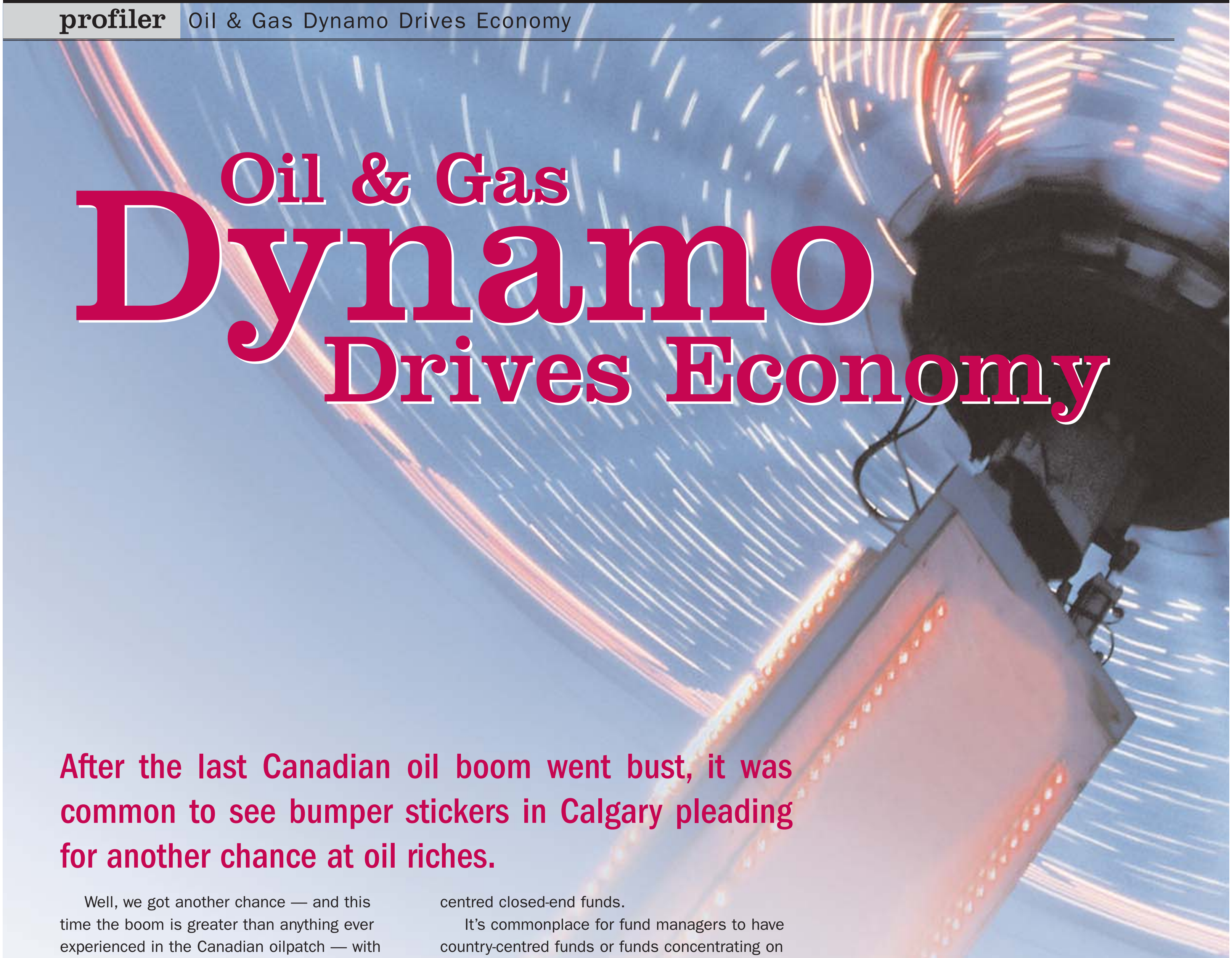


Oil & Gas Dynamo Drives Economy

After the last Canadian oil boom went bust, it was common to see bumper stickers in Calgary pleading for another chance at oil riches.

Well, we got another chance — and this time the boom is greater than anything ever experienced in the Canadian oilpatch — with all the usual economic indicators, from Gross Provincial Product, to unemployment rates, to housing prices, showing growth far beyond what was experienced during the Middle Eastern oil embargo days of the 1970s, when oil prices increased five-fold and Calgary oil entrepreneurs drove Cadillacs with real gold trimming.

Now the vehicles are more likely to be Hummers or Lamborghinis and the million dollar mansions that were front page news in the 1970s are commonplace. The Calgary Real Estate Board reported this spring that the average price for all residential real estate in the city was $341,838, up 37.18% from the same period last year, with the average single family home priced at $376,726, up from $273,953. At the current pace, housing prices will eclipse every major Canadian city.

While the oil and gas boom is benefiting other energy producing areas of Canada, including British Columbia, Saskatchewan, Newfoundland and the north, Alberta is getting the lion's share of the impact.

So much so that, for the first time in Canada, financial service firms have launched Alberta-centred closed-end funds.

It's commonplace for fund managers to have country-centred funds or funds concentrating on certain regions of the world, but the five firms that recently launched Alberta-focused funds are voting with their pocketbooks.

"It's not hard to come up with a compelling story (for a fund emphasizing Alberta companies)," said Dean Orrico, managing director and portfolio manager for Toronto-based Middlefield Capital, which recently launched the Alberta Focused Income and Growth Fund (the first of the five Alberta-focused funds to go the market).

One measure, compiled by Statistics Canada, says it all. The average after-tax family income last year in Alberta was $61,800 a year, $12,000 a year more than the average for all the other nine provinces.

So what is driving this boom? Well, despite Alberta having a more diversified economy than in the 1970s, with a petrochemical industry that didn't exist before then, a growing manufacturing sector, and a strong retail sector, the economic growth still comes primarily from energy.

Just how much of an economic engine the oil and gas industry is can be illustrated by a number of statistics and studies.

For instance, a study of the profitability of the upstream oil and gas sector by Calgary-based ARC Financial Corporation, commissioned by the Canadian Association of Petroleum Producers (CAPP) late last year (the study only looked at the exploration and production sector and not at oilfield service companies or refining and marketing), illustrates how far the industry has come in the last five years. Similar studies were conducted in 2001, 2002 and 2003.

ARC points out that since its February 2003 study, crude oil and natural gas prices had risen 80% and 60% respectively (as of March, 2006).

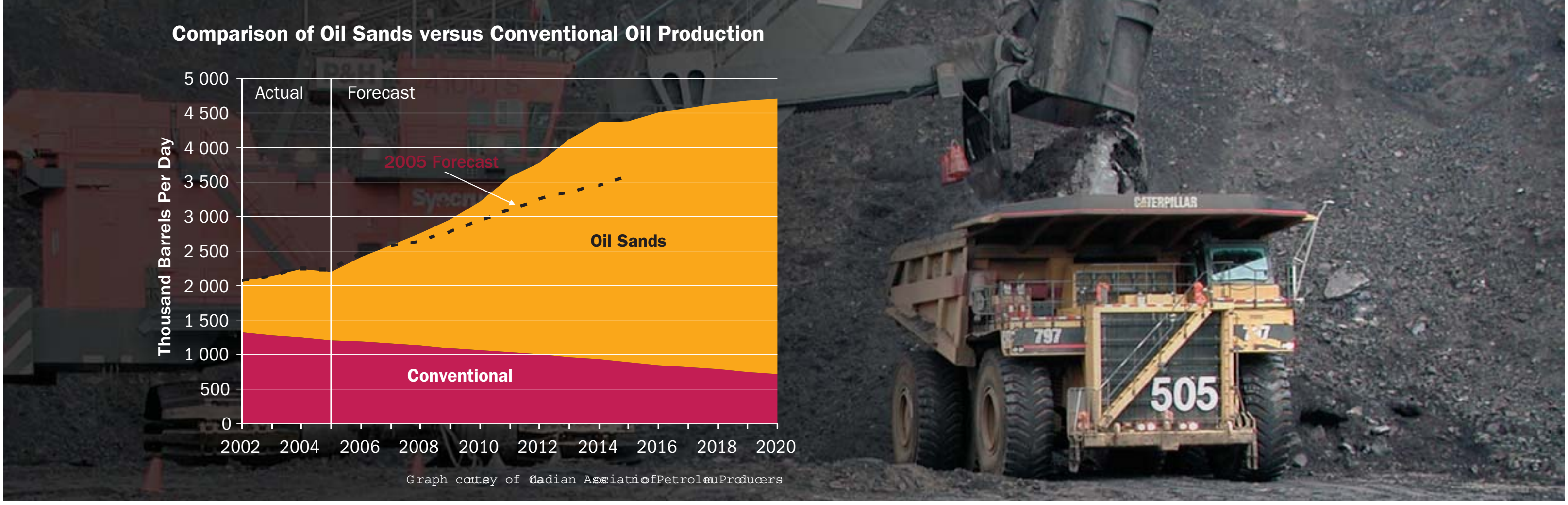
"Such dramatic price appreciation, in a short period of time, has substantially jolted the normal course fiscal dynamics of the Canadian oil and gas industry, and given momentum to trends like oilsands and unconventional gas development, constrained services and cost inflation," says ARC in its analysis, led by well known energy industry economist Peter Tertzakian.

The study concludes that the upstream oil and gas industry, which generated $100 billion of revenue for the first time ever in 2005, will be able to sustain that level through to 2008.

Although ARC predicts oil prices will moderate to the $52 per barrel range by 2008, from levels in the mid $70 range earlier this year, it says rising production volumes, mostly from the oilsands, will allow the industry to continue generating $100 billion in annual revenue or more through to 2008.

Other observations and conclusions include:

- Rising oil and gas prices have roughly doubled government revenues from crown royalties, land sales and cash taxes paid by exploration and production companies, adding up to an estimated $27 billion in 2005, up from $14 billion in 2003. That doesn't include taxes paid by oilfield service firms and other peripheral activity;
- While revenue is up dramatically for the industry, so are its costs, with oilfield services, wages, office space, pipelines and land costs rising at 15% a year for the last three years;
- The oilsands area of northern Alberta now accounts for 33% of total crude production, or one million barrels a day. Over the next 10 years there are expected to be over $60 billion of direct capital expenditures into developing the oilsands, as compared to $93 billion in conventional oil and gas development up to 2008. Oilsands production is expected to rise to 2.7 million barrels daily by 2015;
- Momentum is also growing behind unconventional natural gas production, with coalbed methane grabbing an increasing share of exploration expenditures. For example, of the 21,925 wells drilled in 2005 (a tripling from levels in the 1990s), 70% targeted natural gas and 20% of those, or 3,000, were pursuing coalbed methane;
- ARC also notes the growing role of royalty trusts in the Canadian oil and gas industry. For instance, it notes that in 2003, when its last report was published, trusts controlled 513,000 barrels of oil equivalent per day, representing nine percent of all Canadian production (including the oilsands). Today there are over 35 trusts, producing about 800,000 BOE/d, or about 14% of Canadian production. ARC expects those levels to remain constant through 2008;
- The oil and gas industry is the most profitable sector in Canada, with an average return on capital averaging 13% and return on equity averaging 19%. However, ARC warns that much of that profitability stems from earlier discovered, lower-cost production, saying the higher costs now being experienced by the industry will eventually lead to lower margins.



Graph courtesy of Canadian Association of Petroleum Producers

That warning aside, the industry has never seen better times, as statistics gathered by Nickle's Energy Group show.

The most telling figure is the one measuring industry cash flow, the key metric the industry uses to gauge its success. In 2005 the combined cash flow for the industry was up 35% from 2004, hitting $49.3 billion (more than $12 billion above the previous 2004 record).

Meanwhile, capital spending by those same producers hit $52.007 billion, a seven percent increase from 2004, even though spending on acquisitions declined to $10.7 billion from $17.41 billion in 2004 (when there were several major takeovers).

Those dollars definitely trickled down to the oilfield service sector, with producers having invested over $39 billion on field work such as drilling, land and facilities last year, a 41% increase from the $27.66 billion in 2004 (and an indication also of the worrisome cost increase ARC warns about).

Despite natural gas prices being down by more than half from a peak of around $15 per mcf last year, producers have announced plans to spend about $47 billion this year on exploration and production. And no wonder, since profits in the sector hit a record $22.7 billion in 2005, 30% more than the previous all time high of $16.7 billion in 2004. In the last quarter of 2005 alone, thanks to surging oil and gas prices, the industry recorded profits of $10.2 billion, accounting for 45% of the total annual profits in 2005.

The new century has brought a bonanza for the oil and gas sector, with Nickle's records showing Canadian producing companies achieving over $86 billion in profits and over $193 billion in cash flow between 2000 and 2005.

By comparison, over the decade of the 1990s, profits totaled only $15.4 billion and cash flow amounted to $83.8 billion.

Capital spending by the Canadian oil and gas sector has been a huge driving force in the total Canadian economy, with investments of $214.5 billion in the five years through to 2005, compared to $111.9 billion in the 1990s.

Those benefits to the country's economy don't include the returns experienced by investors in public companies and trusts from dividends and distributions and share and unit appreciation.

Of course, this bonanza can be largely attributed to high oil and natural gas prices. In an industry that had to cope with prices as low as $10 a barrel in the early 1990s, average crude prices of $56.12 a barrel and gas prices of $9.07 per mcf was welcome news.

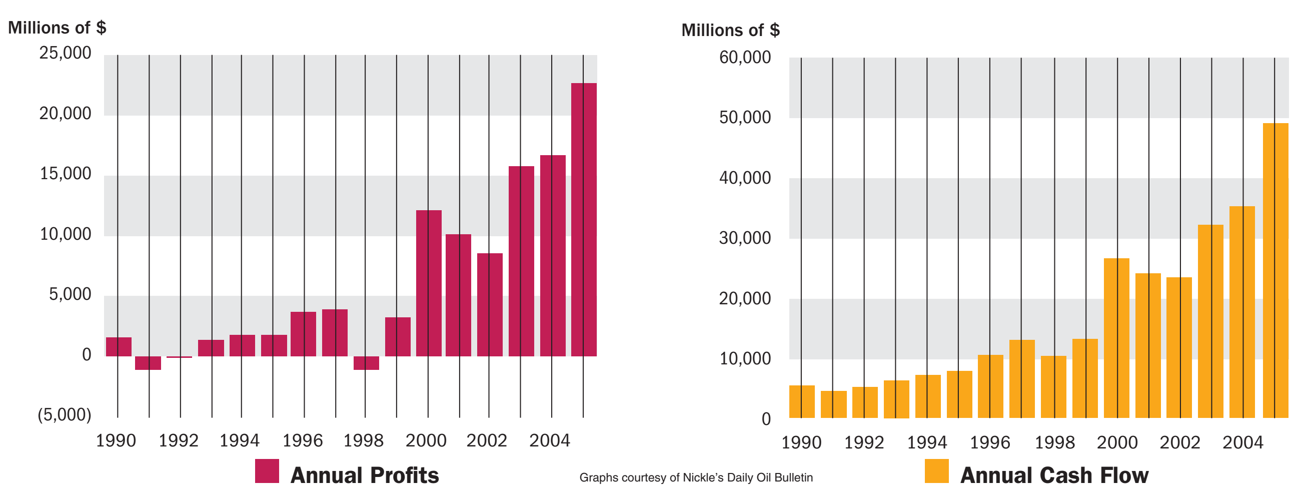
While all boats were lifted by the rising tide, some floated far above the rest. For instance, in terms of year-over-year growth in production per share, stand-outs included Rock Energy Inc. (264% growth in production per share), Galleon Energy Inc. (160% growth), ProEx Energy Ltd. (141% growth), Storm Exploration (140% growth), Cyries Energy Inc. (129% growth) and Rider Resources (100% growth).

As an illustration of how the good times are rolling, Calgary-based EnCana Corp. recorded the highest profit ever achieved by a Canadian producer last year, over $3 billion. In addition, three other producers, Imperial Oil Ltd., Shell Canada Ltd. and Husky Energy Inc. topped the $2 billion profit mark. Another five producers recorded profits over $1 billion, including PetroCanada, Talisman Energy Inc., Suncor Energy Inc. Nexen Inc. and Canadian Natural Resources Ltd.

Although the ARC analysis — and those by others looking forward — suggest the good times for the Canadian energy industry won't continue at the same frenzied pace as last year, they also don't envision a collapse, like that which followed previous energy booms. Given that scenario, it's likely those benefiting from the newest energy good times, including the citizens of all of Canada's producing provinces, will have several years before they have to worry again about exhausting the wealth now flowing into their economies and pocketbooks.

— Jim Bentein

Canadian Producer Profits Top $21.8 Billion In 2005



Graphs courtesy of Nickle's Daily Oil Bulletin