The End of the Shale Era, Part 1

By JAMES STAFFORD, Oilprice.com

The oil and gas game can be a tricky one for junior companies, but if played right the pay-off can be massive. At a time when juniors are risking a lot in volatile venues in the Middle East and Africa, Canada's Aroway Energy [1] (ARW) is planting its feet firmly in homeland soil and in conventional plays.

Why? Because for the smaller juniors this is not a long-term game and blowing all your capital to drill a single unconventional well in a risky frontier won't pay off. Canada still has plenty to offer for juniors, even though you have to kiss plenty of frogs to find the prince. The end game, after all, is merger and acquisition.

In an exclusive interview with Oilprice.com, Aroway CEO Chris Cooper discusses:

1. How to make or break a junior oil and gas company
2. Why rail is becoming more attractive than pipeline transit
3. Why most juniors won't make it big in risky frontiers
4. Why Keystone XL will get the green light
5. Why oil and gas prices will increase
6. Why the smaller juniors will stick to the conventional plays
7. How the asset market is heating up … and what is ideal
8. Why having control of infrastructure is key to success
9. Where Canada's oil and gas industry will be in a decade
10. What every junior's goal should be

James Stafford: Junior oil companies have been storming the scene with some bold investments in tricky frontier areas. Where do you see this going and what will the next phase for the juniors be? Where will the action be, in conventional or unconventional plays?

Chris Cooper: I am a big believer in the conventional plays. I find that the non-conventional plays are turning into more of a game for the intermediate-size companies primarily as a result of the capital that is required to exploit the resources. Horizontal wells with multi-stage fracturing is an expensive game. I find that the conventional plays expose juniors to a less risky scenario with higher returns on investment and longer-term production more often than not.

Given the current state of the capital markets and the scarcity of funding, I think the smaller juniors will continue to play in the conventional arena.

James Stafford: What's the ideal partner for a junior company, and what can make or break it for a junior?

Chris Cooper: As far as make or breaking a junior, I believe you need to minimize the company's risk by drilling wells that are going to give you good internal rates of return and steady production; a good mix of development and exploration wells. It is also very good to have a good operator that is responsible in keeping a control on costs.

James Stafford: What separates the good management teams from the mediocre in the Canadian junior oilpatch?

Chris Cooper: Management teams that have built and sold companies in the past have a responsible, methodical approach to how they run their businesses. More often than not, these teams do not try to re-invent themselves by drilling wells and formations that they have not done in the past. They continue to focus on what they know best, whether it be drilling in the Peace River Arch, chasing Leduc wells, or focusing on cardium wells. They often do not stray from their formulas and that is why they are good teams.

James Stafford: More Canadian oil is now being marketed by rail. Can you put the rail versus pipeline transport comparisons into perspective for us from a Canadian operating perspective?

Chris Cooper: A lot of companies, including Aroway, are capitalizing on the benefits of moving their oil via rail as opposed to pipeline. I think it will increase our netback, our profit per barrel, by several dollars immediately.

For instance, before we purchased our West Hazel Property in Skaskatchewan, the owners would truck to Talisman or another big operator that was pipeline-connected. Then, once the oil got to the pipeline-connected operator, they had to pay a certain amount of money to get it in the pipeline for diluents to meet pipeline specifications. Then they had to pay for the pipeline tariff and then they got the price the pipeline operator provided wherever they were on the pipeline.

So for example, the last month we got $53 to $54 a barrel, after the blend-in tariff for our West Hazel production, which is probably the lowest you're going to see for a long time. Our netback on that oil was still greater than $20 a barrel. But for that $53.32 a barrel we sold, if transported by rail, we remove the pipeline tariff, we remove the blend for the diluents and we get $9 more added to the netback value.

So what we'll end up doing is trucking our oil from the field to a company called Altex Energy, which is partly owned by Shell Canada. Shell owns all the railway cars and all these railway cars get filled up with heavy crude and shipped down to their Port Arthur facility on the Gulf Coast. At Port Arthur what typically happens to our

crude--because it's somewhere between 11 and 13 degree oil—is it goes straight into bunker fuel for ships.

So the refinery doesn't have to touch it in some cases and that's where we get a pretty substantial bump. Then you're not subject to pipeline apportion and issues. It just opens up whole new markets for you.

At the end of the day we will get somewhere around $66 or $63 a barrel this month and then we're going to bump that up by another $9 next month by taking all the crude we have in West Hazel by rail. So our netback will be $35 to $40--and that's just the West Hazel crude.

James Stafford: What is the market like for assets right now, from a junior's perspective? What's the ideal prospect?

Chris Cooper : Asset sales are heating up. We are finding that there are a lot of assets being marketed through companies like Sayer [2] and NRG Divestments [3]. There are also several larger brokerage firms representing companies for “strategic alternatives.”

As an example, Aroway just picked up a great producing asset in Saskatchewan for $10,000/flowing barrel. The market for similar assets in Saskatchewan at that time was about $40,000/flowing barrel. Companies need to exercise patience and do their due diligence. Not to mention kissing a lot of frogs to find these types of assets. They are out there.

James Stafford: A lot of North American juniors are hitting the riskier frontiers with all they've got these days—from Iraqi Kurdistan to Sudan, even Somalia. Why are they willing to take this risk and is it paying off?

Chris Cooper: With higher risk comes higher reward, but I don't think it is paying off in the broader sense. Sure, there are 2 or 3 juniors that have hit home runs, but more often than not a junior is going into those types of plays with only $5 or $10 million in the treasury and they blow this after drilling just one well. I have always believed there is great opportunity offshore, but the risks are lower and infrastructure and political stability in North America is in place. There is plenty of opportunity in North America.

Please tune into the Chemical Equipment Daily for part two of this two-part piece. What’s your take? Please feel free to comment below!

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