GEORGIAN
CAPITAL PARTNERS

Pendulums tend to swing too far, before reversing.
Climate change is real, albeit the sources undecided.
Solar technology is finally breaking through costs.

Debt loads will sort out the weak, as bankers like cash flow, even as lower prices demand continued production.

The loonie is a petro-currency and lower interest rates may combine to lower its value.

Summer is supposed to be quiet!?!

David Knight
Georgian Capital Partners
Scotia Plaza
40 King Street West, Suite 3405
Toronto, ON M5H 3Y2

Toronto: (416) 640-4100
Victoria: (250) 595-7955
www.georgiancapital.ca

July 8, 2015

ARC financialcorp
energy capital partners

ARC energy charts

July 7, 2015

Spot WTI Crude $US/B	Edmonton Light $US/B	Spot Henry Hub $US/MMBtu	Spot AECO $Cdn/GJ	Spot AECO Basis $US/MMBtu	Currency $US/$Cdn
56.93 ↓	53.72 ↓	2.79 ↓	2.57 ↑	0.63 ↑	0.7953 ↓

Chart Watch

1	The Shanghai Composite has fallen sharply
16	Iranian nuclear talks are ongoing
23	Crude oil stocks saw the first gain in 8 weeks
24	US oil exports rose to a record high in April
58	The US oil rig count rose by 12 on the week

The Oil Business is a Tough Rodeo

By Peter Tertzakian

Ouch. The oil price war is hitting Canada hard.

The near-term outlook looks unforgiving. Iran may be joining the fray on the supply side. Economic chaos in Greece and stock market convulsions in China are leaning on demand. It's not clear whether we should turn to Plato or Confucius for wisdom.

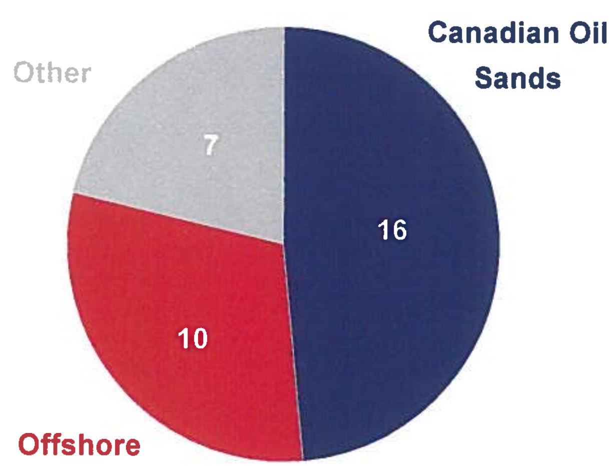
Globally, at least 33 major oil and gas projects have been delayed or cancelled since the start of 2015. That's what a 50% price cut does. Of those 33 axed projects, 16 are in the Canadian oil sands region (see Figure 1). Companies are tight lipped for now; privately the scuttlebutt says the size of the cancelled project pie will expand in the fall.

The rush to a conclusion at a Calgary Stampede party is easy: Canada's industry is of high cost; therefore, our oil sands projects are the most prone to being bucked off the budget when commodity prices are whipped. The oil business is a tough rodeo when it comes to cost control, so there is no denying that some of that conjecture is true.

But let's consult Plato before we judge and condemn Canada's position in the oil world. "A good decision is based on knowledge and not on numbers," the Greek philosopher once wrote. So what do we know about the numbers on the list of delayed and cancelled megaprojects?

For one thing, the knowledge in our current list of 33 is incomplete. The 48% skew to Canada is because we live in a free-market system where public disclosure and transparency are mandatory. Material changes to capital budgets are released to the media. On the other hand, the spending habits of much of the rest of the world's oil industry are largely

Figure 1: Allocation of Disclosed Oil and Gas Megaproject Cancellations and Delays



Source: Various Company Press Releases, ARC Financial Research opaque. State-owned, national oil companies (NOCs) have no obligation to report their plans or budgets. So our list of 33 announced projects is a biased sampling from companies that choose to, or have to disclose their intentions. And it's a small sampling, because according to the World Bank the trajectory of 75% of the world's oil production is decided behind the closed doors of NOC boardrooms. Below ground, they estimate that state-controlled oil companies sit on 90% of the world's oil reserves.

Like Canadian free-market companies, many NOCs are hurting badly in this low price environment, husbanding tight cash flow instead of sanctioning the development of reserves with multi-billion-dollar projects. We just don't hear their stories of delays and cancellations. So their knowledge doesn't make it into our lists and pie charts. If the public list was truly comprehensive, Canada's slice on the gloomy pie chart would be thinner.

Having said all that, we should expect to see a lot of Canadian companies on the major project cancellation list. Canada is the fourth largest producer of oil in the world. All in, we have the third biggest oil reserves after state-controlled Venezuela and Saudi Arabia. Because of this large endowment, we should not be surprised to see a large fraction of Canadian projects on the cancellation list. Further, the oil sands are among the most scalable resources in the world, so they naturally lend themselves to megaprojects. And because they are so large, and soak up billions of dollars, they also naturally lend themselves to early cancellation when the corporate purse gets tight.

But here's a piece of statistical knowledge that spans all producers: Canada's oil industry has contributed almost 1.0 million barrels a day, or 17.5%, to the world's net production growth over the past five years. Since the end of 2012, our net contribution has been 22%. In this regard, Canada can be considered a prime contributor to today's oil oversupply and price war.

Yet if Canada has been a thoroughbred in supply growth, what does it mean when its reins are pulled in with 16 megaproject cancellations? A few weeks ago the Canadian Association of Petroleum Producers (CAPP) cut its long-term oil growth forecast by a million barrels a day. Given prevailing market conditions, CAPP's growth projection is still likely to be optimistic.

The implications of today's major oil project cancellations, disclosed and undisclosed, in Canada and abroad, will be profound in a few years when the barrels from mothballed projects don't show up. More price volatility is highly likely, but there will be derivative impacts on environment, transitions to alternative energy systems, and investment. We will explore these themes in future columns, because Confucius says that, "If a man takes no thought about what is distant, he will find sorrow near at hand."

Peter Tertzakian,
ptertzakian@arcfinancial.com

Jackie Forrest,
jforrest@arcfinancial.com

Kara Jakeman,
kjakeman@arcfinancial.com

Marcus Rocque,
mrocque@arcfinancial.com

Megan Lancashire,
mlancashire@arcfinancial.com

Look for our commentary on www.arcenergyideas.com
Twitter: @PTertzakian, @JackieForrest