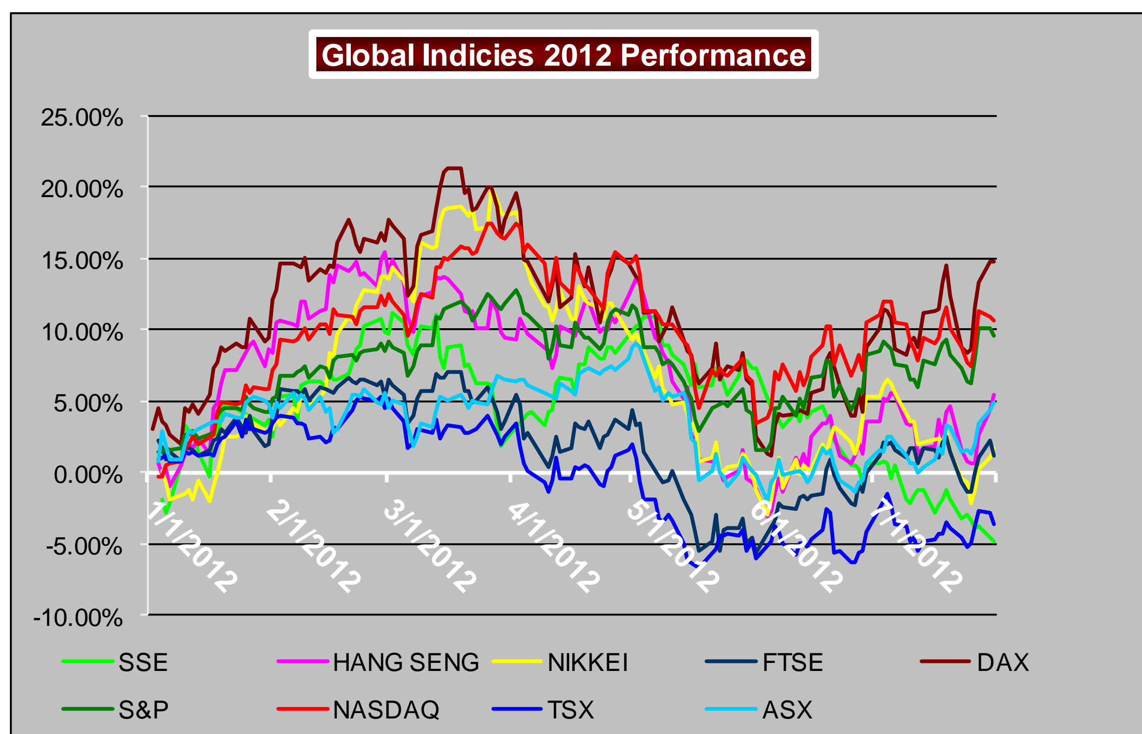
# GDB August 2012 Newsletter

## Monthly Market Summary:

| 2012 July Market Activity | | |
|---|---|---|
| SSE COMPOSITE | ***2,103.63*** | -130.69 (-5.85%) |
| HANG SENG | ***19,796.81*** | +355.35 (+1.83%) |
| NIKKEI 225 | ***8,695.06*** | -408.73 (-4.49%) |
| FTSE 100 | ***5,635.30*** | +64.20 (+1.15%) |
| DAX | ***6,772.26*** | +366.87 (+5.73%) |
| DOW | ***13,008.68*** | +128.97 (+1.00%) |
| S&P 500 | ***1,379.32*** | +16.99 (+1.25%) |
| NASDAQ COMPOSITE | ***2,939.52*** | +1.11 (+0.04%) |
| ASX 200 | ***4,269.20*** | +174.60 (+4.26) |
| TSX COMPOSITE | ***11,664.71*** | -63.29 (-0.54%) |
| TSX VENTURE | ***1,183.08*** | -23.70 (-1.96%) |



## Investment Themes:

On July 29, China's large state-owned oil giant China National Offshore Oil Corp (CNOOC) agreed to purchase Nexen, the sixth largest Canadian oil and gas producer for $15.1 billion. This is China's largest overseas acquisition after its failed attempt to acquire Unocal in 2005, where the deal was defeated by political resistance and adverse public opinion in the US.

Learning from the bitter lessons of Unocal, CNOOC has meticulously tailored the Nexen deal to satisfy the Canadian regulators. Under the current environment, the Canada Investment Act requires any foreign investment over $330 million to demonstrate a "net benefit" to Canada and not impede Canada's national security. To meet these standards, CNOOC has structured the deal as follow:

1. All cash offer of $27.60 per common share, a generous 61% premium over the pre-announcement closing price;

2. Retaining all current management team and employees and obtaining unanimous support from the Nexen's board;

3. Continuing capital investments on Nexen's assets;

4. Listing CNOOC Ltd's shares on the Toronto Stock Exchange;

5. Making Calgary CNOOC's headquarters for North and Central American operations

Wait a minute, listing on the Canadian exchange and making Calgary one of its offshore headquarters? Are these commitments a bit over charitable? One would think in a negotiation between China - a rising super power with deep pockets, and Canada - a country that is eager to welcome new Asian investments in order to balance the US dominance on its oil exports; China would have a slight upper hand in bargaining power. But the deep concessions China is making are signs that China is more eager in this transaction to have Nexen than Canada wants to sell it.  Are the Chinese that anxious to make in roads in Canada to secure its energy needs?  After all, Canada in terms of proximity, economics and "political friendliness" is still not as attractive as say Africa or South America (although arguably some of Nexen's assets are located in offshore Africa and Colombia). Politically, in the

extreme remote scenario of a potential conflict between China and US, will Canada defy the diplomatic pressure from the US and keep the oil flowing to China. So why is the Chinese firm putting such large amount of chips in Nexen?

Let's look at some of the recent M&A made by Chinese state owned oil companies in North America. In 2011, China spent approximately USD 18 billion buying up oil and gas companies, nearly one third (USD 5 billion) was invested in Canada. Among them, in October 2011, Sionpec acquired Daylight Energy for USD 2.2 billion; in 2012, PetroChina bought 20% stake in a Royal Dutch Shell's Canadian shale gas project; in 2011, PetroChina attempted to ink a investment deal with Encana for USD 5.4 billion, which did not ultimately consummate due to disagreements on terms. On the other side of the boarder, CNOOC has shown particular interest in Chesapeake energy, investing USD 3.43 billion since October 2011 in two separate deals. The common thread among these deals? - **Shale gas.**

Without a pipeline to the Pacific here in Canada, and the direct transport to China still uneconomical, we can safely assume China is not counting on the proportion of Canadian gas import to surge. What China really wants is the quest for shale gas technology. China is willing to pay up big to acquire the core technology and know-how on how to extract the massive shale gas reserves under its own feet, a massive 134 trillion cubic meters of it. Shale gas will be a game changer for China in its ascend to global dominance and put it on a leveling playing field with the US. Energy independence is the name of the game to achieve super power status. China, being late to the party is struggling to scramble together conventional energy resources; while US and the western nations have already got a firm grip on global oil reserves. So China, in order to be self-reliant on energy, must find an alternate energy source, and the answer lies in the abundance of shale gas reserves within its own boarders.

The shift to shale gas could be a seismic change for the energy industry both domestically and internationally. In China, Ministry of Land Resources (MLR), the National Development and Reform Commission (NDRC), Ministry of Finance (MoF), and National Energy Administration (NEA) have set an annual shale gas production target of 6.5 billion cubic meters by 2015. The current output - zero. Scores of energy firms, small companies, and regional governments are applying for shale gas drilling and exploration rights. MLR has been

accepting applications for the second round of the nation's shale gas rights auction since May 17, and so far, 75 applications have been submitted. This compares to the six companies - PetroChina, Sinopec, CNOOC, China CBM, Henan Provincial and the Shaanxi Province government's Shaanxi Yanchang Petroleum that were invited to bid in the first round for shale gas blocks back in 2011. Many of these firms have limited or no experience in shale gas drilling. Hence, they are forced to make aggressive strategic moves to acquire the core competencies from industry leaders in the US and Canada that possess the expertise and management policies.

Unfortunately there are many intertwined interests that will oppose China's ambitious move to shale gas. Economically and politically, there are many stakeholders that will have much to lose if China were to shift even a portion of its energy needs to shale gas. The global oil giants will see declining exports to China. The oil giants want to make sure they have a piece of the lucrative shale gas play by locking themselves into long-term production agreements with the Chinese; hence, one of their most crucial bargaining chip is to not to fully relinquish their knowledge and expertise so they can leverage from the dependence from the Chinese. US will also want to hinder China's efforts to become fully self-proficient in shale gas extraction. Once China becomes more self-sufficient on its energy needs, US will have less of a political strangle hold on China on the world political arena. China on the other hand, at least up to now, wants full control of its national resources and will be reluctant to grant production-sharing arrangements with other foreign entities. So far, the only domestic foreign venture awarded by the central government is the one by PetroChina and Royal Dutch Shell for the Fushun-Yongchuan block in Sichuan.

We think China's current strategy of acquiring shale technology from buying stakes or entity of large oil and gas producers alone are an expensive strategy that may encounter roadblocks due to the economic and political resistances discussed above. In addition to working with the foreign multinationals, it is essential for China Inc. to develop complementary strategies such as working with and acquiring smaller and medium sized players, and poaching key personals from the large corporations to demonstrate the availability of competing technologies to the "Big Oils". This will help force the hands of larger oil and gas producers to play at more favorable terms. For our

investors, there are and will be plenty of opportunities in the shale-gas space in Canada, we are glad to provide a list of them upon request.

## Investment Opportunities:

1. **Sino-GDB Fund**
   Fund managed by GDB Capital. Investments using hedging strategies and combinations of long/short positions in derivatives of public traded equities. Also private equity investments with a focus on mid-markets growth companies, distressed assets, M&A, and buyout opportunities. Industry focus targeted at metals and mining, oil and gas, clean energy, fertilizer and agricultural chemicals, real estate, and technology. Fund targets gross pre-tax IRR of 20% per annum, minimum investment US$500,000.

2. **Clear Hill – Iron Ore**
   The Clear Hills properties consist of ten Metallic and Industrial Mineral permits and four Mineral Leases comprising 76,652 hectares. The Clear Hills property encompasses three main project areas, Rambling Creek, Whitemud Creek and Worsley.

   Estimate on Rambling Creek portion of the Clear Hills iron deposit contained 139,777,000 tons grading 33.04% Fe classified as Indicated Mineral Resources and 62,824,000 tons grading 33.70% Fe classified as Inferred Mineral resources.

   It is noted that the Rambling Creek Iron deposit is associated with appreciable concentration of vanadium pentoxide (0.21%). Early work indicates that the vanadium may be recoverable during the DRI process.

3. **Tampoon Resources Inc – Oil**
   $50,000,000 private placement. Proceeds used for oil and gas exploration in Western Canadian Basin Oil Property Acquisition and Farm-in opportunity. Currently producing ~300bbls/d with significant reserve/deliverability (Est. 600bbls/d flush; 200bbls/d aver prod); 600,000 barrels 38-42 API/well.)

4. **Open Range – Oil**
   $10,000,000 private placement of preferred and common shares. $5,000,000 preferred shares Series B – 8% Cumulative Dividend, Voting, Redeemable December 31, 2012 priced at $1.00 per share. $5,000,000 Common Share priced at $1.50 per share. Proceeds used to increase land ownership from 11,000 acres to 70,000 net acres. Projected production is estimated at 2,000 BOPD for 2011.

Properties located in North Dakoda where large US oil companies such as Hess, and Occidental Petroleum have both recently acquired a number of smaller firms.