



# Yes, It Can

In a year that brought a massive drilling push, an all-time high in oilpatch profits, intense interest in Canada's oilsands, rapid growth of coalbed methane and a record level of oil production, the question on a lot of minds is — *can it last?*

No one knows for sure and anyone who has been in the oilpatch for a decent length of time, knows how fickle the cycles can be and how fast things can turnaround. But all signs — from the best oilpatch oracles of the day — point to many years of intensive activity ahead.

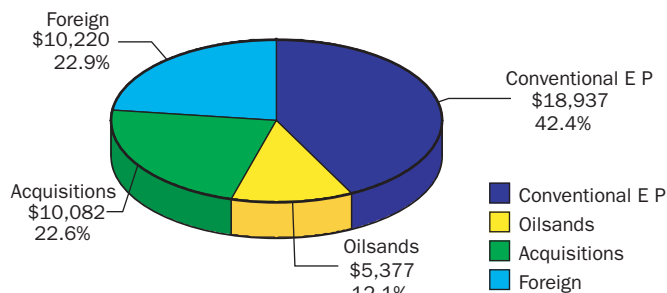
The challenges ahead are many but the opportunities are even greater. Armed with healthy balance sheets and wielding a powerful flow of cash (a whopping \$35 billion last year), producers are pursuing the big opportunities (oilsands, coalbed methane, deep gas drilling and Arctic gas) aggressively.

At the same time, the conventional oil and gas assets in the Western Canadian Sedimentary Basin are being efficiently realigned with investor needs into trusts (steady development assets) and junior explorers (higher risk lands). And Canada's huge oilsands resources are starting to muscle their way onto the world stage as Canada is one of the few major oil-producing

countries able to grow its production over the next decade. This has caught the attention of the two of the world's biggest oil consumers — the United States and China.

With several years of high oil and gas prices under their belts, producers are finally ramping up exploration and industry is having real success replacing production with new reserves, despite the view of many older, integrated firms that the basin is played out. Higher prices are turning a lot of formally marginal assets into valuable properties.

New oil and gas discoveries are being made and while not big by world standards, there are enough of them put together to make an impact. Resource plays such as EnCana Corporation's Cutbank and Sierra Ridge plays in British Columbia and the Horseshoe Canyon coalbed methane (CBM) fairway in Alberta are starting to contribute sizeable numbers. And the list of conventional discoveries is growing as well — Shell Canada Limited's Tay River gas find in the



2004 Oil Industry Capital Spending

Alberta foothills, Talisman Energy Inc.'s Monkman deep gas discovery in the B.C. foothills, the large, shallow gas play in the Shackleton region of Saskatchewan, Duvernay Oil Corp.'s Wild River-Fir Cadomin gas play in western Alberta, the Northrock Resources Ltd. oil and gas discovery in the Northwest Territories, and the BlackRock Ventures Inc. expanding Seal heavy oil play in Alberta are just some of the industry successes of the past two years. Older fields such as the West Pembina Nisku play, started in the 1970s, have been revived with considerable exploration success by juniors such as West Energy Ltd., Kick Energy Corporation, Vaquero Energy Ltd. and Lightning Energy Ltd. Plus tight gas plays — made economic by today's high gas prices — are being pursued with success by Duvernay at Groundbirch, British Columbia, Compton Petroleum Corporation in southern Alberta and Eastshore Energy Ltd. at Hanlan in west central Alberta.

About \$38 billion worth of capital investments have already been announced by producers for this year and not all producers have revealed their budgets.

It all points to a healthy, confident and growing oil and gas industry in Canada with the first decade of the new century almost a mirror opposite of the last decade of the 20th century.

"Drilling will continue at a rampant pace for the foreseeable future," Michael Heier, chairman and CEO of Trinidad Energy Services Income Trust, Canada's fourth

biggest drilling contractor, told his shareholders this spring. "We are experiencing the strongest market fundamentals in [the petroleum industry's] history."

Looking further down the pipe, a series of oilsands megaprojects, tackling the very large Mannville CBM resource potential, one or two Arctic gas pipelines from the North and possibly development of the Hebron-Ben Nevis oil discoveries, or even the large discovered gas reserves, off Newfoundland, will keep the oilpatch humming. No one has a crystal ball, but at this point it looks like only a major worldwide recession that would take a heavy toll on energy demand and hence oil and gas prices could derail Canada's oilpatch.

On top of all that a major new oilsands pipeline to connect Alberta oil to a port on the British Columbia coastline will be built to send Alberta crude to far-flung markets now served mainly by OPEC.





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Canada's gross export revenues from oil, gas, electricity and coal amounted to almost \$59 billion last year, most of it from petroleum and natural gas. Revenues from oil and gas booked by Canadian-based producers topped \$112 billion in 2004, a new record and more than triple the revenues received a decade earlier in 1994. Canada's energy trade surplus (the value of exports minus imports of energy) was \$36.2 billion last year, according to the National Energy Board. A dozen years earlier in 1992 the country's trade surplus in energy was only \$9.5 billion.

A record level of natural gas and CBM drilling last year helped bring a turnaround in national production which fell in 2003 and although the increase was small (at 0.5% to 16.87 bcf per day of marketable gas), the extra gas is badly needed in North America which has suffered from severe price spikes in the past few winters.

Even more encouraging, Daily Oil Bulletin (DOB) statistics on proved gas reserves booked by producers in Canada shows more than six trillion cubic of proved reserves were added through drilling in 2004, the highest since the publication began tracking reserves of public companies in 1990. Those additions — about 24% more than in 2003 — more than replaced production of 4.88 tcf by those same producers last year.

The most successful gas drillers last year were EnCana (which booked a whopping 1.42 tcf of new proved reserves from drilling), Apache Canada Ltd. (543 bcf of new proved reserves) and Talisman Energy (420 bcf of new reserves).

Producers also reported a further 625 bcf of probable gas reserves added through drilling in 2004.

"At \$7 per mcf, exploration companies can afford to drill just about any reasonable gas prospect in the Western Canadian Basin, including the foothills," commented Don Herring, president of the Canadian Association of Oilwell Drilling Contractors, in a recent DOB article.

"We don't have a (deep-rated) rig ready for service that isn't spoken for after break-

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up," added Duane Mather, president of Nabors Canada LP. "I've only seen the sector this busy once before, in 1997."

2004 was another record-breaking year for the Canadian oil and gas industry with new highs set for profits, cash flow, revenues, capital expenditures and oil production. The combined profits of 154 producers were \$16.68 billion, a new high that beat the previous record of \$15.88 billion set in 2003. Very high world oil prices and a continuation of strong North American natural gas prices were the main reason for all the 2004 records. Producers releasing year-end financial results reported an average well-head oil price of \$45.66 per bbl last year, up 34% from 2003. At times last year, light oil posted prices at Edmonton were as high as

\$70 a bbl. Natural gas prices reported by producers averaged \$6.83 per mcf, up from \$5.82 in 2003.

The final quarter of the year — when light oil prices peaked — brought profits of \$5.88 billion, the highest of the year.

Producer cash flows rose to \$35.3 billion in 2004 but couldn't keep up with capital expenditures which continued at very high rate due to acquisitions and oilsands ventures. Capital spending soared 47% last year to a record \$47 billion, by far the most invested by Canada's oil and gas industry. Of that amount, \$10.21 billion involved expenditures outside of Canada on foreign operations or acquisitions of foreign assets.

It was also another year of intense merger, acquisition and asset sales with some \$10.08 billion spent on acquisitions in Canada, mostly by the income trust sector, nearly double the dollar transaction value recorded in 2003. Companies such as Murphy Oil Corporation and ChevronTexaco sold off their conventional Western Canadian assets in a hot market dominated by acquisition-hungry income trusts.

The oilsands absorbed a growing amount of producer cash flows last year with capital spending of \$5.38 billion, up 41% from 2003. Regular field operations such as drilling — still the bread and butter of most service and supply companies working in Canada — consumed \$18.94 billion of investment capital in 2004, a solid 16% rise from the previous year.

At \$47 billion, capital spending was 34% more than cash flow for the year, reflecting industry confidence in the sustainability of high prices and in direct contrast to earlier years when most producers were conservative with budget spending.

The biggest acquisitions, almost all for foreign assets, of 2004 were made by

Nexen Inc. (\$2.58 billion), EnCana Corporation (\$2.3 billion) and Petro-Canada (\$1.9 billion).

Excluding acquisitions, the producers that were most aggressive re-investing cash flow into exploration and development and field facilities were Canadian Natural Resources Limited (spending rose \$628 million from 2003), Petro-Canada (a \$540 million expenditure hike from 2003), Suncor Energy Inc. (spending rose by \$530 million) and Husky Energy Inc. (increase of \$481 million).

Very few producers reported lower capital spending in 2004 but some of the larger ones included Canadian Oil Sands Trust which invested \$1.32 billion less than in 2003 when it had a big acquisition, ARC Energy Trust which spent \$508 million less in 2004 than in 2003 and Husky which cut its capital expenditures overall by \$226 million to \$2.45 billion.

Reflecting industry prosperity, one producer topped the \$3 billion a year profit level, another surpassed the \$2 billion a year bar

and five others generated net earnings above \$1 billion in 2004. By comparison, total industry oilpatch profits by all producers in 1993 amounted to only \$1.35 billion.

EnCana's profits soared by over \$1 billion from 2003 to \$3.5 billion last year, well ahead of second place Imperial Oil Limited which achieved a \$2.05 billion profit. EnCana booked an extra \$1.4 billion in profits after selling its United Kingdom North Sea assets to Nexen for \$2.1 billion (U.S.) last year. The other five producers with more than \$1 billion in net earnings were: Petro-Canada (\$1.76 billion), Canadian Natural (\$1.4 billion), Shell Canada Limited (\$1.29 billion), Suncor (\$1.1 billion) and Husky (\$1 billion).

The largest year-over-year production increase (Canadian and international assets) came from EnCana last year which produced 760,050 bbls of oil equivalent per day in 2004, up over 100,000 BOE a day from 2003. Canadian Natural came second with an increase of 54,930 BOE per day to 513,822 BOE a day while Talisman had the third highest increase at 39,885 BOE per day (to 438,267 BOE a day). Canadian Natural and Shell Canada reported the biggest increases in oil production while EnCana and Talisman booked the largest jumps in natural gas production.

With record producer cash flow and spending, albeit tempered by the large sums spent buying and selling assets or companies rather than exploring or drilling, service and supply companies also reported improved fortunes in 2004.

While many service sector firms dependent on conventional drilling had disappointing second and third quarter activity levels due to poor weather conditions in Western Canada, the first and final quarters of 2004 were very busy for most companies. The seismic shooting business was the exception with little improvement in 2004 as companies are still emphasizing development drilling and buying older seismic data rather than shooting new surveys.

Overall, the service and supply companies recorded a combined profit of \$1.04 billion for the year, up \$423 million from 2003. For the final three months of 2004, profits jumped by \$176 million from 2003 to \$375 million as drilling levels were very high.

Like the producers, service and supply companies are showing more confidence in the future and investing more capital. Can the industry sustain the current level of activities? The best oilpatch oracles say — Yes it can!"

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