

## Grim oilpatch anxiously awaits cold weather

**Jon Harding and Claudia Cattaneo**

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CALGARY - To the outside world, Calgary, the centre of the oilpatch, is booming -- office real estate is tight as a drum, retailers are gearing up for a bountiful Christmas haul and labour shortages continue.

Yet in Cowtown's oil towers, pessimism is running so deep the usual Christmas cheer has turned into Christmas fear.

The shop talk on the party circuit: Big oil companies are slashing budgets by the billions, drilling for oil and gas is plummeting, stock options are in the tank, many juniors are headed into a New Year bloodbath, oilsands companies are out of favour and oil and gas trusts are in shock.

All eyes are on natural gas prices and anxiety is high that if cold weather hasn't swept the continent by Christmas, the glut in inventories of the fuel could extend the sector's downturn into late 2007.

By January, with winter well under way, the market will firm up its views of prices for the remainder of the year.

If the outlook is going to be weak, it'll be tough slugging, say analysts.

Canaccord Adams analyst Andrew Bradford said the mood is the polar opposite of a year ago, when business was so good conversations at company Christmas parties were euphoric and revolved around holidays, vacation plans and the latest on the Calgary Flames.

"It's hard not to get a sense of the pessimism," Mr. Bradford said. "A lot of people want to talk about natural gas markets, whether there are too many rigs, issues no one seemed too concerned about last year. It's weighing on people's minds more and more."

The downturn started early in 2006, but was expected to be a blip; the prevailing sentiment was that the boom had long legs amid continuing concern about world energy shortages.

To be sure, oil and gas prices are high by historical norms. Gas was trading at US\$8.84 per million British thermal units in New York yesterday, double the September price, and oil was US\$63.13 a barrel, up 10% from a year ago.

But this is a different world, as a litany of other factors in Canada have combined to turn the boom into gloom. One energy executive expressed concerns that governments and investors are still talking about dividend hikes when many companies in fact could wind up in a tight squeeze next year.

Rising costs for everything from drilling services to exploration lands have outraged big companies to the point they are slashing plans just to send a message they won't pay up.

ConocoPhillips is said to be planning a \$1-billion cut to its 2007 Canadian gas program, down from \$2.1-billion this year. That would follow cuts by EnCana Corp. of \$1-billion, by Canadian Natural Resources Ltd. of between \$1-billion and \$1.5-billion.

Cathy Cram, spokeswoman for Houston-based ConocoPhillips, said her company will be spending more money on oilsands development, but less on natural gas in Western Canada because of rising costs and volatile prices. The industry-wide cuts are so deep drilling activity is expected to decline 15% in 2007. Already, the number of active drilling rigs has declined almost 25% from a year ago, and rental day rates are off by \$2,000 to \$15,000 on average.

Natural gas supply from Western Canada is already taking a hit. Volumes in December are expected to be below last year, and decline 1% to 2% in 2007, said Chris Theal, analyst at Tristone Capital Inc.

Junior producers are also reeling from high costs, but the pain in the group runs deeper because it doesn't have the staying power to also weather low gas prices and rising debt. It got further stung by Ottawa's decision to tax income trusts, which have been buyers of juniors.

Meanwhile, trusts have been paralyzed by the new federal tax rules and are holding back on their plans. Mr. Theal said land prices have already declined 10% to 15% because trusts are no longer bidding as aggressively.

Ryan Ferguson Young, associate at Calgary-based Sayer Energy Advisors, said the market is becoming flooded with new assets and it's going to get worse in January. "We see the number of [properties] available in January rising as high as [collectively producing] 135,000 barrels of oil equivalent a day, compared to June, when there was 40,000 boe/d, which has been the norm," he said.

Is there any upside to the downturn? Mr. Theal predicted a return of mid-sized companies, as strong juniors buy up the weaklings. Investment dealers are gearing up for a flurry of mergers and acquisitions, resulting in an even stronger oilpatch. The deep activity cuts are expected to eventually lead to a strong rebound in gas prices once the glut disappears.

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