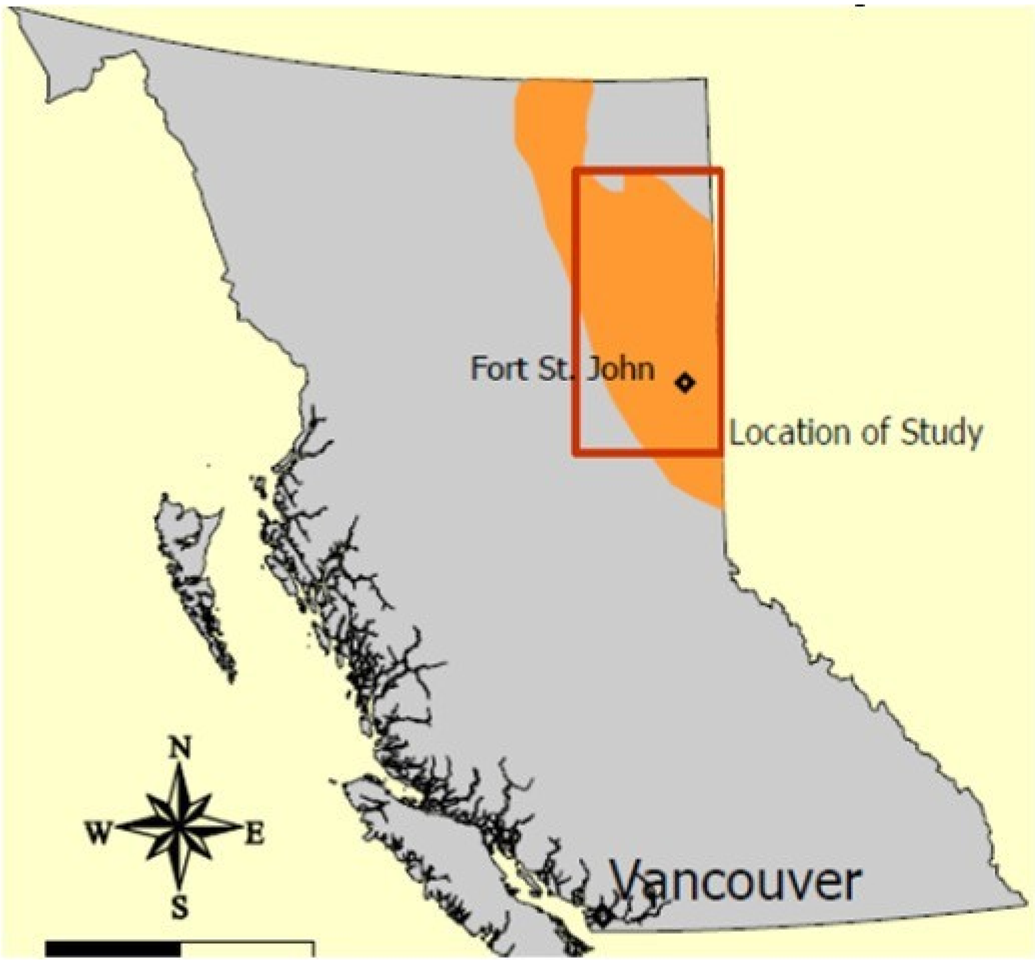
Macro Enterprises: Long Record Constructing Oil and Gas Pipelines

This article by Michael Melby is excerpted from a letter of Gate City Capital Management.

Macro Enterprises constructs oil and natural gas pipelines, provides maintenance and repair services on existing pipelines, and builds pipeline-related infrastructure. The Company's customer base includes many of the largest pipeline companies and oil and gas producers in western Canada. Macro Enterprises is headquartered in Fort St. John, British Columbia which is strategically located within the natural gas-rich Montney Formation and between the oil sands of Alberta and the port cities of western British Columbia. The Company has 46 full-time employees and supplements its workforce with subcontractors and hourly unionized employees. Macro Enterprises was founded in 1994. All figures in this section are presented in Canadian dollars.

Fort St. John, British Columbia

Fort St. John and the Montney Formation



Source: GoogleMaps and British Columbia Ministry of Energy, Mines and Petroleum Resources.

Macro Enterprises is best known for constructing oil and natural gas pipelines. The Company has a 20-year track record and has completed projects for major energy companies including Talisman, Kinder Morgan, Encana, and TransCanada. Macro Enterprises has a clean safety record with 16 consecutive quarters and 3.2 million-man hours without a single lost time for injury. Macro Enterprises has also developed a strong reputation for delivering projects on-time and on-budget with a particular expertise in challenging areas such as mountainous terrain. The Company also builds other energy-related facilities including compressor stations, interconnect piping, and pumping equipment. Macro Enterprises also generates maintenance and service revenue through the Company's three Master Service Agreements. Pipelines require regular maintenance and repairs to ensure the integrity of the pipeline. Many pipeline owners enter into Master Service Agreements with companies like Macro Enterprises to provide a framework for expected service work at pre-negotiated rates. Macro Enterprises currently has Master Service Agreements with TransCanada, Enbridge and Pembina. These contracts have historically provided the Company with an annual recurring revenue base of $80-120 million.

Macro Enterprises has made the strategic decision to own its equipment and has accumulated a valuable portfolio of construction equipment and real estate. The Company's equipment base including 84 pipe-layers, 44 excavators, 30 bulldozers, 4 trenchers, 24 heavy duty trucks, and 68 trailers was recently appraised at over $80 million. This amount easily exceeds the Company's market capitalization. Macro Enterprises also has a considerable amount of owned real estate in the Fort St. John area including a recently-constructed corporate headquarters, a mechanics shop, a truck station, and a storage facility. Collectively, Macro owns 27 acres of land and five buildings likely worth over $15 million. Our team visited the Company earlier in the quarter and came away impressed with the scale and condition of the Company's assets.

The Canadian pipeline construction market underwent a sharp contraction in 2016, as many energy companies reduced spending following the decline in energy prices in 2014 and 2015. The Company's financial results suffered in 2016 as service and maintenance work was cut dramatically and project work was almost non-existent. Despite the setback in 2016, we expect the long-term outlook for Macro Enterprises and the Canadian pipeline market to remain robust. Canada exports most of its energy production, with virtually all of Canada's energy exports now destined for the United States. Historically, Canadian oil and natural gas prices have traded at a sharp discount to U.S. benchmark prices due to the additional transportation costs. The construction of additional pipelines would allow more oil and natural gas to be exported to overseas markets and would also likely reduce the discount Canadian energy producers receive for their products. Importantly, Canada currently has 16 LNG facilities under consideration on the Pacific Coast and the construction of any of these LNG facilities would require a large amount of pipeline infrastructure.

Several major pipeline construction projects in western Canada are scheduled to begin construction in 2017 and 2018. We have identified nearly $15 billion in potential Canadian pipeline construction projects from the Company's three Master Service Agreement partners alone. Macro Enterprises also recently announced that the Company is a partner in a 50/50 joint venture that was recently awarded a $375 million contract from Kinder Morgan to construct an 85- kilometer section of the Trans Mountain pipeline expansion. The award is structured as a time and materials contract and could have a significant impact on the Company's financial results should the project proceed as expected. In addition to new pipeline construction, Macro Enterprises has already seen a noticeable increase in maintenance and services work as MSA clients catch up on maintenance spending that may have been delayed during the downturn.

When evaluating any potential investment, Gate City Capital Management considers the price we would pay for the entire company. Macro Enterprises currently has a market capitalization of $70 million. The Company has $28 million of cash and only $1 million of debt resulting in an enterprise value of $43 million. We expect Macro Enterprises to generate nearly $200 million of revenue in 2018 and approximately $20 million of EBITDA. We value Macro Enterprises using a discounted cash flow analysis to arrive at a target enterprise value of $105 million. We added $27 million of net cash to obtain our target market capitalization of $133 million or $4.00/share, representing potential upside of over 75%. In addition, the Company's cash balance and large owned asset base provide a significant margin of safety in the event our financial forecasts prove overly optimistic.

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been payable to manage the portfolio and that would have reduced the portfolio's returns. Actual performance results will be reduced by fees including, but not limited to, investment management fees and other costs such as custodial, reporting, evaluation and advisory services. The net compounded impact of the deduction of such fees over time will be affected by the amount of the fees, the time period and investment performance. Specific calculations of net of fees performance can be provided upon request.