



Second Quarter Update

June 20, 2018





Welcome



Trevor Hammond

Partner, Audit



Agenda

- **Politics, markets and the 2018 geopolitical landscape, presented by Divya Reddy, Eurasia Group**
- **Financial reporting update**
- **Tax hot topics**



Geopolitics and Global Energy Markets: Canadian Competitiveness Outlook

Divya Reddy
Practice Head, Global Energy & Natural Resources

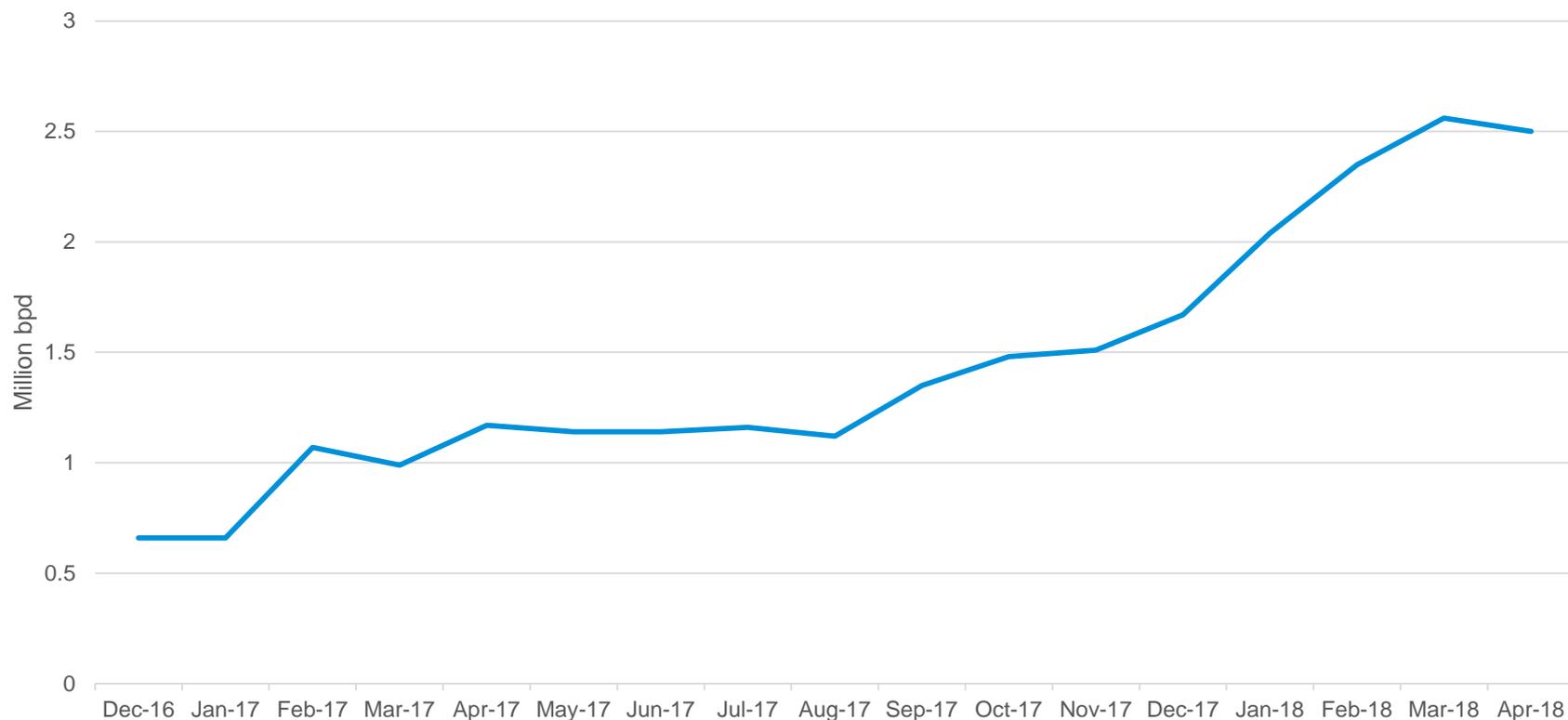




Geopolitics and oil markets

Geopolitical tensions likely to increase throughout 2018, but non-OPEC growth (mostly US shale) will be problematic for OPEC

Forecasts of non-OPEC 2018 production growth



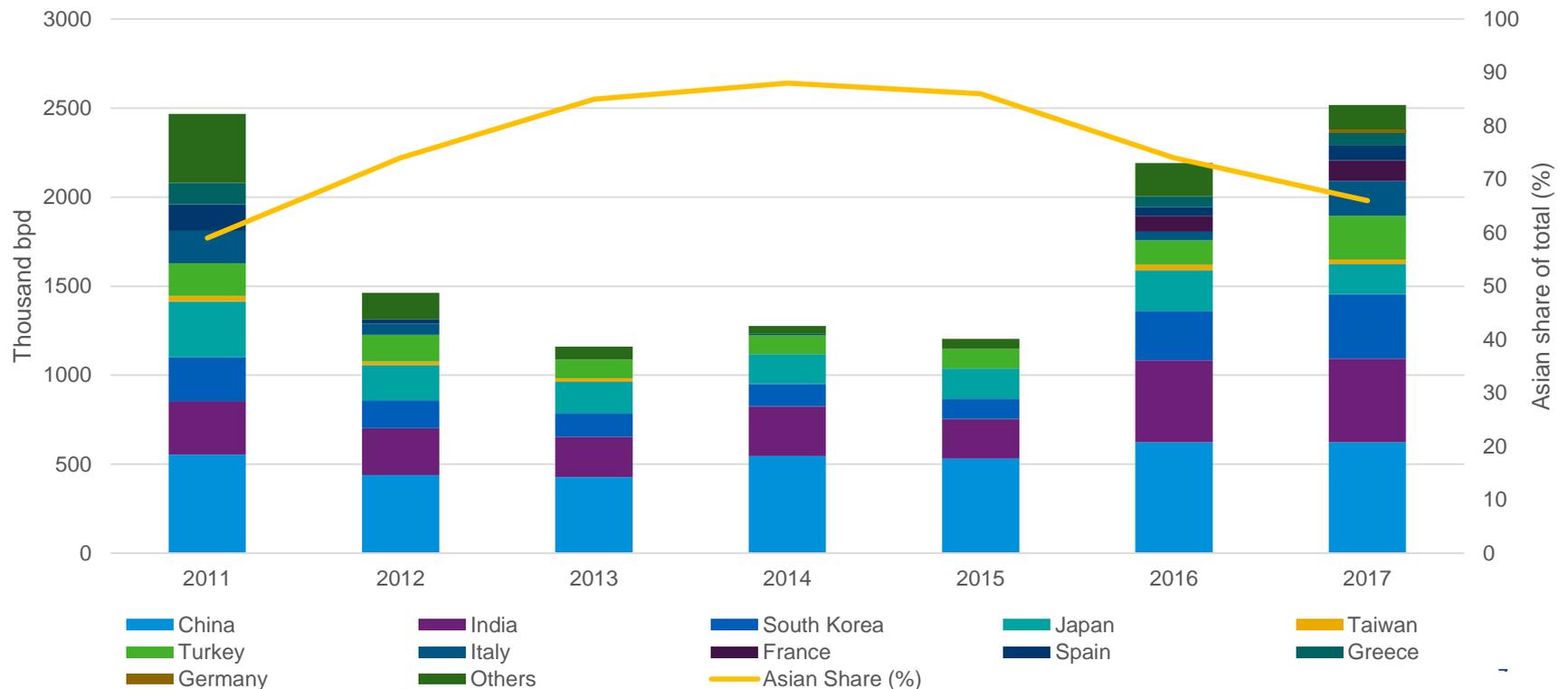
Source: Bloomberg, Energy Information Administration

Risk has increased with US withdrawal from Iran nuclear deal

Odds of renegotiation are low (20%): Iran will generally react with restraint, but proxy wars will flare up in the region and US relations with Germany and France will suffer

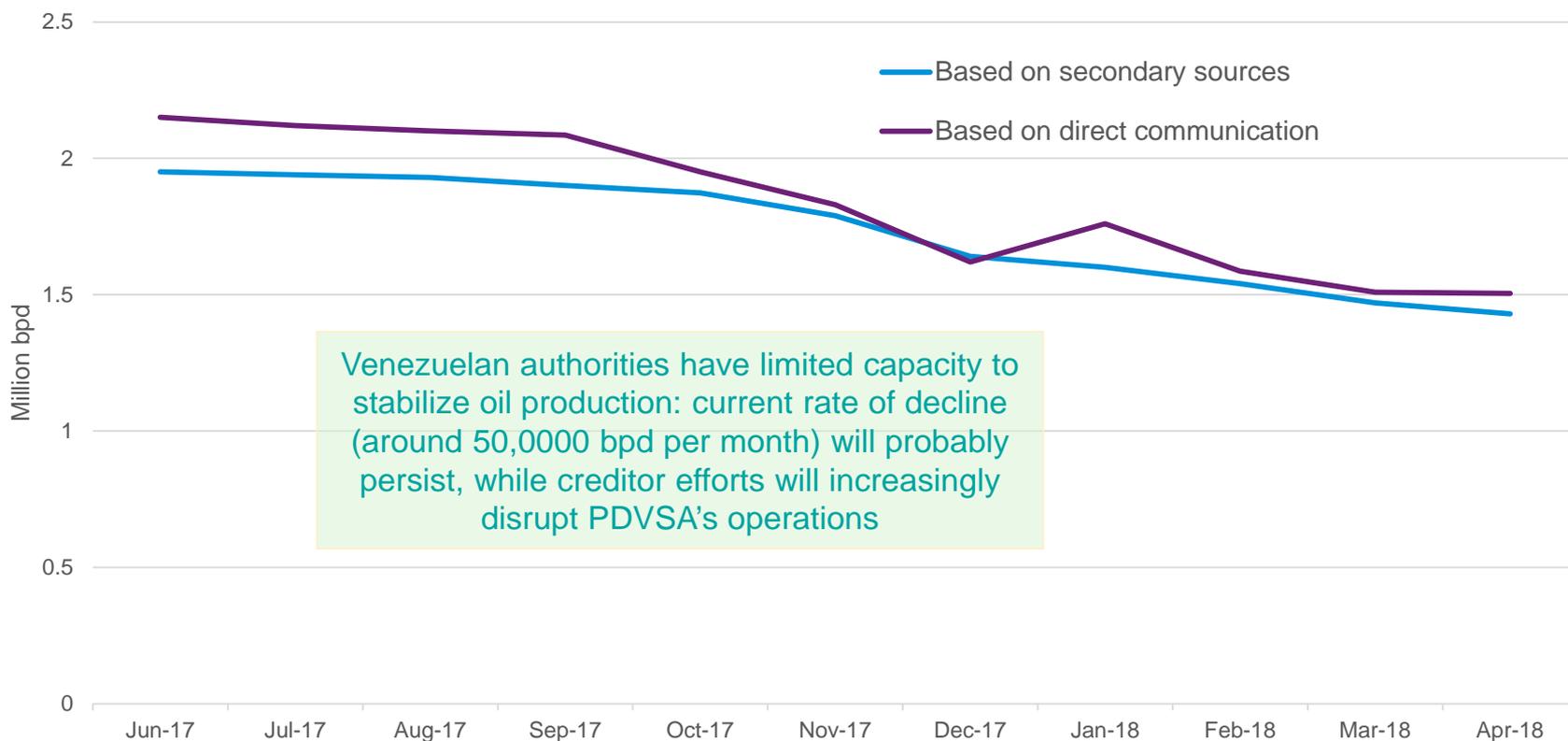
Iranian volume losses likely around 300,000-500,000 bpd in next 6 months as buyers such as China, India and possibly Turkey continue to purchase Iranian crude

Iranian crude and condensate exports



More sanctions likely from the Trump administration, though oil import ban pushed off as concerns about domestic gasoline prices rise

Venezuelan oil production



Venezuelan authorities have limited capacity to stabilize oil production: current rate of decline (around 50,000 bpd per month) will probably persist, while creditor efforts will increasingly disrupt PDVSA's operations

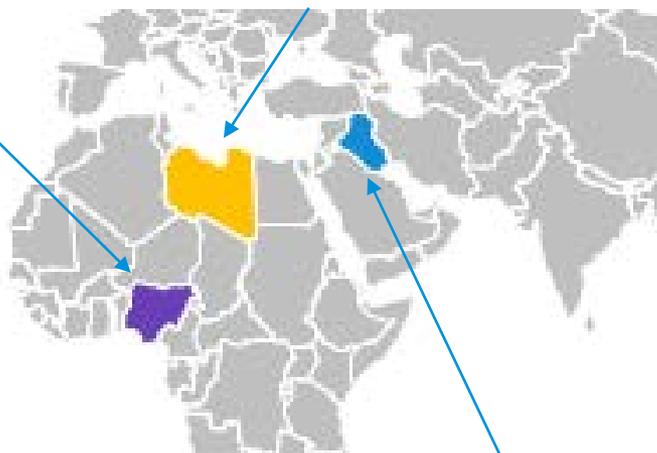
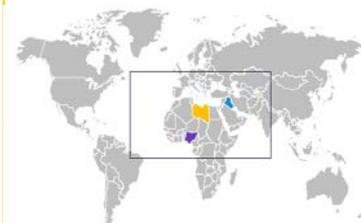
Geopolitical risk premium is back in oil markets, but impact varies

Nigeria: Oil production likely to remain stable

- President Muhammadu Buhari is the favorite to win next year's election, but there remain risks from his weaknesses
- Should he win reelection (our basecase), his administration would continue to prioritize conciliation efforts with the most sophisticated militant groups, likely helping to avert a significant attack that disrupts oil production

Libya: Improved political situation will help stabilize Libyan production

- Current levels of 1 million bpd likely to be maintained in short-term
- Violence and terrorist attacks, especially around vital oil ports and oilfields, will remain key risks over short and medium-terms



Iraq: election puts Kurds in a better position to negotiate an oil deal

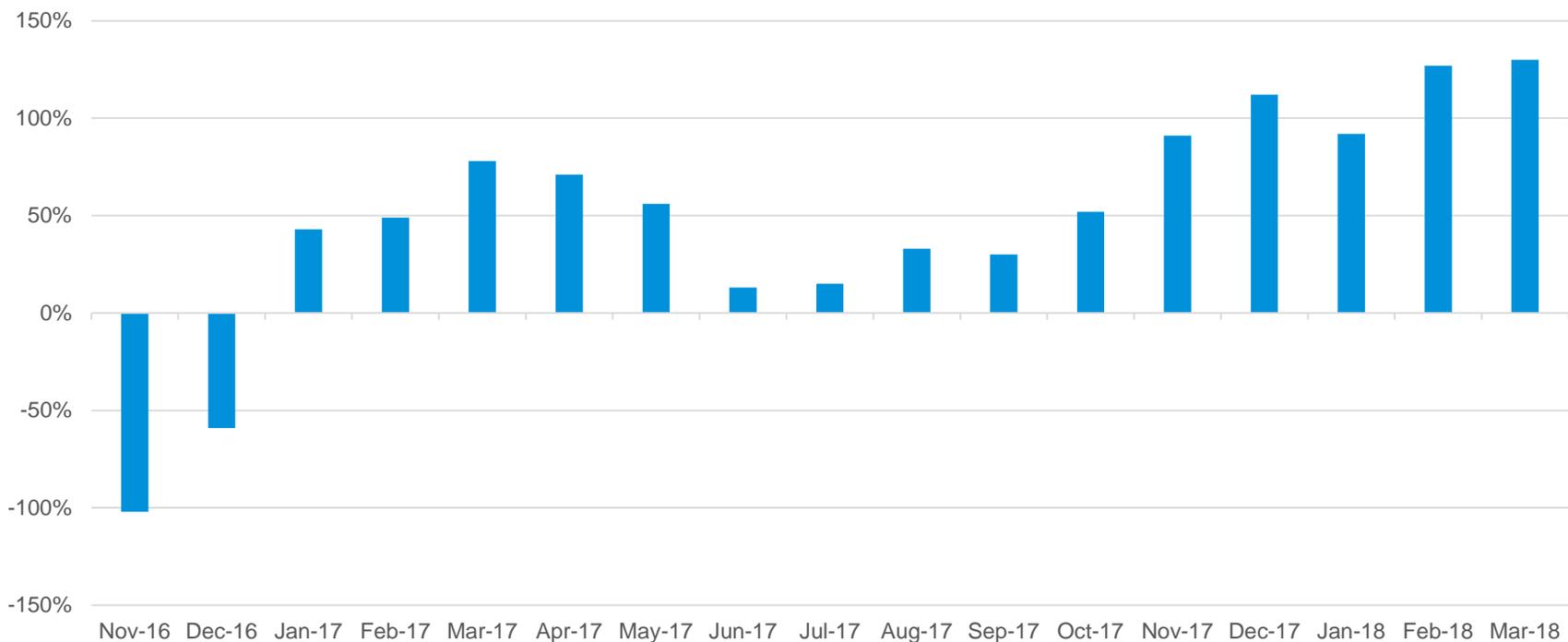
- Exact structure of a new Baghdad-Irbil oil agreement will not emerge immediately, though the process will most likely involve a reset in relations with the central government
- Infrastructure limitations will put a lid on short-term production growth

OPEC+ supply cuts will not immediately unwind

Most likely outcome is an unspecified commitment to maintain market stability in the face of unforeseen outages

Russia, the Saudis, and other GCC members would likely expand their output outside of the official agreement should prices trend uncomfortably high based on outages from Iran and Venezuela

Total OPEC compliance

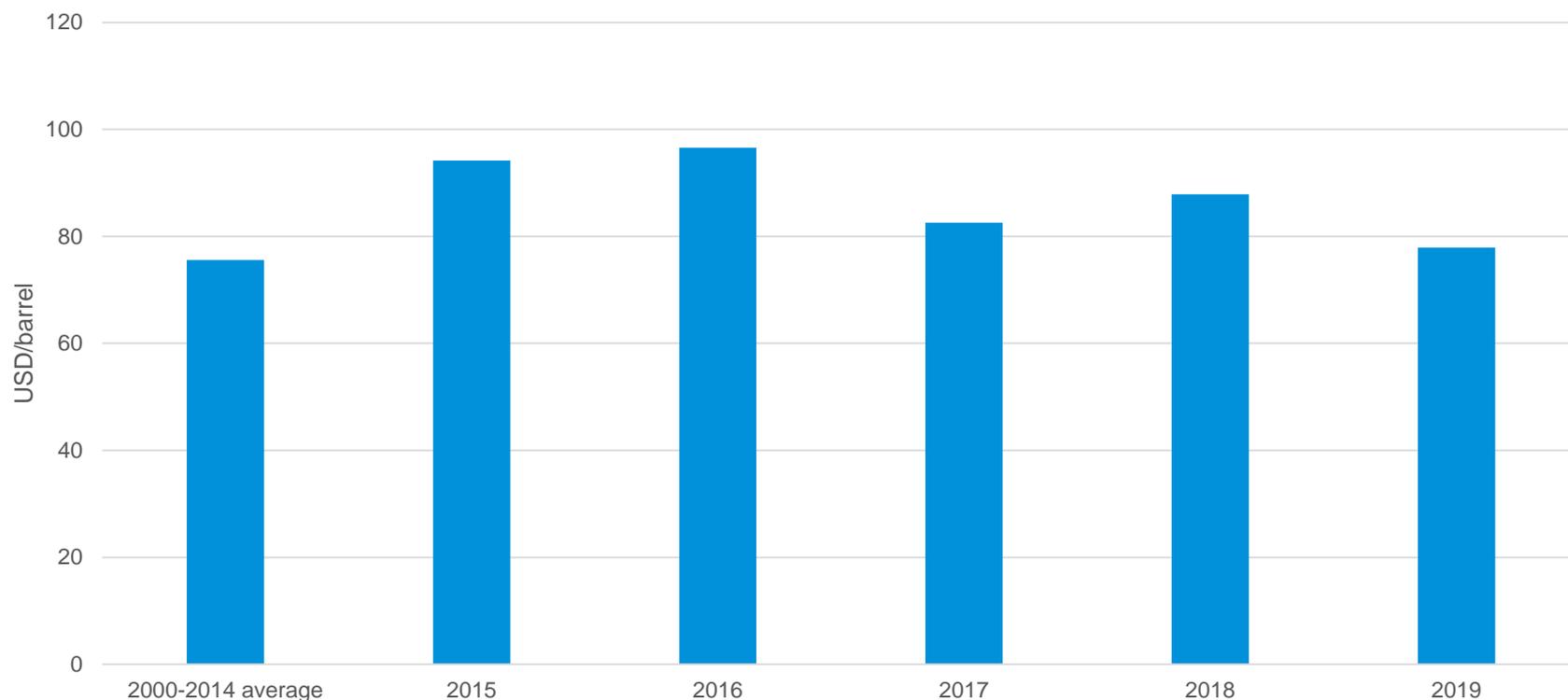


Source: Bloomberg, OPEC

Mohammed bin Salman's position has improved, and he remains a strong king in waiting despite division within the ruling family over policy direction

Aramco IPO in 2019 is still the plan, probably local listing at first

Saudi Arabia's fiscal breakeven oil price



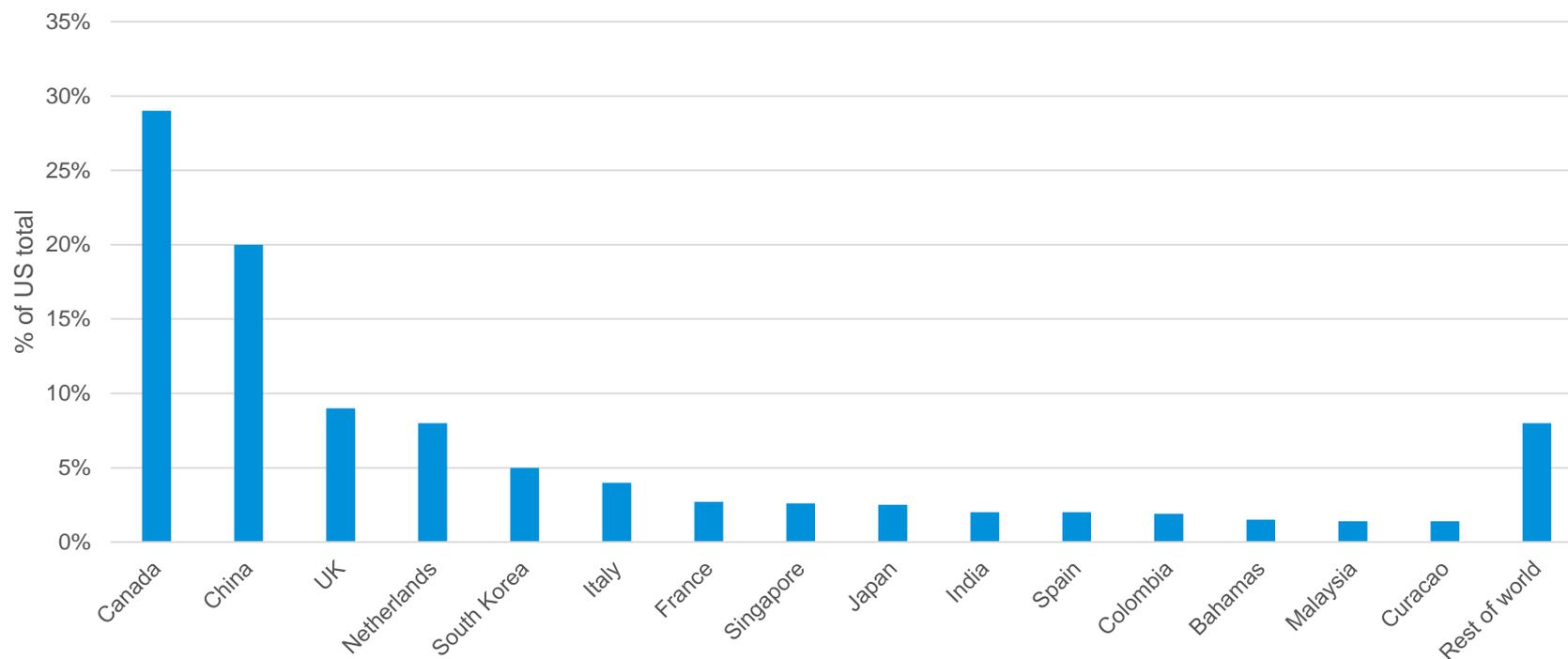
Source: IMF

Infrastructure constraints will put a lid on near-term growth

Projects currently under construction or planned are likely to ensure that the headwind to output and export growth is modest, though capital discipline is also likely to keep a lid on the scope of upside for US shale growth this year

US export capacity suggests room to grow an additional 1 million bpd beyond the nearly 2.6 million bpd exported in May

US crude exports by destination (2017)

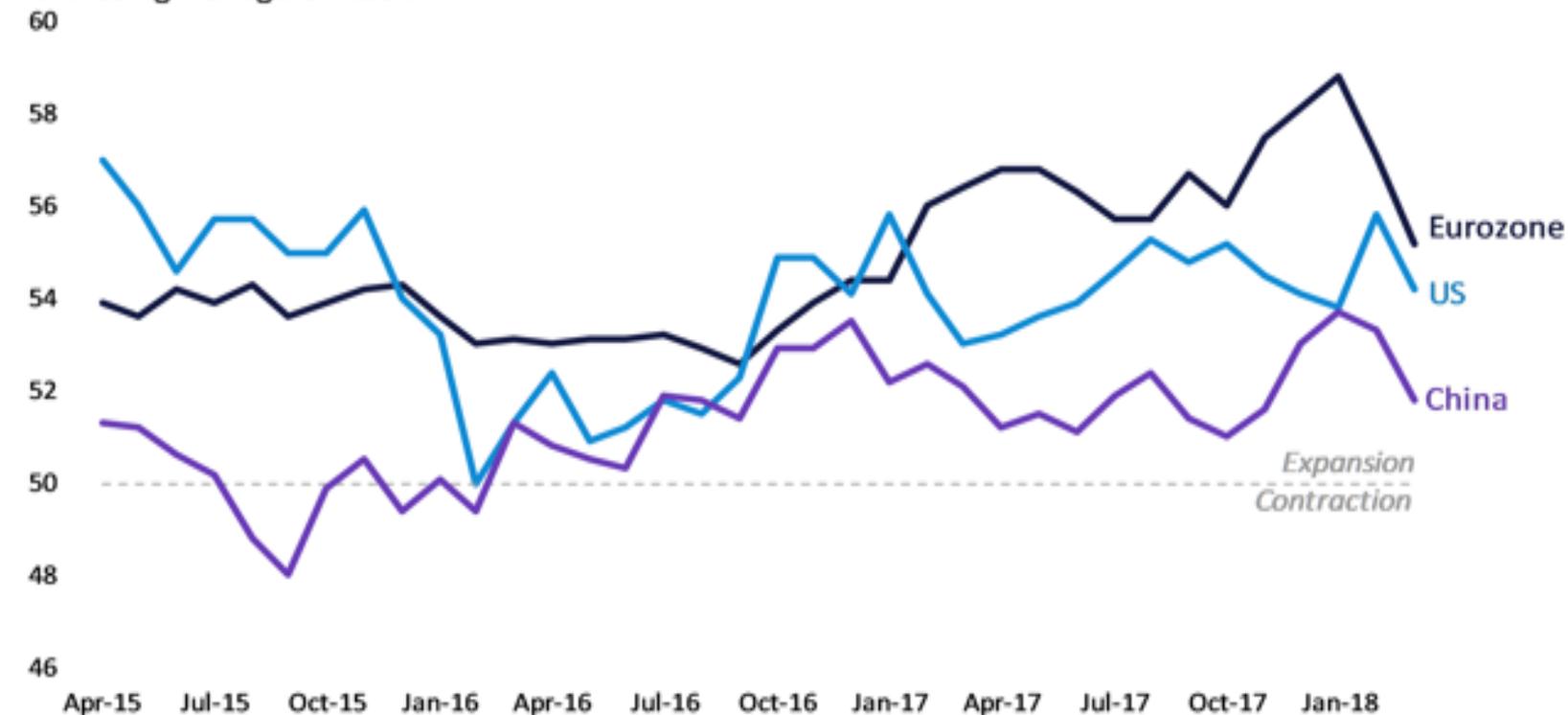


An all-out trade war would dampen global economic growth and trade flows, with negative consequences for oil demand

US tariff decisions set stage for retaliatory measures, creating challenges and uncertainties for the energy sector and broader trade tensions

Rising trade tensions put global growth momentum at risk

Purchasing managers' index



Source: Bloomberg

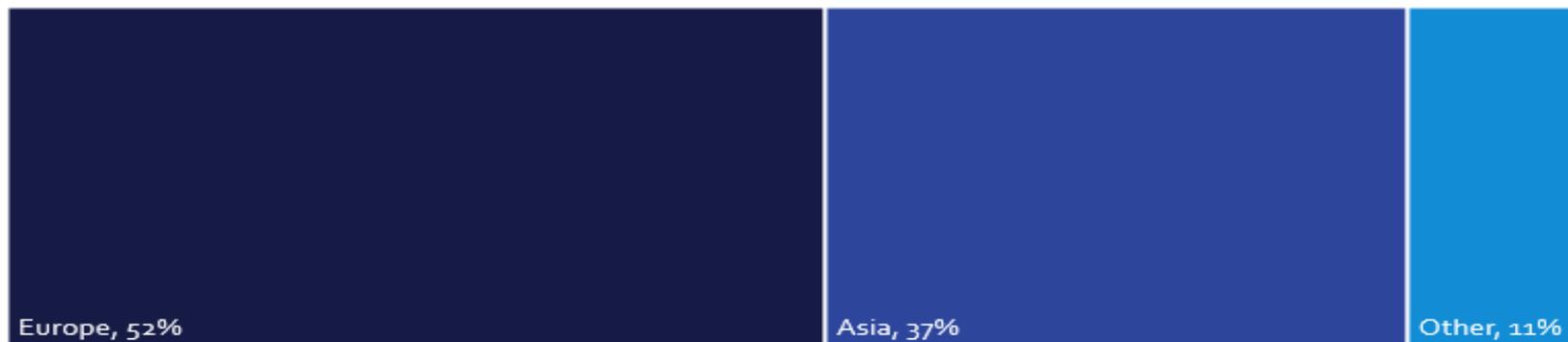


Global LNG markets



Asian demand will drive need for new LNG export projects

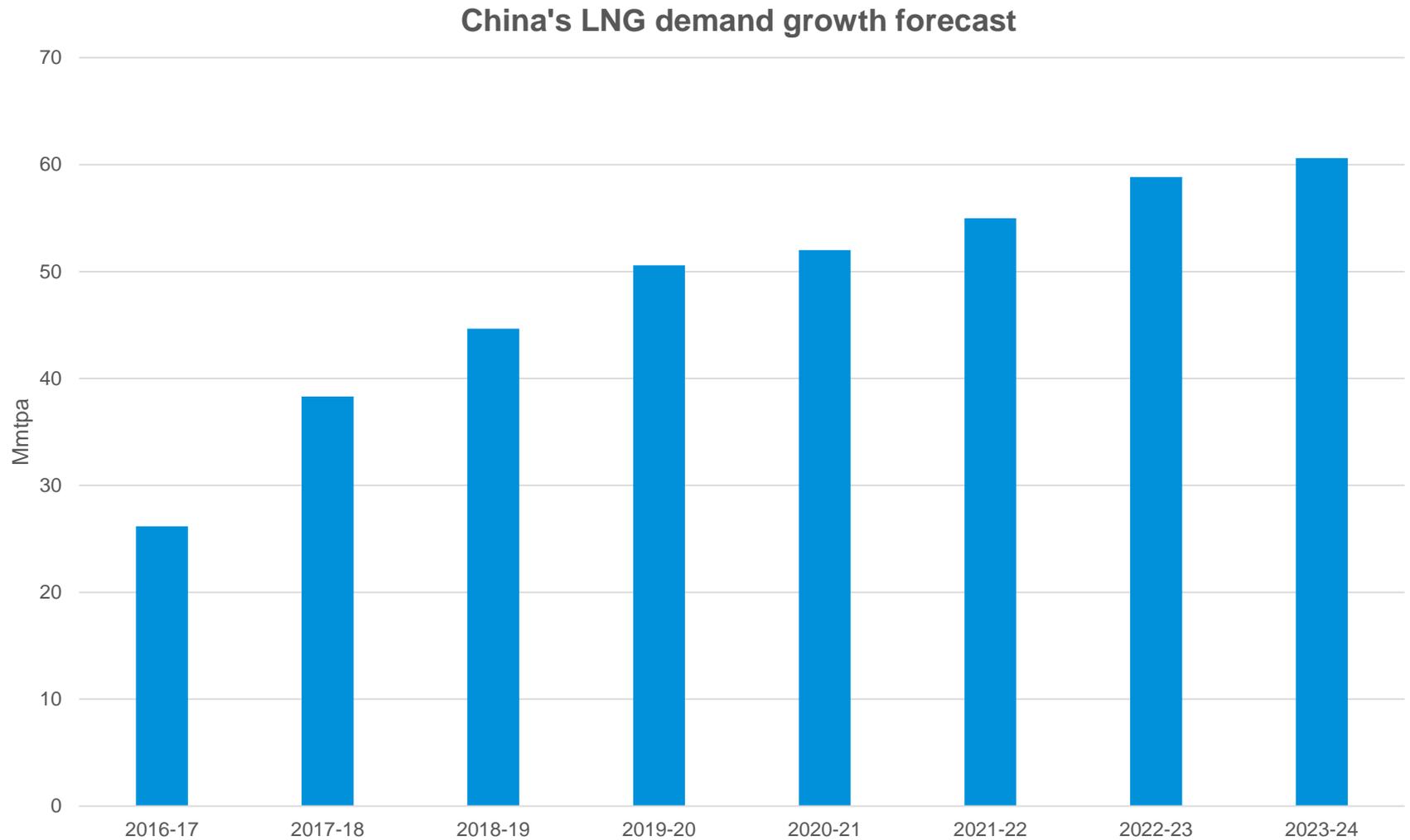
Gas importers in 2016



Gas importers in 2040



Global LNG supply picture is clear over the next five years, so policy-driven demand is the key story



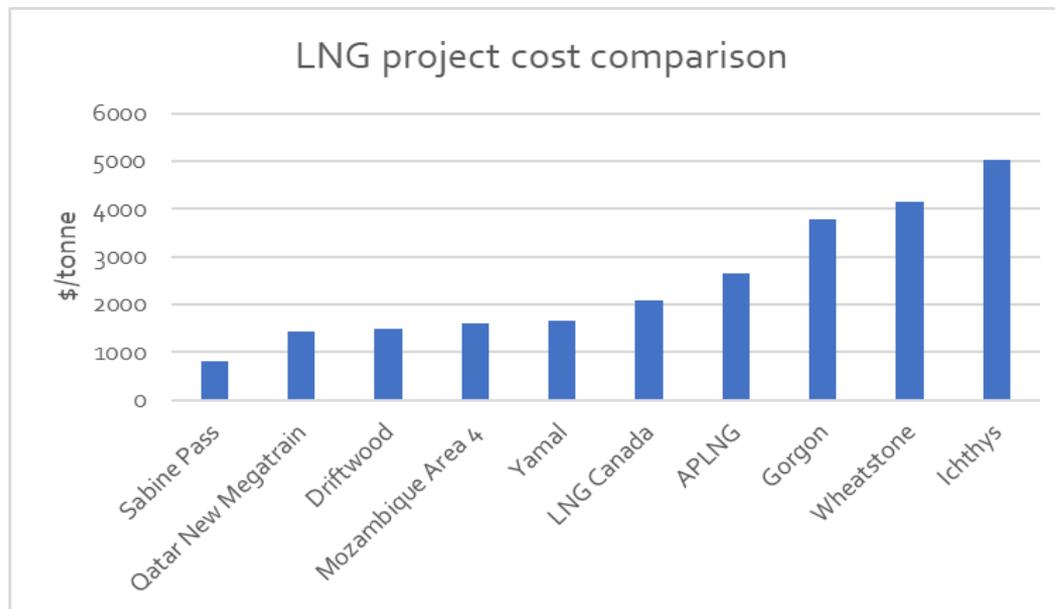
Source: Bloomberg

Stiff competition for new projects

As Asian demand surprises on the upside, companies are again considering investments in new LNG export projects to meet future demand growth

Competitiveness across jurisdictions angling for new investment will vary, in part based on policy and regulatory environments; Qatar is best-placed to capture new market share into the 2020s

Frontier markets such as Mozambique and Papua New Guinea also look promising, while Russia may struggle to attract foreign investment in the near term; the North American competitiveness landscape has partially shifted away from the US, because of new steel import tariffs, in favor of Canada, which is lowering fiscal burdens





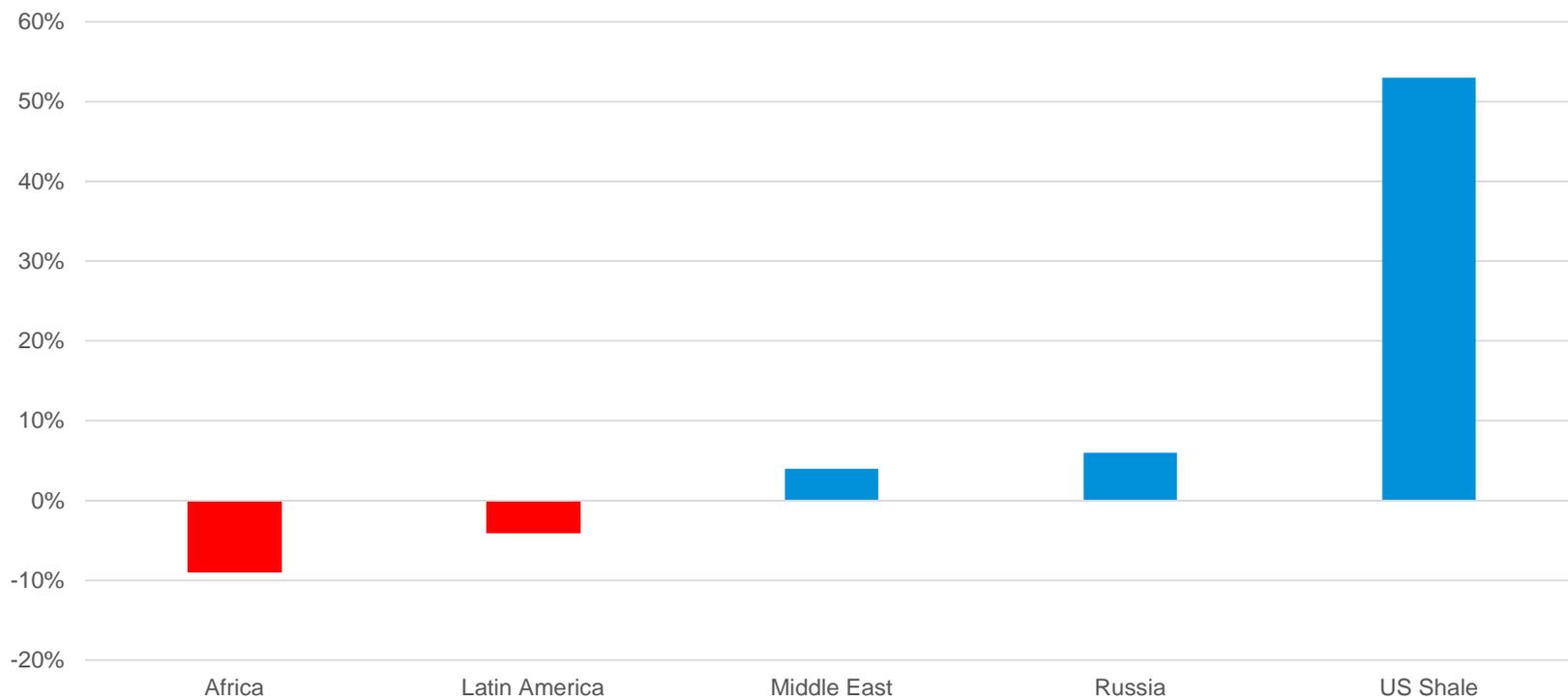
Canadian competitiveness
in the current geopolitical environment

Canadian competitiveness: upstream spending is coming back globally, will there be FIDs in Canada?

Upstream capital investment driven by structural shifts in global reserve picture and concerns about the demand outlook

Investment is targeting resource plays with moderate to low below-ground risk combined with moderate to low political risk

Upstream oil and gas investment (2017 vs. 2016)



Mexican election:

- A Lopez Obrador presidential victory in Mexico on 1 July would lead to a strong chilling effect on investment and on oil supply growth post-2020, even if the current contracts are not cancelled outright
- Lopez Obrador would be limited in his ability to completely reverse the energy reform given that it is unlikely that the Morena party will control a majority of congress---but that doesn't mean he isn't going to try

Brazilian election:

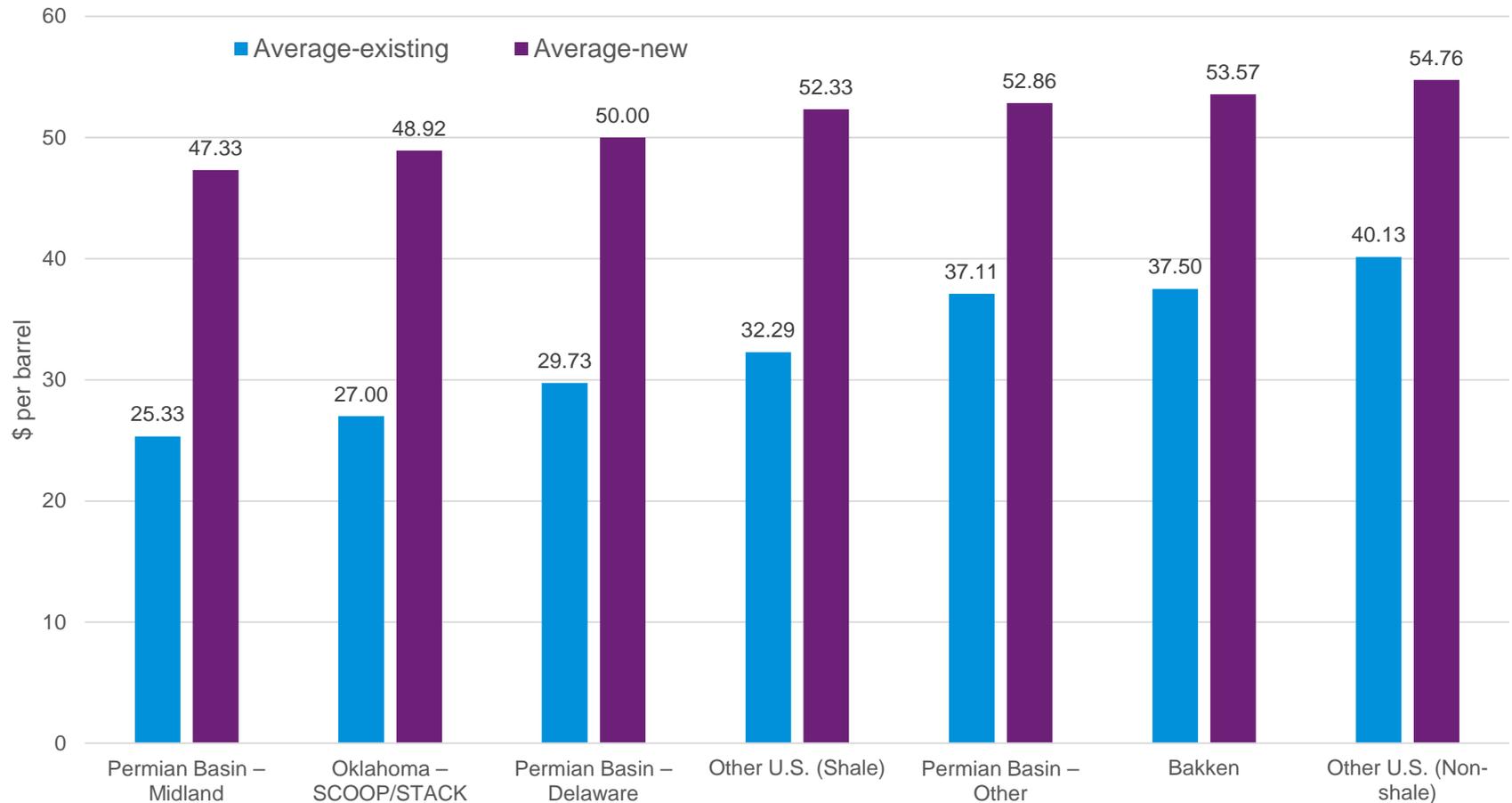
- Upcoming election is unlikely to undermine constructive outlook for the sector—but it is still generating uncertainty for investors
- The possible election of leftist Ciro Gomez would bode poorly for the sector as he has promised to rescind all contracts with IOC's in the pre-salt—it is unlikely that he carry out those threats, but an auction under current rules for the excess reserves would be unlikely in his administration (in year one)

Venezuelan crisis:

- An oil import ban against Venezuela is now less likely in the near term: options that remain on the table include a ban on the sale of diluents and lighter crudes to PDVSA
- If milder actions do not prompt a shift in behavior by Maduro, the Trump administration will probably end up escalating to a full import ban, though over a longer timeframe (likely post-November)
- Authorities have limited capacity to stabilize oil production, so the current rate of decline (around 50,000 bpd per month) will probably persist, while creditor efforts will increasingly disrupt PDVSA's operations

Developments weighing on Canadian competitiveness:
Short-cycle competition/US shale

Average WTI price needed to cover operating expenses for existing wells and to profitably drill a new well



Source: Federal Reserve Bank of Dallas

Developments weighing on Canadian competitiveness: NAFTA renegotiations: revised deal unlikely in 2018

Base case

Following the US announcement of steel and aluminum tariffs, a NAFTA deal by July is unlikely (the probability has been reduced from 65% to 10%); while talks will continue, a successful renegotiation seems improbable this year (30%)

Risks

- There is a window for finalizing an agreement in 2019, but this also seems challenging; the risk of full US withdrawal from NAFTA remains low but would increase because the various parties might be less collaborative
- A failure to renegotiate the treaty would leave the survival of the current NAFTA agreement as the most likely outcome
- Talks will likely extend well into and potentially beyond 2019 under a new US Congress and if leftist leader Andres Manuel Lopez Obrador wins the election in Mexico

Progress of NAFTA talks

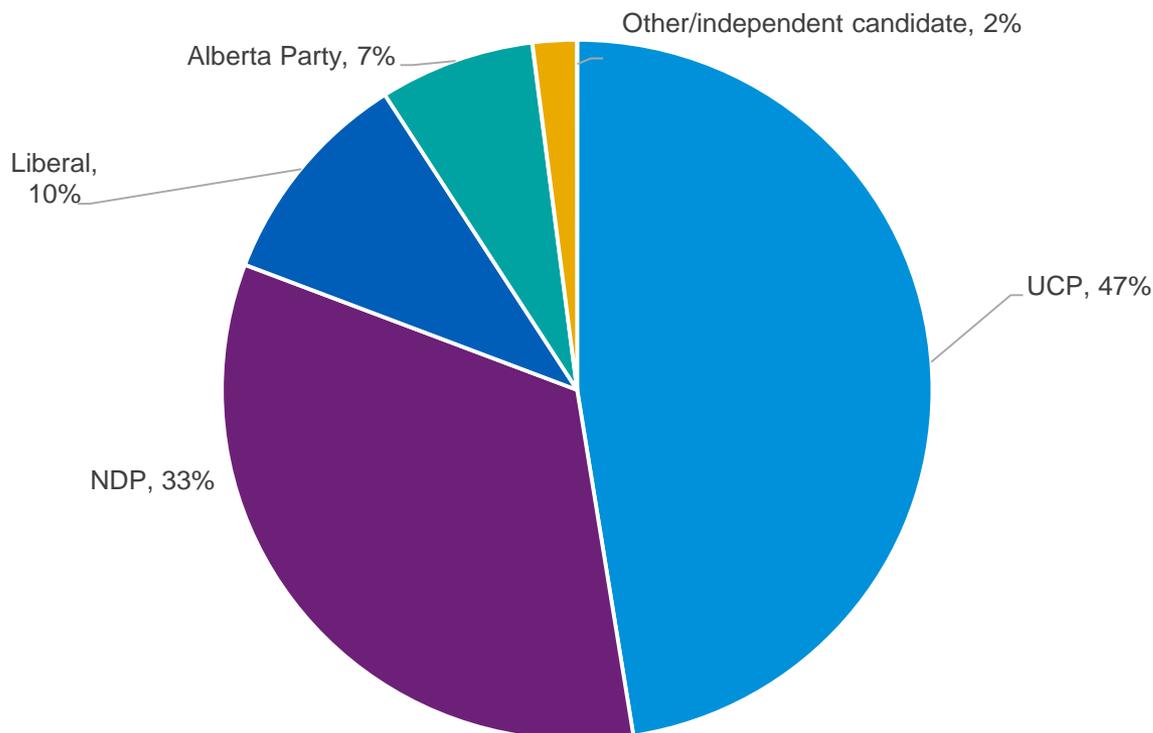
Completed	SMEs
	Competition policy
	Anticorruption policies
	Transparency
	Best regulatory practices
	Sanitary and phytosanitary measures
	Sectoral annexes (energy efficiency, information technologies, chemical substances, food safety)
In progress	Digital trade
	Trade facilitation
	IP rights
	Gender standards
	Labor standards
	Environmental standards
Red lines	Energy and telecommunications annex
	Auto rules of origin
	Seasonal restrictions
	Sunset clause
	Dispute settlement
	Government procurement
Canadian supply management	

Source: Eurasia Group analysis

Developments weighing on Canadian competitiveness:
Uncertainty about future of carbon pricing/provincial tensions

Elections in 2018 and 2019 will be important signposts for trajectory of carbon policy in Canada—investors don't like the uncertainty

If the Alberta provincial election were held tomorrow, which party would you vote for?*



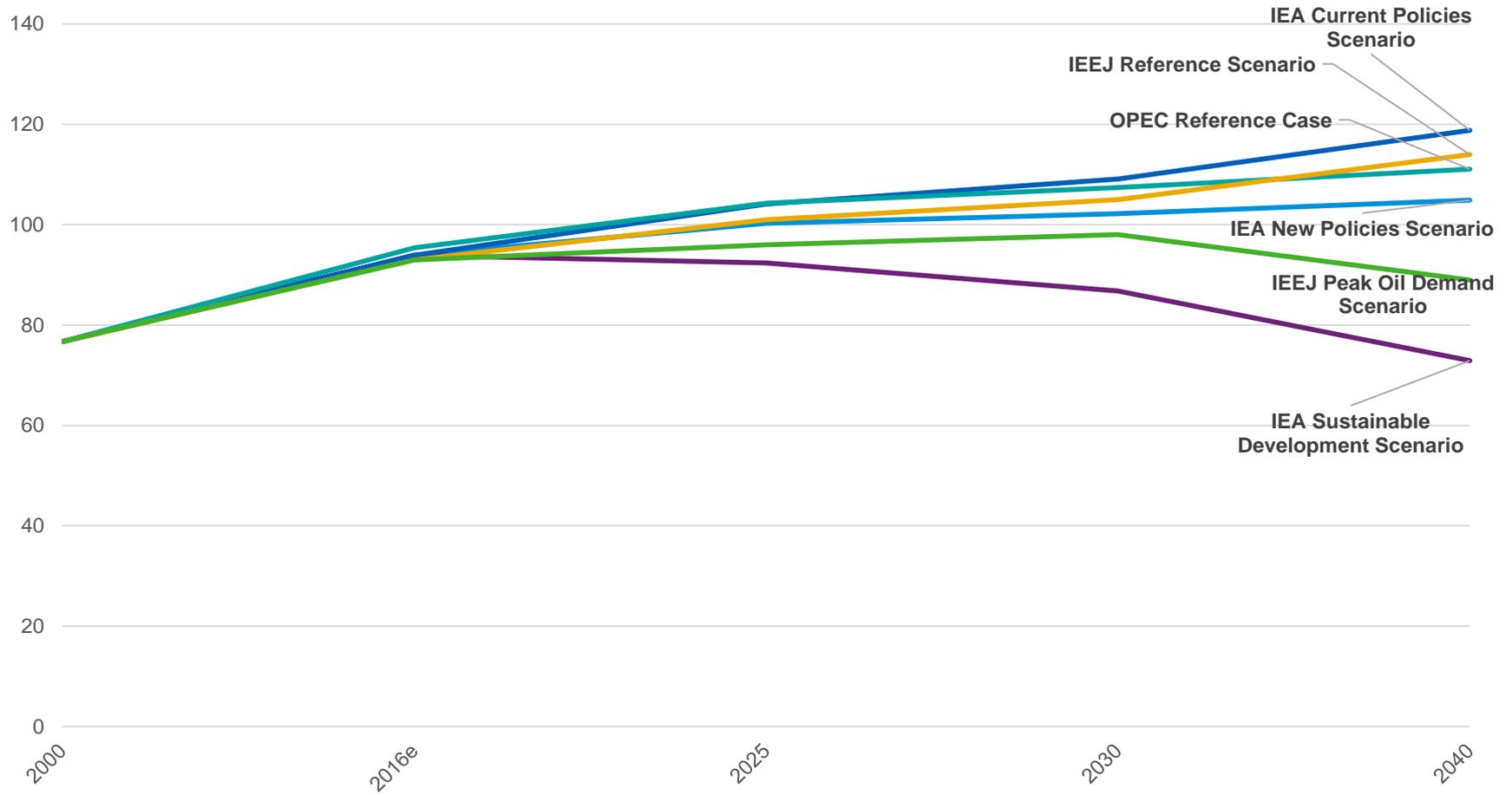
Source: Insights West

*Poll conducted among decided voters in November 2017



Developments weighing on Canadian competitiveness:
Peak demand is complicating investment outlook for long-cycle upstream projects- including the oil sands

Varying long-term oil demand forecasts



Source: International Energy Agency, the Institute for Energy Economics, OPEC



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Q2 financial reporting reminders



Sharlene Wilson

Partner, Audit

Q2 financial reporting reminders

- Impairment considerations

- No long-term changes to long-term external economic environment
- Consider internal factors

- Borrowing arrangements under IFRS 9

- Consider debt modification as a result of annual renewal
- IFRS 9 debt modification accounting differs from IAS 39
- Modifications that are not substantive may have P+L impact

Q2 financial reporting reminders

- F/S disclosures for IFRS 9 / 15 (adopted in Q1, 2018)
 - Is it appropriate to cross-reference to Q1, 2018 F/S?
 - Consider all material changes or impacts that should be disclosed (IAS 34.16(A)(a))
- F/S disclosure for IFRS 16 (Jan 1, 2019)
 - Project status, expected impact of adoption
- IFRS 16
 - Scoping – comprehensive; documented; consideration of embedded leases
 - Clarity on transition:
 - “grandfathering” of IFRIC 4 conclusion
 - Low dollar exemption



Tax hot topics



Adrian Adams

Senior Manager, Tax

Tax hot topics

- Multilateral Instrument (“MLI”) – a background
 - Part of the OECD’s BEPS initiative
 - Provides a single instrument without needing to renegotiate individual treaties between countries
 - Minimum standards must be adopted on provisions for treaty abuse and dispute resolution
 - Optional standards may be adopted on provisions for items such as hybrid mismatches and artificial avoidance of permanent establishments
 - Operates in tandem with existing tax treaties and only applies to provisions and treaties that are ‘matched’ with that of another country

Tax hot topics

- Multilateral Instrument (“MLI”) – a timeline
 - June 7, 2017 – first signing ceremony was held resulting in 67 signatories (indicating intent to adopt) including Canada
 - At this time Canada committed only to adopt the minimum standards of the MLI
 - March 22, 2018 – Slovenia became the fifth country (alongside Austria, Isle of Man, Jersey, and Poland) to deposit its ratification instruments, allowing the MLI enter force effective July 1, 2018
 - May 28, 2018 – Canada’s department of finance (“Finance”) indicated Canada will be adopting additional provisions of the MLI

Tax hot topics

- Multilateral Instrument (“MLI”) – the minimum standards
 - Principal Purpose Test (“PPT”)
 - Treaty benefits are not granted “if it is reasonable to conclude...that obtaining that benefit was one of the principal purposes of any arrangement or transaction”
 - Dispute resolution
 - Canada has agreed to mandatory binding arbitration clauses to satisfy the requirement for standards on dispute resolution

Tax hot topics

- Multilateral Instrument (“MLI”) – the new standards
 - Dividend transfer transactions
 - 365 day holding requirement to obtain lower withholding tax rate on dividends paid to shareholders with a significant interest
 - Capital gains from alienation of certain shares or interests of entities
 - 365 day valuation period (look-back rule) will apply to the disposition of shares or other interests deriving their value from Canadian immovable property
 - Dual-resident entities
 - Where a person other than an individual is resident of more than one contracting jurisdiction the residency will be determined by mutual agreement of the competent authorities
 - Application of methods for elimination of double taxation
 - Will allow certain taxpayers to move to a foreign tax credit system



Questions?



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Thank you



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