sequeira PARTNERS

THE WELL STREET JOURNAL

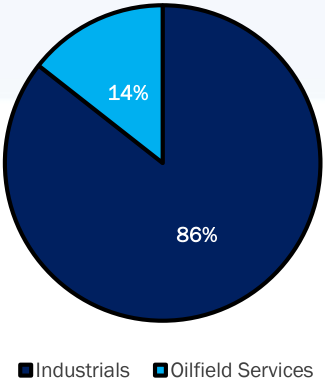
Oilfield Services and Equipment Deep Dive

2019 | Q3 Report

Q3 | Deep Dive

Crude pricing continued to decline quarter over quarter while the average Canadian active rig count in Q3 2019 fell to 132 rigs versus 209 rigs in Q3 2018, representing a decrease of 37%. In Canada, activity continues to be restricted due to limited takeaway capacity and consequently government mandated curtailments. The impact of these obstacles is amplified by a perception of political uncertainty, which has had the effect of dampening investor enthusiasm for the country's energy sector.

However, the largest issue facing the industry globally is the prospect of constrained economic growth due to continued challenges to free trade. Much of the future outlook is heavily dependent on the outcome of U.S.-China trade negotiations.



As for transactions in the oilfield and industrial industry segments, Q3 2019 saw 118 disclosed transactions with either a Canadian target or buyer. Of the 118 transactions, 14% were specific to the oilfield services sector, compared to 5% in Q2 2019.

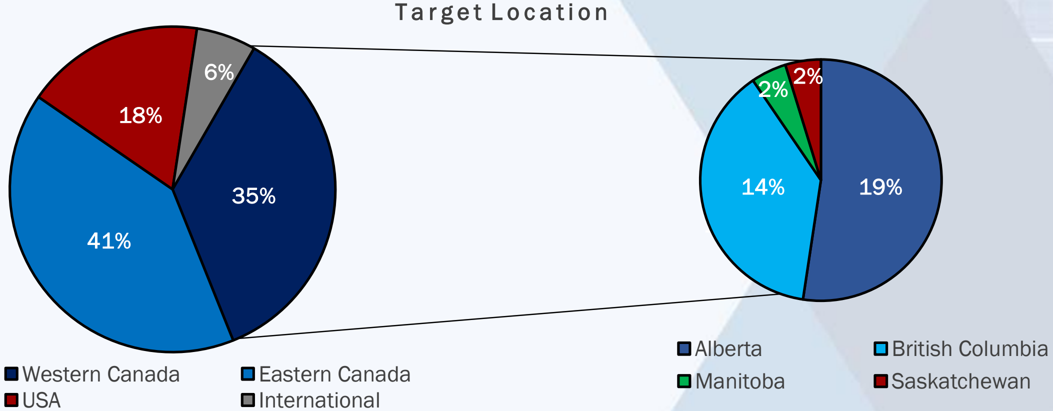
sequeira PARTNERS

Transactions Over the Quarter

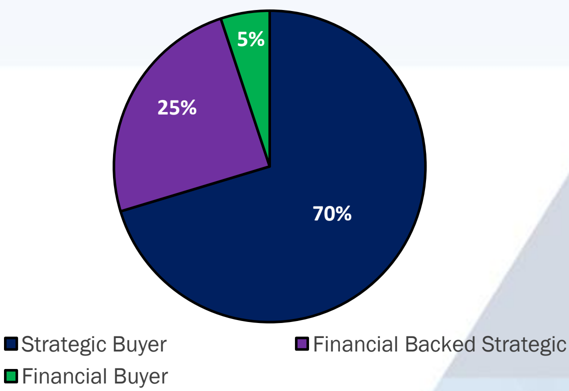
Of the 118 disclosed transactions in the quarter with either a Canadian buyer or target, 35% of target companies were located in Western Canada and 19% of those targeted companies being located in Alberta. Strategic purchasers continue to be the most active buyers, participating in 70% of transactions while Financial backed strategic purchasers increased their activity by 8% quarter over quarter.

The acquisition of Kinder Morgan Canada Ltd. by Pembina Pipeline Corporation for $3.1 billion marks the largest transaction in the space over the third quarter. With this acquisition, Pembina increases its commitment to the future of Canada's Oilsands industry.

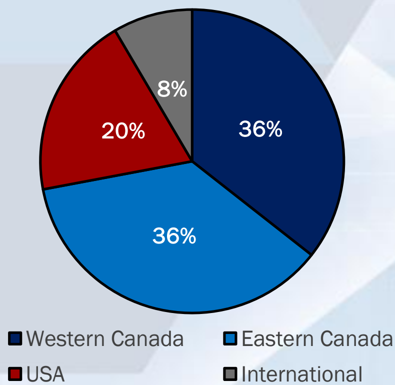
Target Location



Buyer Type



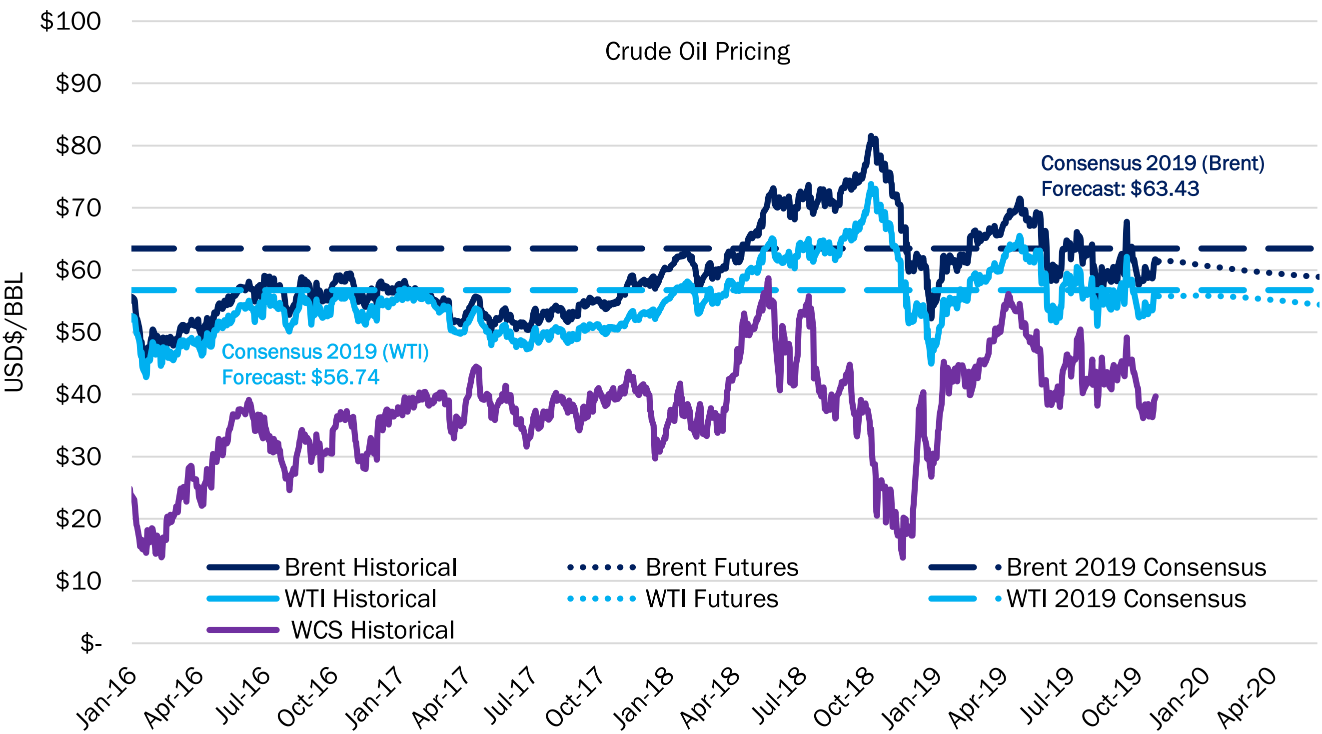
Buyer Location



Commodity Pricing and Analyst Forecasts

Q3 2019 saw a moderate decline in oil prices after an optimistic start to the year with Brent and WTI benchmarks falling 7% and 8% in the quarter respectively. Prices have not taken off despite political uncertainty in major producing regions such as Iran, as investors continue to view the ongoing U.S.-China trade war as a significant risk to the global economy. As a result, many analysts, as well as organizations such as the IEA, have cut their 2020 demand growth forecasts and predicted a well supplied market for the foreseeable future.

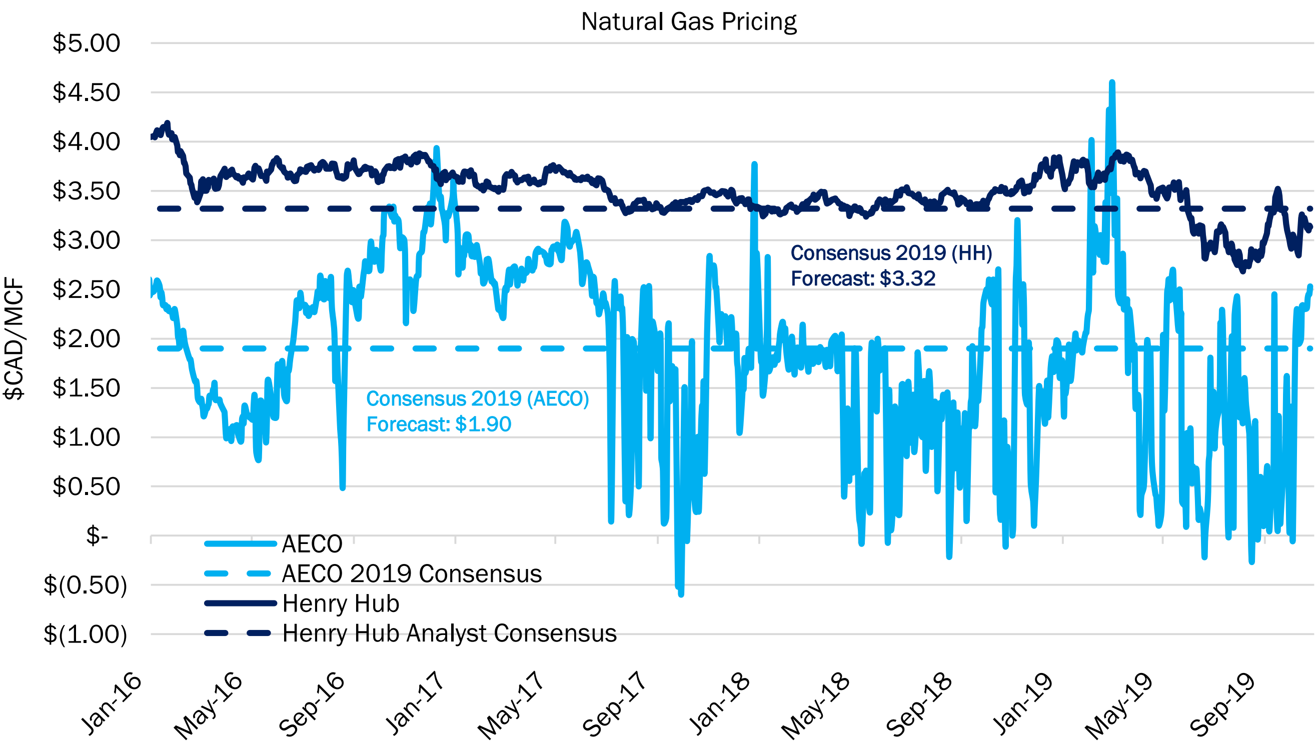
Canada's WCS benchmark saw a similar drop during the same period, decreasing 9%. However, the WCS differential increased substantially through October as the Alberta government is expected to ease production cuts for producers who agree to ship crude by rail.



Commodity Pricing and Analyst Forecasts

AECO pricing continued to struggle in Q3 2019, posting an average price of less than $1/MCF on the quarter. However, October saw the return of optimism to the market as the price has maintained above the $2/MCF benchmark for the latter half of the month. With storage levels being relatively low, many analysts are predicting a bullish winter for the struggling benchmark, a welcome change for producers.

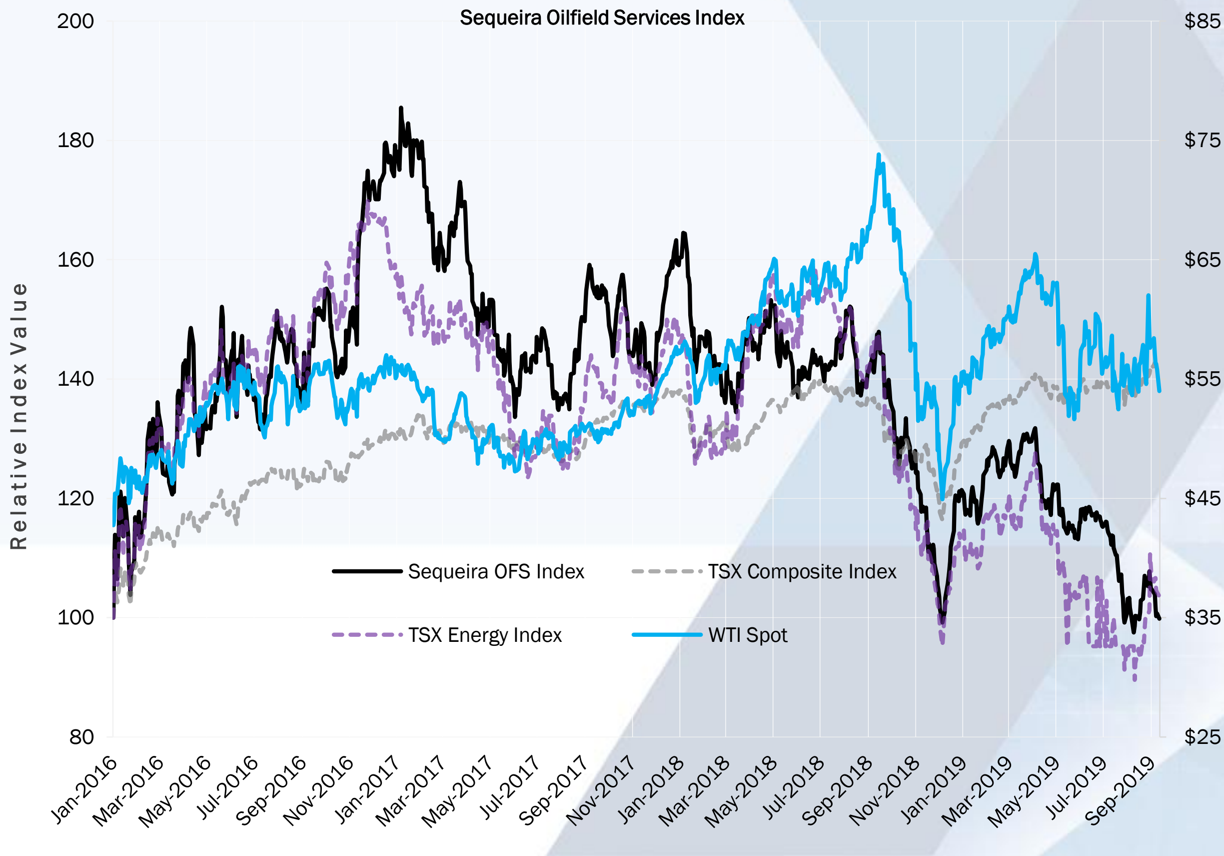
Henry HUB pricing remained depressed through Q3 following a highly negative Q2. U.S. gas markets have been struggling with a persistent oversupply as storage has seen the largest seasonal gains since 2014. LNG markets overseas have also provided limited egress, as storage in major export markets is also running near full capacity, and Asian LNG demand has grown more slowly than had been expected.



Sources: DOB, Capital IQ and Analyst Forecasts

Market Overview

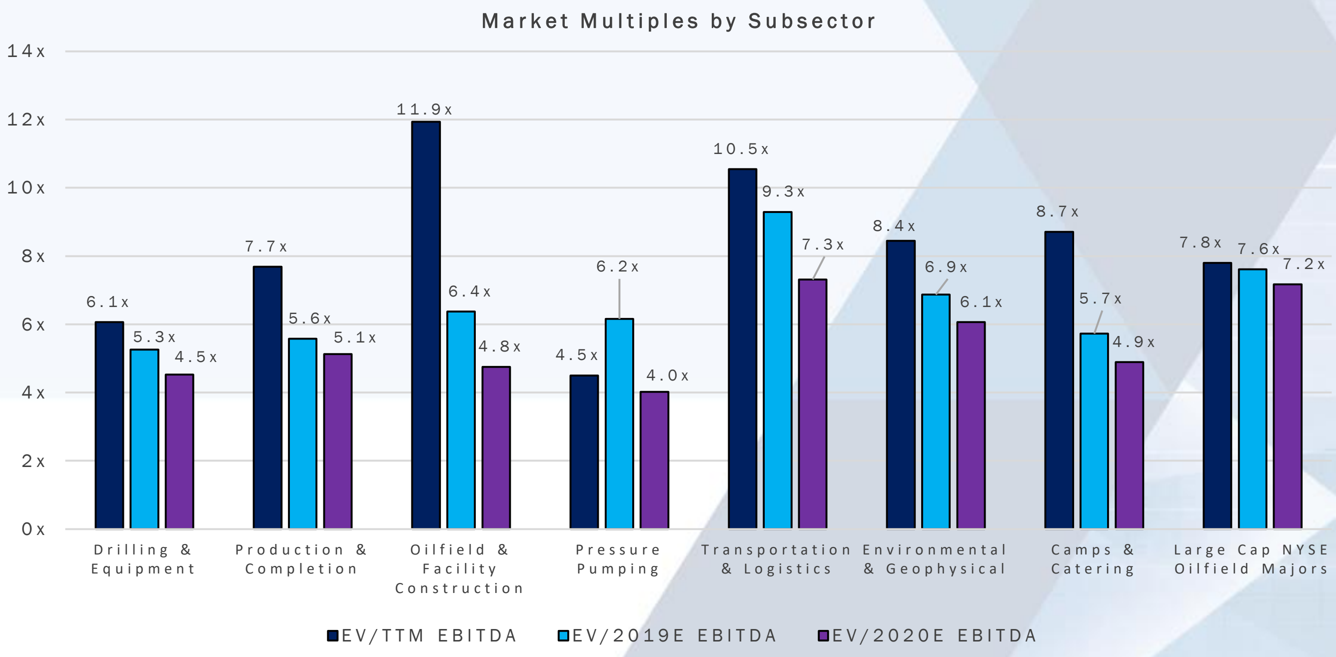
Sequeira's OFS index tracks publicly listed Canadian Oilfield Service companies with Enterprise Values averaging more than $30 MM CAD. The decline in oil prices in Q3 resulted in further declines in our index, exacerbated by more negative analyst sentiment surrounding Permian activity. Our index ended the quarter down 6% year to date and down 15% quarter over quarter.



sequeira PARTNERS

Market Overview

Despite the decrease in index value, market multiples in Q3 remained relatively steady, with decreasing stock prices accompanied by declining earnings and estimates. Some sectors did see further multiple retraction, in particular the production and completions sector as producers begin to see diminishing returns to increasing completions intensity. The only sector to remain relatively flat was oilfield and facility construction, due to near-term visibility to significant energy infrastructure projects.



Value*INSIGHTS*

The most significant development in the accounting world this past year has been the introduction of the new lease standard under International Financial Reporting Standards (IFRS). IFRS 16 came into effect in January 2019, and it has transformed how businesses measure and disclose their leases. While the transition to IFRS 16 has been a time-consuming process for businesses, it has also caught the attention of valuation practitioners for its impacts on certain key valuation metrics.

IFRS 16: The Basics

Under the old lease standard (IAS 17), leases could be categorized one of two ways: as a finance lease reported on the balance sheet, or as an operating lease off the balance sheet (with lease payments being expensed through the income statement as incurred). IFRS 16 has eliminated this distinction; all leases will be treated as finance leases and recognized on the balance sheet. Specifically, on the statement of financial position, the lessee will recognize a right of use (ROU) asset and a lease liability, with the liability representing the obligation for future lease payments over the remaining lease term. On the statement of profit and loss, operating lease expense will be replaced with depreciation on the ROU asset and interest on the lease liability.

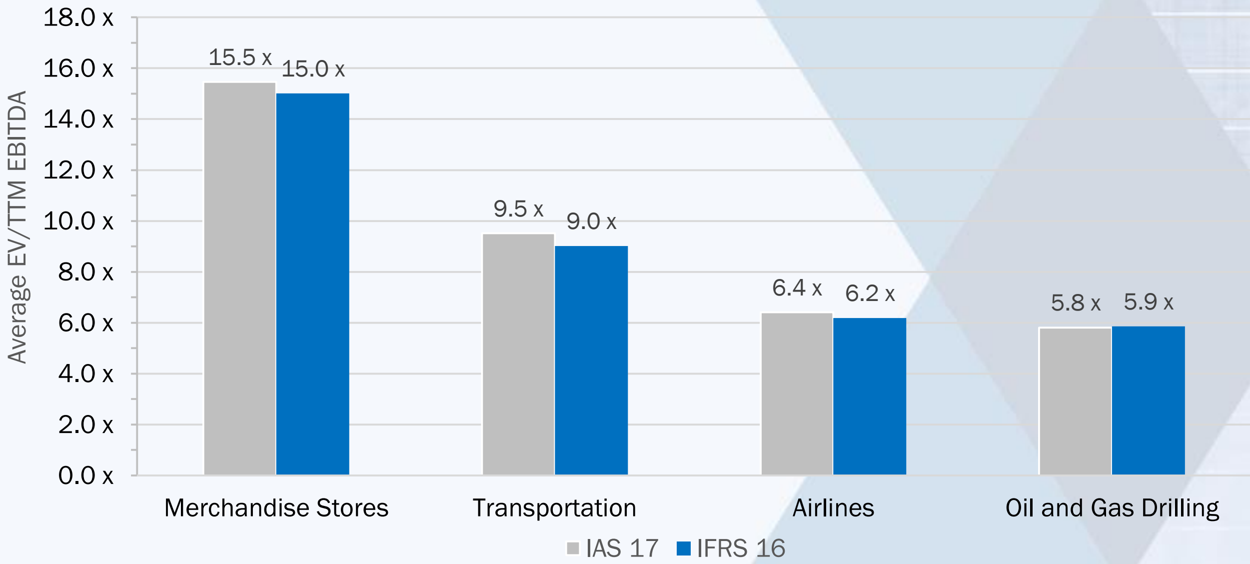
Impact on Valuation Metrics and Ratios

It is important to preface this discussion by stating that, in theory, the introduction of a new accounting standard should not have an impact on economic value. While the treatment of the lease has changed, all else being equal, there has been no change in the cash flow generating ability of the business. However, there are impacts on some of the outcomes of valuations and considerations made in preparing a valuation. Specifically:

- **Increased EBITDA**: Under IFRS 16 lease/rental expenses are excluded from EBITDA. Higher EBITDA results in higher free cash flow. This means that when applying a discounted cash flow (DCF) approach to value a business, the enterprise value (or net present value of expected free cash flows) will also increase. We note that the transition to IFRS 16 has a negligible impact on net operating income; that is, the lease payments that were previously expensed are effectively replaced with depreciation expense on the ROU asset and interest expense on the lease liability.
- **Increased Debt**: The transition to IFRS 16 means that the obligation for future lease payments is recognized as a liability, rather than disclosed as an operating lease commitment in the notes to the financial statements. However, the increase in enterprise value from higher free cash flows, noted above, will theoretically be offset by the increase in net debt, resulting in minimal impact to equity value.
- **EV/EBITDA multiple**: Observed EV/EBITDA multiples are impacted. Enterprise value (EV) will increase due to the increase in debt from the lease liability. EBITDA will also increase from the removal of lease expense. While both numerator and denominator increase, in general it is expected that the EV/EBITDA multiple will decrease. This is because the relative impact of removing lease expenses from EBITDA is more profound that the incremental addition of debt to enterprise value.

Observed Impact on Valuation Multiples

The industries most impacted by the transition to IFRS 16 are retail, distribution, and transportation (most notably, airlines). The figure below illustrates the impact that the transition to IFRS 16 has had on the observed EV/EBITDA multiples of companies operating in each of the aforementioned industries as at September 30, 2019. On average, EV/EBITDA multiples have trended consistent our expectation, and have declined by 3% to 5%. Although we note that the impact is not as profound in the oil and gas drilling and services sector, where multiples remained relatively flat.



Conclusion

The impact of IFRS 16 is specific to a company and varies based on the industry; it depends on the number of material lease agreements that were previously recognized off balance sheet. While all IFRS-reporting companies will be treating lease arrangements consistently, comparability of year-over-year information will be an issue; IFRS 16 provides the option to apply the standard prospectively and not restate prior periods. Further, historical transaction multiples or observed multiples may no longer be comparable; it will not be reasonable to apply pre-IFRS 16 multiples to post-IFRS 16 EBITDA. IFRS 16 has introduced new areas of concerns for valuations and will undoubtedly result in additional complexities. Now more than ever, it is important to gain appropriate insight into the treatment of lease obligations of the subject business and ensure consistent treatment.

Sequeira Update

Advisor to

trailer wizards

on the pending sale to

TIP

A portfolio Company of I SQUARED CAPITAL

sequeira PARTNERS

On September 9, 2019, our Vancouver team announced the pending acquisition of our client, Trailer Wizards Ltd. (“Trailer Wizards”), by TIP Trailer Services.

Founded in 1963, Trailer Wizards is Canada’s largest national commercial trailer rental, leasing, sales, service, parts, and storage company. Today, Trailer Wizards has 21 locations spanning Canada coast-to-coast including 14 fully staffed customer care centres, over 400 employees, and a diversified fleet of over 23,000 units in Canada.

As the exclusive financial advisor to the shareholders of Trailer Wizards, our team assisted and provided advisory services throughout the transaction.

About Us

With offices in Edmonton, Calgary, and Vancouver, Sequeira Partners is focused on providing mergers and acquisition advisory, corporate valuations and financial opinions, and recapitalization services to mid-market energy services, industrial and diversified companies.

We welcome your thoughts or comments and inquiries as to how we could assist your business with its transaction needs.

sequeira PARTNERS

400, 520 – 5TH Avenue SW
Calgary, AB T2P 3R7
587-352-2500

2250, 10088 102 Avenue NW
Edmonton, AB T5J 2Z1
780-633-5200

1790, 999 West Hastings Street
Vancouver, BC V6C 2W2
604-687-5300

Our Team

Aroon Sequeira, CA, CBV, ICD.D
asequeira@sequeirapartners.com
780.784.0114

Mark McRae, CA, CBV
mmcrae@sequeirapartners.com
780.784.0115

Julie Afanasiff, CA, CBV
jafanasiff@sequeirapartners.com
780.784.0116

Ken Tarry, MBA
ktarry@sequeirapartners.com
604.687.5300 ext. 201

Kellie Manchester, CFA
kmanchester@sequeirapartners.com
604.687.5300 ext. 202

Jordan Martel, CBV, ASA, MBA
jmartel@sequeirapartners.com
587.352.2500 ext. 302

Scott Acheson, CA, CBV, CFA
sacheson@sequeirapartners.com
780.784.0124

Erica McGuinness, CA, CBV
emcguinness@sequeirapartners.com
604.687.5300 ext. 203

Kira Gregson, CA, CBV
kgregson@sequeirapartners.com
780.784.0125

Ryan Turpin, CPA
rturpin@sequeirapartners.com
780.784.0121

David Cameron, CPA
dcameron@sequeirapartners.com
780.784.0127

Wenlei Tang, CA
wtang@sequeirapartners.com
587.352.2500 ext. 306

Kurt Chao, CPA
kchao@sequeirapartners.com
604.687.5300 ext. 204

Nicole Hutchinson
nhutchinson@sequeirapartners.com
780.784.0118

Appendix A

Sequeira Oilfield Services Index – Sector Drilldown

As at September 30, 2019

Source: Capital IQ

Company	Ticker	Share Price	Dividend Yield	Market Cap	Enterprise Value	Revenue	TTM EBITDA	EBITDA Margin	EV/EBITDA TTM	EV/EBITDA 2019E	EV/EBITDA 2020E	Price/ Book	Net Debt/ 2019E EBITDA
Drilling & Equipment			(%)	($mm)	($mm)	($mm)	($mm)	(%)	(x)	(x)	(x)	(x)	(x)
AKITA Drilling Ltd.	TSX:AKT.A	$ 1.09	31.2%	46	122	165	19	11.7%	6.3x	5.7x	4.0x	0.2x	3.1x
Cathedral Energy Services Ltd.	TSX:CET	$ 0.28	-	14	39	155	(1)	NM	NM	7.5x	5.3x	0.2x	3.1x
CWC Energy Services Corp.	TSXV:CWC	$ 0.14	-	71	108	124	15	12.3%	7.1x	6.6x	5.7x	0.4x	2.8x
Ensign Energy Services Inc.	TSX:ESI	$ 3.06	15.7%	490	2,141	1,458	355	24.4%	6.0x	5.0x	5.0x	0.3x	3.9x
Essential Energy Services Ltd.	TSX:ESN	$ 0.29	-	41	65	166	16	9.9%	4.0x	3.6x	3.1x	0.3x	1.3x
High Arctic Energy Services Inc	TSX:HWO	$ 2.27	8.7%	113	109	196	31	15.8%	3.5x	4.7x	2.6x	0.5x	NM
McCoy Global Inc.	TSX:MCB	$ 0.63	-	17	16	54	3	6.2%	4.8x	4.5x	2.3x	0.5x	NM
Pason Systems Inc.	TSX:PSI	$ 16.15	4.7%	1,378	1,204	319	137	42.8%	8.8x	7.8x	7.6x	3.7x	NM
PHX Energy Services Corp.	TSX:PHX	$ 2.80	-	156	216	352	41	11.5%	5.3x	4.3x	4.0x	1.1x	1.3x
Precision Drilling Corporation	TSX:PD	$ 1.52	-	447	1,953	1,596	402	25.2%	4.9x	5.0x	5.3x	0.3x	3.9x
Total Energy Services Inc.	TSX:TOT	$ 6.85	3.5%	311	567	887	116	13.1%	4.9x	5.5x	5.3x	0.6x	2.6x
Western Energy Services Corp.	TSX:WRG	$ 0.25	-	23	250	214	26	12.1%	9.6x	10.7x	10.2x	0.1x	8.5x
Mean								**16.8%**	**5.9x**	**5.9x**	**5.0x**	**0.7x**	**3.4x**
Median								**12.3%**	**5.3x**	**5.3x**	**5.1x**	**0.3x**	**3.1x**
Production & Completion			(%)	($mm)	($mm)	($mm)	($mm)	(%)	(x)	(x)	(x)	(x)	(x)
Bri-Chem Corp.	TSX:BRY	$ 0.11	-	3	33	107	7	6.4%	4.8x	NM	NM	0.1x	ND
CES Energy Solutions Corp.	TSX:CEU	$ 2.05	2.9%	540	977	1,332	143	10.8%	6.8x	5.5x	5.1x	0.8x	2.6x
Computer Modelling Group Ltd.	TSX:CMG	$ 6.11	6.5%	490	482	76	33	43.5%	14.5x	NM	17.2x	10.6x	NM
Enerflex Ltd.	TSX:EFX	$ 11.62	3.6%	1,042	1,223	1,939	253	13.0%	4.8x	3.7x	4.0x	0.8x	0.6x
Source Energy Services Ltd.	TSX:SHLE	$ 0.56	-	33	278	362	20	5.5%	13.9x	5.9x	5.3x	0.1x	5.2x
Strad Inc.	TSX:SDY	$ 1.62	-	92	112	121	29	23.8%	3.9x	3.1x	2.3x	0.7x	0.6x
Wolverine Energy and Infrastructure Inc.	TSXV:WEII	$ 0.94	-	100	210	69	18	25.7%	11.8x	NM	3.9x	1.1x	6.7x
Mean								**18.4%**	**8.7x**	**4.5x**	**6.3x**	**2.0x**	**3.1x**
Median								**13.0%**	**6.8x**	**4.6x**	**4.6x**	**0.8x**	**2.6x**
Oilfield & Facility Construction			(%)	($mm)	($mm)	($mm)	($mm)	(%)	(x)	(x)	(x)	(x)	(x)
Badger Daylighting Ltd.	TSX:BAD	$ 40.69	1.4%	1,451	1,563	655	149	22.8%	10.5x	8.0x	6.7x	4.3x	0.6x
ClearStream Energy Services Inc.	TSX:CSM	$ 0.06	-	7	345	351	12	3.5%	28.2x	NM	NM	NM	ND
Enterprise Group, Inc.	TSX:E	$ 0.20	-	10	18	21	3	12.1%	7.1x	NM	NM	0.2x	ND
Macro Enterprises Inc.	TSXV:MCR	$ 4.03	-	123	157	398	60	15.0%	2.6x	2.5x	3.0x	1.2x	0.5x
North American Construction Group Ltd.	NYSE:NOA	$ 15.26	-	391	795	579	125	21.6%	6.4x	4.4x	3.8x	0.0x	2.2x
Shawcor Ltd.	TSX:SCL	$ 15.26	3.9%	1,071	1,506	1,466	114	7.8%	13.2x	9.1x	6.6x	1.0x	2.7x
Mean								**13.8%**	**11.3x**	**6.0x**	**5.0x**	**1.3x**	**1.5x**
Median								**13.5%**	**8.8x**	**6.2x**	**5.2x**	**1.0x**	**1.4x**
Pressure Pumping			(%)	($mm)	($mm)	($mm)	($mm)	(%)	(x)	(x)	(x)	(x)	(x)
Calfrac Well Services Ltd.	TSX:CFW	$ 1.57	-	227	1,192	2,034	246	12.1%	4.8x	6.6x	6.0x	0.5x	5.3x
STEP Energy Services Ltd.	TSX:STEP	$ 1.45	-	97	372	773	93	12.1%	4.0x	4.0x	3.5x	0.2x	2.8x
Trican Well Service Ltd.	TSX:TCW	$ 1.01	-	287	298	778	51	6.5%	5.9x	8.1x	5.0x	0.4x	0.3x
Mean								**10.2%**	**4.9x**	**6.3x**	**4.8x**	**0.4x**	**2.8x**
Median								**12.1%**	**4.8x**	**6.6x**	**5.0x**	**0.4x**	**2.8x**
Transportation & Logistics			(%)	($mm)	($mm)	($mm)	($mm)	(%)	(x)	(x)	(x)	(x)	(x)
ENTREC Corporation	TSX:ENT	$ 0.10	-	11	268	179	19	10.5%	14.2x	10.1x	7.7x	0.5x	9.2x
Gibson Energy Inc.	TSX:GEI	$ 22.75	5.8%	3,307	4,638	7,121	436	6.1%	10.6x	11.0x	10.9x	4.3x	3.1x
Mullen Group Ltd.	TSX:MTL	$ 8.73	6.9%	915	1,449	1,297	194	15.0%	7.5x	7.1x	6.8x	1.0x	2.7x
Mean								**10.5%**	**10.8x**	**9.4x**	**8.5x**	**1.9x**	**5.0x**
Median								**10.5%**	**10.6x**	**10.1x**	**7.7x**	**1.0x**	**3.1x**
Environmental & Geophysical			(%)	($mm)	($mm)	($mm)	($mm)	(%)	(x)	(x)	(x)	(x)	(x)
Pulse Seismic Inc.	TSX:PSD	$ 2.15	-	116	147	22	16	71.0%	9.4x	6.9x	5.9x	3.3x	1.3x
Secure Energy Services Inc.	TSX:SES	$ 5.60	4.8%	885	1,393	3,094	170	5.5%	8.2x	6.5x	6.0x	1.1x	2.4x
Tervita Corporation	TSX:TEV	$ 7.50	-	874	1,690	2,165	217	10.0%	7.8x	7.4x	6.8x	2.4x	3.6x
Vertex Resource Group Ltd.	TSXV:VTX	$ 0.34	-	32	141	172	22	12.6%	6.5x	5.3x	4.7x	0.5x	4.1x
Mean								**24.8%**	**8.0x**	**6.5x**	**5.8x**	**1.8x**	**2.8x**
Median								**11.3%**	**8.0x**	**6.7x**	**5.9x**	**1.8x**	**3.0x**
Camps & Catering			(%)	($mm)	($mm)	($mm)	($mm)	(%)	(x)	(x)	(x)	(x)	(x)
Black Diamond Group Limited	TSX:BDI	$ 1.79	-	99	218	175	25	14.4%	8.6x	5.3x	4.8x	0.5x	3.0x