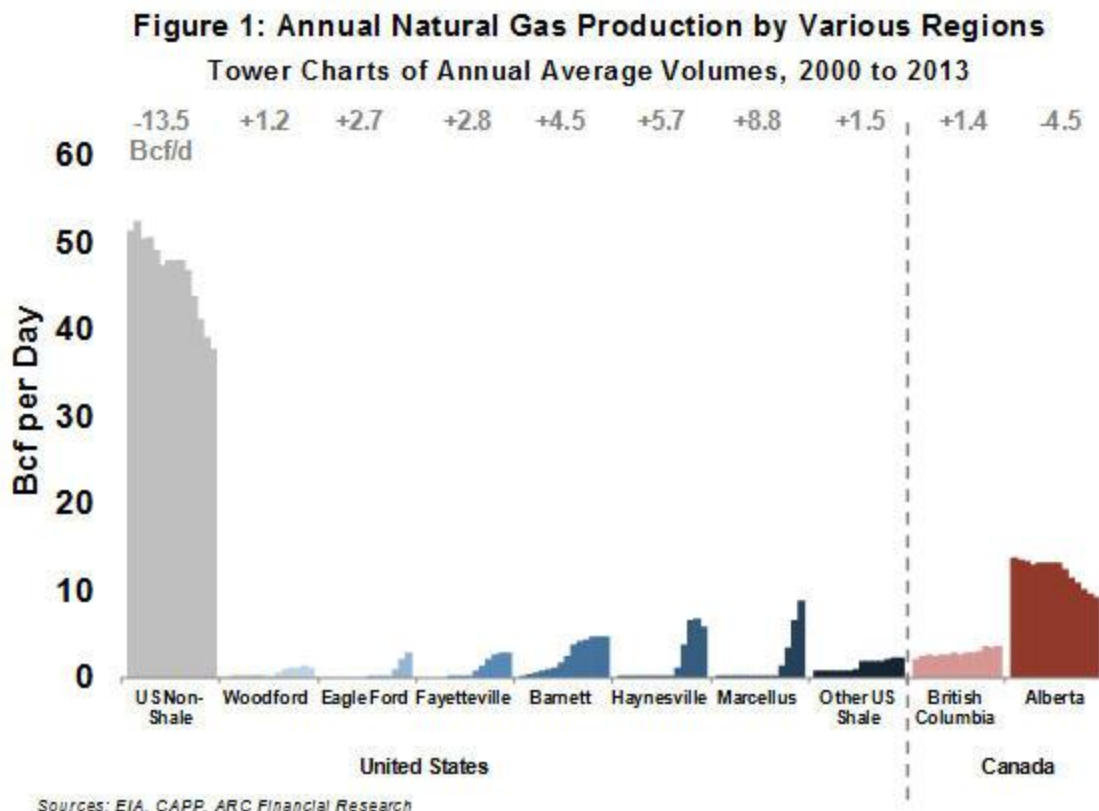
LNG IN BRITISH COLUMBIA

Canada's natural gas industry was once a \$50 billion juggernaut. The advent of shale gas drilling in the US changed the landscape dramatically. In less than 10 years Alberta's gas producers are down in sales by a collective \$30 billion with production contracting by 30%.

Blame the Barnett, Fayetteville and Haynesville shale gas plays in the US!

The Marcellus play in Pennsylvania grew to take 13% of the US market in only 4 years. Compared to western Canadian gas, Marcellus production doesn't need to travel a long distance to reach the lucrative north east US market.

Shale gas has even clobbered US non-shale gas production according to the figure below!



Western Canadian producers simply cannot compete; their traditional eastern markets in both the US and Canada have been lost to more competitive sources like the Marcellus given the advantage of low cost production and geography.

The solution is to look towards higher value markets in Asia where natural gas sells between \$14 and \$18 per mcf. That's up to six times AECO at \$3.00/mcf!

This is what the LNG race is all about and it's a game changer for the Canadian natural gas industry.

About a dozen multibillion-dollar proposals are on the table to build LNG export terminals on the coast of British Columbia. The product would be supplied from natural gas fields across northern British Columbia and Alberta. These fields would be linked through existing and new proposed pipeline routes.

LNG Projects Proposed / Under Evaluation						
Project	Company	Location	Status	Initial Capacity ~bcf/d	Expanded Capacity ~bcf/d	Initial Start-up
BC LNG Co-op	Tatham Family	Kitimat	Contracts signed to sell LNG to Asia customers	0.13	0.23	Q2/15
Kitimat LNG	Chevron (50% WI), Apache (50% WI)	Kitimat	Completing FEED with early site work in progress; License approved	0.7	1.4	2015
LNG Canada	Shell, KOGAS, Mitsubishi, PetroChina	Kitimat	25-year export license approved. Filed description of project	1.6	3.2	2017
Pacific NW LNG	PETRONAS, Japex	Prince Rupert	Filing of the project description; environmental impact study	1.0	1.5	2018
Western Canada LNG	BG Group / Spectra	Prince Rupert	Filing of environmental impact study	2.2	3.3	2021
TBD	Idemitsu -Altagas	Prince Rupert	Feasibility Study On-Going	TBD	TBD	2017
TBD	ExxonMobil	Prince Rupert	Eligible Expression of Interest Submitted (Mar 18 Closing)	TBD	TBD	TBD
TBD	CNOOC, INPEX, JGC	Prince Rupert	Eligible Expression of Interest Submitted (Mar 18 Closing)	TBD	TBD	TBD
TBD	Woodside Petroleum	Prince Rupert	Eligible Expression of Interest Submitted (Mar 18 Closing)	TBD	TBD	TBD
TBD	SK E&S (Korea)	Prince Rupert	Eligible Expression of Interest Submitted (Mar 18 Closing)	TBD	TBD	TBD
Total - bcf/d				5.6	9.6	
Total tcf per Year				2.1	3.5	
Total tcf required for 25 Year Life				51.4	87.9	

By 2021, the initial LNG export capacity from Canada's West coast is estimated at 5.6 bcf/d according to Altacorp Capital. That's based only on 5 out of a dozen proposed LNG facilities becoming operational from 2015 through 2021. The figure

does not include super major Exxon looking for its share of the LNG pie; they want to have a 4 bcf/d facility in operation by 2020.

In theory each 1 bcf/d of natural gas requires 7.3 Tcf of reserves over 20 years.

$1 \text{ bcf/d} * 365 \text{ days} * 20 \text{ year lifespan} = 7.3 \text{ tcf of gas reserves}$

An export capacity of 5.6 bcf/d represents more than 40% of Canada's 2012 natural gas production (~13.3 bcf/d).

The figure will most likely be much higher than 5.6 bcf/d as it does not take into consideration expansions or other terminals in operation.

Each 1 bcf/d of demand requires drilling in excess of 1,400 wells over 20 years based on a recovery of 5 bcf per well. Meeting this demand requires a multi-year development plan that includes *a lot of drilling*.

The LNG development cycle should support higher realized prices for domestic natural gas in Canada. In turn, this will trigger an expansion in capital expenditures targeting natural gas.

Greg Colman, an analyst at National Bank Financial, said in a July 9 report he estimated producers will spend \$55-billion on gas wells for LNG by 2021. It is clear that LNG spending will give the natural gas industry a big boost.

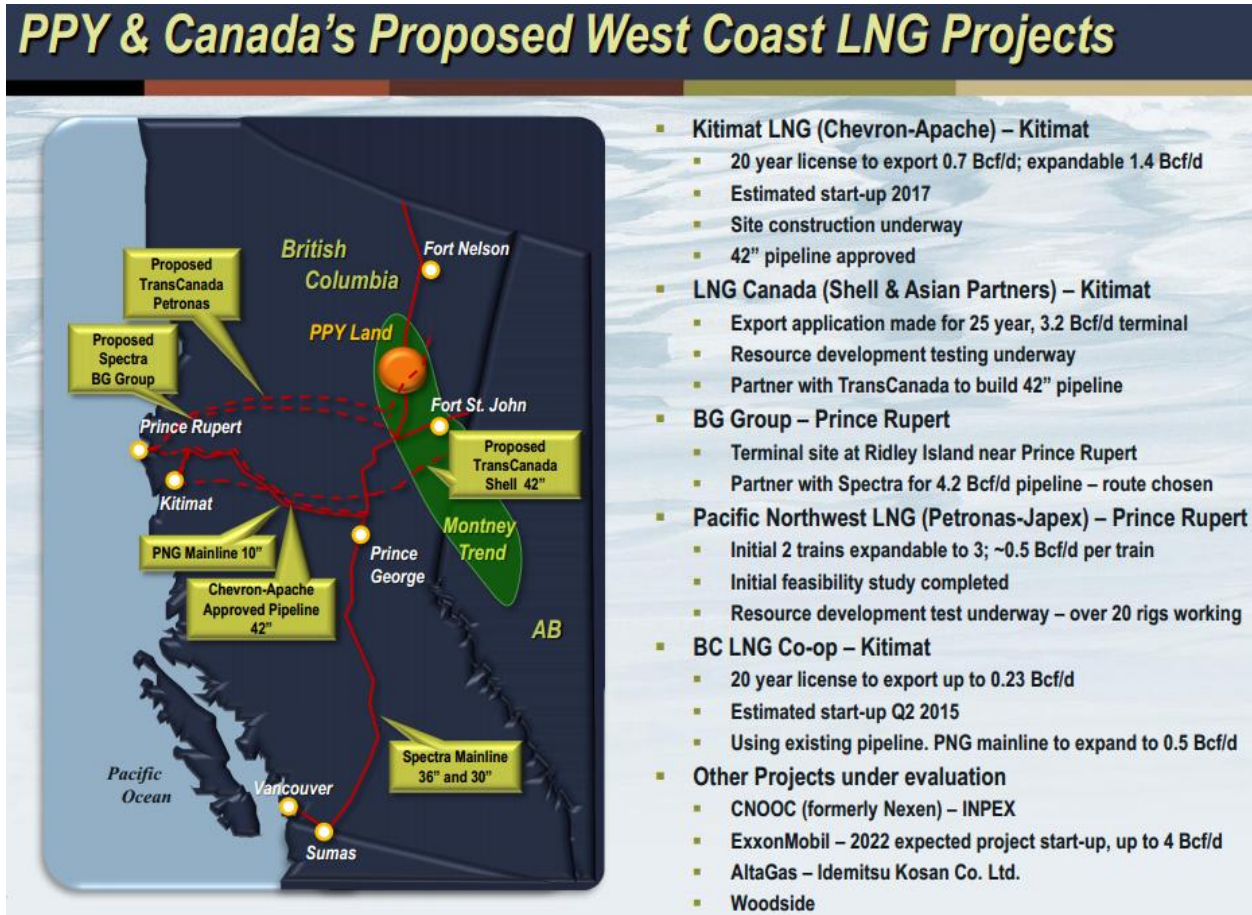
And all that drilling will have to start in earnest; analysts believe 2014 will be busier than 2013 as the natural gas industry ramps up spending in anticipation of LNG.

For Macro, this translates into new construction contracts for small gathering pipelines as well as oil & gas processing facilities.

Expertise & Location, Location, Location!

At this point, I only covered the impact of increased drilling. All that natural gas will have to be transported to the west coast export facilities. This will require sinking billions of dollars in building new pipeline routes.

Proposed natural gas pipelines (source: Painted Pony Petroleum presentation)



Macro is based in Fort Saint John, BC an ideal location given the expected LNG infrastructure development. The company specializes in pipeline construction with years of experience working in mountainous terrain.

Their expertise of dealing with the harsh climate, limited access and rocky, steep topography sets them apart from their competitors regardless of their size.

Naturally, as the years go by, all these new transmission lines will also provide a steady stream of pipeline integrity work.

Finally, construction work associated with new pipelines might also come from the proposed Keystone XL or Northern Gateway oil pipelines. But given the hurdles they are facing, the natural gas angle is by far more probable and enough to bring about a significant source of revenue and growth to Macro's business.

WHAT THE ANALYSTS SAY

FIRM 12 MONTHS TARGET PRICE

PI Financial \$7.00

STOCK CHART...



CONCLUSION

Macro is another company that fits my 50%+ return upside criteria looking 12 months out. The company is ideally located in LNG territory that will see billions of dollars in investments over the next decade. It's expertise in the construction of pipelines and oil & gas facilities along with providing pipeline integrity work provides investors with massive exposure to this spending.