



SUSTAINABLE WEALTH MANAGEMENT LTD.

Suite 224, 222 - 16th Ave NE
Calgary, Alberta
T2E 1J8

phone: 403.454.0881
fax: 403.454.0884

web: www.swmindex.com
email: dgates@swmindex.com

Sustainable Oil Sands Sector Index™ (SOSSI) Alberta Royalty Change Commentary October 25, 2007

Today's announcement of the new royalty regime for oil and gas producers from the Alberta government will substantially reduce profitability of oil sands producers. The majority of the recommendations in the review panel's report (see previous comment):

www.oilsandsindex.com/pdf/Alberta%20Royalty%20Review%20Comment.pdf

are being adopted in total or with only slight modifications. Luckily, the most damaging proposal, the Oil Sands Severance Tax (OSST) was rejected by the government but higher royalty rates on pre and post project breakeven will apply starting in January 2009.

The full 23 page report is available at the link below and I encourage investors to read it.

www.energy.gov.ab.ca/Org/Publications/royalty_Oct25.pdf

Here's a quick summary of the key changes that will impact oil sands producers in the Oil Sands Sector Index™.

Base Royalty Rate (Pre Breakeven): Rate remains the same at 1% when WTI crude oil prices are \$55 US/bbl or lower. The rate will increase by about 1% for every additional \$8 above the \$55 cutoff level until a maximum of 9% royalty rate applies at the \$120 level.

After Payback Royalty Rate (Post Breakeven): Rate remains the same at 25% when WTI crude oil prices are \$55 US/bbl or lower. The rate will increase by about 1% for every additional \$4.33 above the \$55 cutoff level until a maximum of 40% royalty rate applies at the \$120 level.

Elimination of Accelerated Capital Cost Allowance – Federal Government recently cancelled the same depreciation charge.

Creation of a Formula-based Bitumen Valuation Methodology – Reduces the ability of integrated oil sands producers from using internal transfer pricing to reduce royalties owed to the government.

No grandfathering of existing oil sands producers – A push will be made by the government to convince Suncor & Syncrude to abandon their crown arrangement for the new royalty regime.



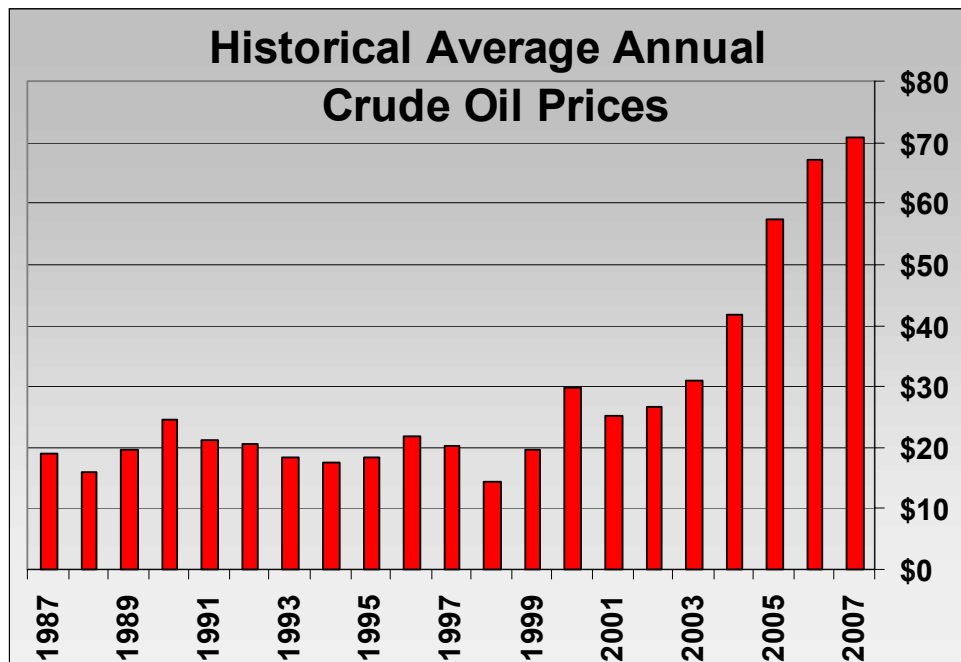
Sustainable Wealth Management Ltd.



Analysis of the new Royalty Regime

Alberta Government:

Based on my own analysis and my expectations for a recovery in natural gas prices and the continued rise in crude oil prices, by 2009 the government will increase revenues substantially. The government is expecting additional royalty revenue of \$1.4 billion by 2009 based on \$60 WTI oil and \$6 AECO gas. My expectations are that oil will average at least \$80 and natural gas will trade at a 7 to 1 ratio (historical trading ratio, energy equivalent ratio is 6 to 1) which puts it at \$11-\$12. Based on my more realistic assumptions under the current system the government will collect \$12.8 billion in royalties from all oil and gas sources. The government panel's prediction was for only \$7.2 billion under the current system and they proposed an increase of 26% to \$9.1 billion. I consider the government's numbers highly suspect. For instance, they predicted a \$10.2 billion in total royalty last year yet they received \$14.3 billion. The new proposal by the Alberta government is likely to collect substantially more than the government is projecting and I estimate that it will collect at least \$15 billion in 2009 which is over \$6 billion more than they are hoping for in the panel review. The historical average price of WTI crude oil clearly shows that energy prices are much higher than government projections and are on a clear uptrend that I expect will continue in the future (2007 figure is a year to date figure and current prices are likely to boost the average).

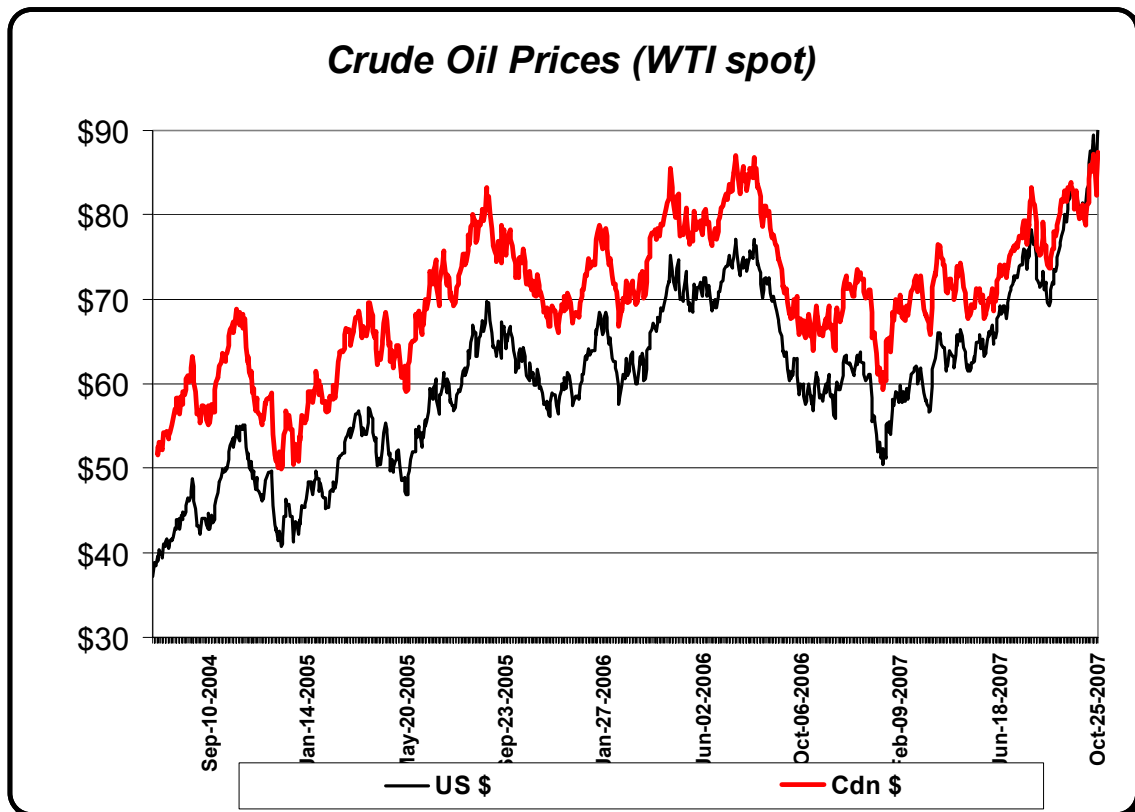




Oil Sands Producers

Oil sands producers are going to face higher royalty rates significantly above the 20% increase the royalty review panel was targeting. Based on my higher WTI crude oil expectations and the escalating royalty rates on prices above \$55 I expect that most oil sands producers will be paying at least 25% higher royalties in 2009. This change along with higher Canadian dollar, higher development costs and stricter environmental regulations should reduce profitability by about 10% in 2009 compared to my prior profitability estimates before all the recent changes in the sector.

The saving grace for the sector and the reason I am still very bullish going forward is that I expect crude oil prices to continue climbing aggressively in the next few years. The chart below shows that WTI crude oil is up 144% in US terms and 78% in Canadian dollar terms since I began tracking the oil sands index on June 30, 2004. My belief is that future crude oil price increases will more than offset rising taxes, royalties and costs and ensure that oil sands producers continue reporting record profits.





Making Up for Lost Ground

Other than the oil sands sector index, energy stocks have struggled to keep up with crude oil prices since the uptrend began in 2004. The table below shows the tremendous gap in oil sands stocks vs. traditional energy stock benchmarks and WTI crude in US dollar terms.

Since 06/30/2004	% Change In US\$
Sustainable Oil Sands Sector Index	359%
S&P/TSX Capped Energy Index	173%
WTI Crude Oil	144%
S&P Energy Sector – US	142%
S&P Global Energy Sector	114%

The year-to-date results indicate that energy stocks are lagging the rise in crude oil prices by a wide margin.

2007 YTD	% Change In US\$
Sustainable Oil Sands Sector Index	42.5%
S&P/TSX Capped Energy Index	30.4%
WTI Crude Oil	48.2%
S&P Energy Sector – US	29.3%
S&P Global Energy Sector	26.5%

I expect that Canada's oil sands stocks will regain their leadership role in the energy sector now that the uncertainty in the royalty regime has been resolved.



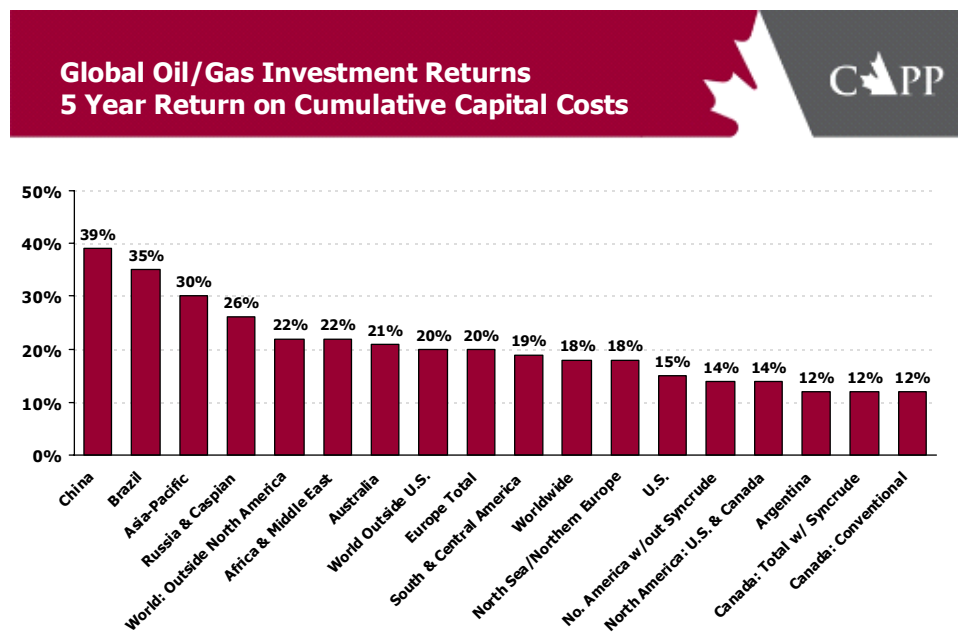


My approach to investing in the sector going forward is as follows (modified from my Sept 19, 2007 commentary):

1. I believe that the sector will recover quickly from the fallout over the proposed royalty changes. I will be buying into any dip that will occur over the short term.
2. I will not be exiting long term positions with imbedded capital gains that would guarantee that I lose part of my capital to taxation.
3. I will focus my investing on low cost producers, companies that are in production or near production and integrated producers that can maximize their profit per barrel of production.

Final thoughts

There is no doubt that many commentators will take a negative view on the sector over the next few weeks and that the stocks in my index will likely drop 5% or more similar to the drop in September after the review panel report was published. One of the points that will be made is that the rates of return in other parts of the world are much higher and that oil companies would be justified to move their investments to these other locations with higher rates of return (see below for a review by the CAPP).



Source: John S. Herold Inc.
2007 Global Upstream Performance Review





SUSTAINABLE WEALTH MANAGEMENT LTD.

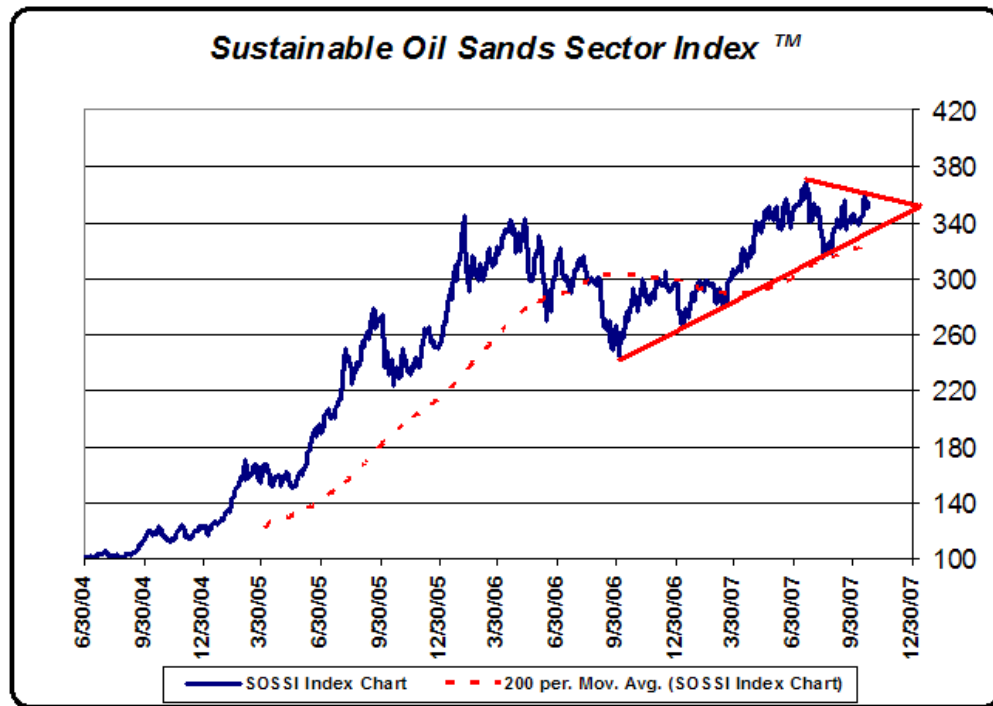
Suite 224, 222 - 16th Ave NE
Calgary, Alberta
T2E 1J8

phone: 403.454.0881
fax: 403.454.0884

web: www.swmindex.com
email: dgates@swmindex.com

My view is that the rate of return on oil projects is a secondary concern at this unique moment in time. The primary concern should be the ability for the average investor to participate in the growth of the energy sector without fear of confiscation by national governments. Canada recently ranked fourth in the world as the best place to invest your money over the next five years, well ahead of 9th place US and last place Venezuela and Angola which have massive competing oil reserves. Despite what some commentators have said, Alberta is not appropriating our investments in the sector. Canadian oil sands producers still retain complete control over their oil sands projects and can develop them as they see fit. In my opinion, Canada's oil sands are still the premier investment play globally until meaningful alternatives to crude oil are developed in the decades to come.

The chart below shows how the oil sands index is poised for a break above the triangle pattern as long as the supporting trend-line is not broken in the near term.



Derek Gates, CFA
Founder of the Oil Sands Sector Index™
Sustainable Wealth Management, Ltd.
www.oilsandsindex.com
www.swmindex.com



Sustainable Wealth Management Ltd.