

Few choices for investors looking at pure oilsands plays

Unlike light crude, unconventional oil offers growing output with little risk

Ray Turchansky

When Calgary-based Western Oil Sands announced this week that it will spend \$45 million US on oil exploration in the Kurdistan region of Iraq, its shares fell \$1.69 to \$30.78 on the Toronto Stock Exchange.

In a conference call, one analyst noted: "The name of your company is Western Oil Sands, and this is a Middle Eastern conventional oil exploration play."

The move symbolized a growing polarization about investing in oil companies.

On one hand, you have companies primarily involved in exploration and production of conventional oil, which continually becomes more difficult and expensive to find and produce, and often incurs geopolitical risk.

On the other hand, you have the oilsands, where reserves seem to expand almost every day – even into Saskatchewan now — and improving technology is reducing the cost of getting the oil out of the muck. As for geopolitical risk, the biggest unrest has been a Lethbridge swipe at the quality of life in Fort Mc-Murray.

These two types of oil production are now viewed by many investors as apples and oranges, and those wanting a bag of apples don't want to find a bunch of oranges mixed in.

But somehow it seems difficult to invest in pure oilsands plays while at the same time getting diversification among many companies.

A case in point was a seminar this week by Blackmont Capital, a Calgary-based independent financial services company. A viewing of the recent 60 Minutes story on the oilsands gave way to presentations by Derek Gates of Sustainable Wealth Management Ltd., who in 2004 developed the Oil Sands Sector Index, and by Peter Dodenhoff of SciVest Alternative Strategies Inc., which runs the Oil Sands Index Plus Fund based on Gates' index.

There is no disputing the potential wealth coming out of the oilsands. Each one of those giant truckloads of oilsands is worth \$10,000. And other methods of extraction are becoming more economical. At the same time, after being range bound between \$15 and \$25 US a barrel earlier this decade, the price of oil is now over \$70 a barrel and Gates doubts it will fall below \$40 for any significant time.

In the next 10 years, Gates predicts a four-fold increase in oilsands production growth, a 50-per-cent improvement in long-term oil prices, a 20-per-cent reduction in the discount on bitumen as the quality upgrades, and a 20-per-cent increase in operational efficiency from running larger plants and projects.

"Over the next 10 years, these companies are going to get eight to nine times bigger than they are right now."

Gates used five factors for company inclusion in his oilsands index: must be Canadian-based, must produce at least 50,000 barrels a day from oilsands by 2015, must be at least 35-per-cent focused in the oilsands, must be worth at least \$250 million dollars in valuation, and must have liquidity of at least \$2 million traded every

day.

Right now the index includes 13 companies – UTS Energy, Suncor Energy, Shell Canada, Petro-Canada, Petrobank Energy, OPTI Canada, Nexen, Imperial Oil Ltd., Husky Energy, EnCana Corp, Canadian Oil Sands Trust, Canadian Natural Resources and the aforementioned Western Oil Sands.

Three more companies are on the verge of inclusion.

“In my weightings for the index, the higher the focus on oilsands, the bigger the percentage of your money gets placed into it,” said Gates.

But his criteria that companies derive at least 35 per cent of their revenue from oilsands production by 2015 still leaves companies open to the downside of conventional oil operations becoming a drag on oilsands profits.

He said that EnCana has talked about splitting off its oilsands operation.

“Their oilsands are actually going to be very big, but they can’t find a partner to work with because people think of them as a natural gas company. If they split off that company, and I think they will do it, they’ll be a bigger part of my index.”

The same won’t happen with the likes of Shell and Imperial Oil.

“The big risk with those companies is that they’ll be taken out by their parents. Shell and Imperial are 70- and 78-percent owned by Shell International and Exxon Mobile, and I think what they’d like to do is buy them out. “So then they’d be eliminated from my index altogether, because they’d be foreign owned.” While separating oil from the sand is getting easier, separating the oilsands from conventional oil remains a challenge for investors.

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