

CANADIAN INVESTMENT OPPORTUNITIES

NG



A Special Report from
**Oil and Gas
Investor**

The experience you expect. The results you deserve.

Selected Transactions Since January 2003

 <p>\$51,100,000 Common Stock Follow-On Offering</p> <p>Lead Manager April 2004</p>	 <p>\$530,300,000 Common Stock Private Placement</p> <p>Co-Lead Manager March 2004</p>	 <p>\$113,000,000 Trust Unit Follow-On Offering</p> <p>Lead Manager March 2004</p>	 <p>\$200,000,000 5.875% Senior Subordinated Notes</p> <p>Co-Manager March 2004</p>
 <p>\$316,000,000 Common Stock Initial Public Offering</p> <p>Co-Lead Manager February 2004</p>	 <p>\$270,200,000 Common Stock Follow-On Offering</p> <p>Co-Manager January 2004</p>	 <p>\$78,600,000 Advantage Energy Income Fund has acquired MarkWest Resources Canada from MarkWest Hydrocarbon, Inc.</p> <p>Financial Advisor to MarkWest November 2003</p>	 <p>\$90,700,000 Carbon Energy Corp. has been acquired by Evergreen Resources Inc.</p> <p>Financial Advisor to Carbon Energy Corp. October 2003</p>
 <p>\$281,319,000 Common Stock Follow-On Offering</p> <p>Co-Manager September 2003</p>	 <p>\$1,010,000,000 Canadian Oil Sands Trust has acquired a 13.75% Syncrude Interest from EnCana Corporation</p> <p>Financial Advisor to EnCana Corporation June 2003</p>	 <p>\$109,100,000 Common Stock Follow-On Offering</p> <p>Lead Manager February 2003</p>	 <p>\$575,000,000 Common Stock Follow-On Offering</p> <p>Co-Manager January 2003</p>

RBC Capital Markets is one of North America's leading energy and power investment banks. With equal strengths in both the Canadian and U.S. markets, we have played a significant role in all major energy and power transactions. Since January 2003, we have raised more than \$12 billion for the sector through 88 transactions. Put our experience to work for you.

Look to our industry professionals for the results you deserve.



www.rbccm.com/energy

Communications, Media & Entertainment • Consumer • Diversified • Energy • Financial Institutions • Forest Products • Healthcare • Mining and Metals • Real Estate • Technology

Canadian Returns

With meeting new reserves definitions behind them, as a result of NI 51-101, many Canadian producers are resuming their business of portfolio growth, while some have put themselves on the market.

Calgary-based investor-relations and consulting firm Iradesso Communications reports that since January 1, more than a dozen among the 68 Canadian producers that began the year have since been purchased or merged and 15 new ones have been formed.

"The usual life-cycle of a junior in western Canada is three to five years, with production growth from zero to 1,000 or 2,000 BOE (barrels of oil equivalent) per day... The management normally parachutes out of the transaction and starts again," Peter Knapp, Iradesso president, writes in "Canadian Juniors" in this special report on Canada.

Start-ups are being purchased by royalty trusts or in some cases by U.S. independents that are looking for growth opportunities in the Western Canadian Sedimentary Basin.

U.S. companies have been net sellers, however, and some are finding their assets fetching tremendous premiums. In one recent transaction, the western Canadian divestment by U.S.-based Murphy Oil, the buyers paid historically high prices: an implied average of C\$18 per proved BOE (after royalties). Paul Cheng, an analyst with Lehman Brothers, calls it "an alarming high price."

Knapp says, "If oil and gas prices continue to stay at historically high levels, these trusts will continue to enjoy exceptional access to capital and will use that to buy up juniors to replace their reserves and production. Conversely, if commodity prices were to weaken for a sustained period, the royalty trusts would need to deal with lower distributions and cash flow."

Analysts with Calgary-based investment-banking firm FirstEnergy Capital Corp. report, "The valuations of Canadian junior and midcaps are influenced by expectations of

CONTENTS

C-5 CALGARY START-UPS

They form, grow, sell or merge, and start anew. Here's a spotlight on some of Canada's newest E&P companies.

C-9 ALBERTA'S CBM

The development of Canadian coalbed methane centers in Alberta, and this year promises to be the province's busiest yet.

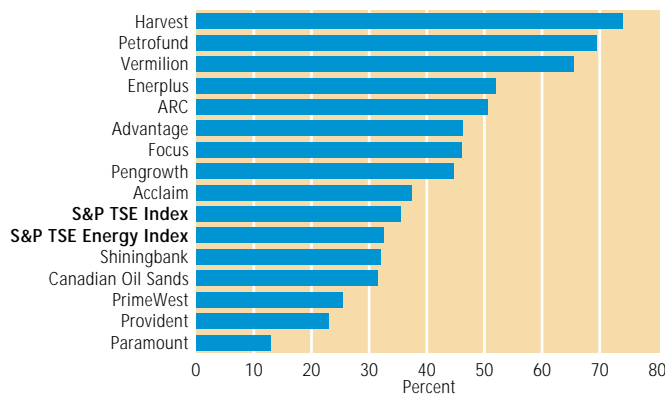
C-11 CANADIAN JUNIORS

Canadian junior oil and gas companies are exciting to watch, and even more exciting to participate in.

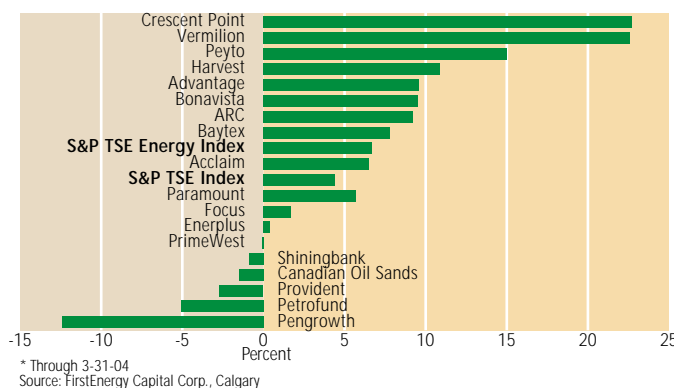
C-15 THE VIEW FROM CALGARY

To supply the insatiable U.S. demand for oil and gas, Canadian producers are creatively trying to beat their own decline curves.

12-Month Oil & Gas Trust Total Returns*



Three-Month Oil & Gas Trust Total Returns*



* Through 3-31-04
Source: FirstEnergy Capital Corp., Calgary

royalty trust-type metrics either by way of reorganizing or acquisition. The Canadian environment is even more competitive than the U.S. market."

Consolidation among trusts is expected, as not all trusts are performing equally. The royalty trusts' total returns during the first quarter of 2004 have been disappointing, compared with their 12-month returns, according to William Lacey, one of the FirstEnergy analysts.

"What hasn't helped are the interest-rate concerns out there," Lacey says. U.S. Federal Reserve Chairman Alan Greenspan is hinting that the U.S. federal funds rate may be pushed higher in coming months. Trusts compete with money-market and other secure investments for dollars. Some trust investors are getting skittish that they may need to redirect their assets.

But it would take a significant upward push in interest rates to make cash investments more attractive: the 12-month total returns (unit-price improvement plus distributions through March 31, 2004) of the 14 Canadian trusts that Lacey covers have ranged from 74% to 13%. In this range, trusts' competition would be more likely with loan-shark investing.

"Investors should be more concerned with commodity prices," Lacey says. The market price for oil and gas more greatly affect royalty trusts' total returns than interest rates.

—Nissa Darbonne,
Executive Editor

Providing blanket coverage of Western Canada

Wood Mackenzie is announcing the launch of its new **Western Canada upstream service**. In conjunction with Wood Mackenzie's coverage of Canada's Frontiers, the Western Canada upstream service is a powerful reference and analytical tool for any company either active in or evaluating potential opportunities in the region.

Our product suite and comprehensive Western Canada database allows the user to:

- › Identify key areas of exploration and production growth
- › Benchmark company activities across a range of metrics
- › Generate competitor positions and compare assets and infrastructure
- › Run company and asset valuations

To receive the Western Canada upstream service brochure email energy@woodmac.com

Calgary Start-Ups

New E&P companies are finding plenty of growing room in western Canada.

ARTICLE BY BRIAN A. TOAL

For energy pundits who believe North America is an overworked, mature basin that's literally and figuratively running out of gas, there's a plethora of emerging Calgary junior oils, private and public, that see just the converse in Canada's Western Sedimentary Basin.

True, the so-called "one-well wonders" may no longer abound in much of Alberta's Foothills area or northeast British Columbia as they once did.

But the use of horizontal drilling, 3-D seismic and well-stimulation technologies is helping small operators drill up plays that were economically out of their reach years ago.

Also, most of today's emerging junior Canadian oils are being helmed by seasoned management teams that have the desire and know-how to replicate much of their past production and reserve growth.

Indeed, one such new Calgary producer, Duvernay Oil Corp., headed by the former management team of Berkley Petroleum Corp., is already outpacing the daily output and in-ground inventory growth achieved by Berkley itself during its first 30 months of operations in Canada's western basin.

Meanwhile, Calgary start-up MEG Energy Corp. is taking a patient approach to building its position in the world-class, oil-sand-laden Athabasca Fairway. There, it expects by 2006 to begin drilling, which shortly thereafter could lead to daily oil output of 25,000 barrels—a level of production usually associated only with intermediate-size oils.

In short, there are plenty of untapped drilling opportunities still left in western Canada. It just takes a little more patience and seasoned skill to go after them—that and a judicious use of technology to lower finding and development costs to manageable levels.

Exploration still key

When it comes to drilling in the Western Canadian Sedimentary Basin, Michael L. Rose, president and chief executive officer of newly public Duvernay Oil Corp. (Toronto: DDV), is no stranger to successfully tapping the region's various play types.

In 1993, he and a group of ex-Shell Canada explorationists

started Berkley Petroleum Corp. with C\$11 million of private equity and bank debt. That same year, Berkley went public and began in earnest to zero in on the basin's vast oil and gas potential. That effort translated into remarkable reserve and production growth—so remarkable that by March 2001, Berkley sold out to Anadarko Petroleum Corp. for C\$1.5 billion.

One would think a nearly 136-fold return on investment would have sated the aspirations of almost any producer. But not Rose. By July 2001, he formed privately held Duvernay, and two months later, funded it with C\$60 million of private-equity backing led by Peters & Co.

"If you're a petroleum geologist, there's nothing more exciting than finding new oil and gas pools and having the satisfaction of being right and creating value," says Rose. "Besides, the team we brought over from Berkley, which includes Bob Yurkovich, our vice president of exploration, is still relatively young and really doesn't know how to do anything else."

Such a band of explorers really doesn't need to know how to do anything else. With the September 2001 private funding it received, Duvernay—a name derived from the source rock responsible for most of the Devonian-age oil and gas accumulations in western Canada—has grown daily hydrocarbon output from zero to north of 6,000 barrels of oil equivalent (BOE).

Proved reserves, meanwhile, climbed from zero to 18.7 million BOE by year-end 2003. Add proved plus probable reserves and that asset base swells to 25 million BOE.

This rapid growth—well ahead of Berkley's pace after 2.5 years—has been largely accomplished by accelerated drilling along a broad trend extending from Wild River-Sundance in north-central Alberta to Groundbirch-Sunset in northeast British Columbia. The play areas in northern Alberta also include Peace River High, Fir, Spirit River and Dawson-Puskwa.

Duvernay's drilling in these areas has ramped up from one well in late 2001 to 20 wells in 2002 and 40 wells in 2003. Total capex



Mike Rose started another Canadian E&P company, Duvernay Oil Corp., after selling Berkley Petroleum to Anadarko.

during this period was north of C\$200 million. In 2004, the producer, whose C\$52.5-million IPO this February was led to market by Peters & Co., plans to spend an initial C\$80 million to drill 50 to 60 wells.

"In the Wild River area, we've made light-oil discoveries in the Jurassic and gas finds in the Cretaceous; in the Puskwa area, the oil and gas finds have occurred in the Devonian and Mississippian; in the Groundbirch and Sunset areas, they've all been in the Triassic," says Rose. "All these formations occur at depths between 5,000 and 10,000 feet."

The biggest of Duvernay's finds to date have occurred at Groundbirch—a tight-sand gas discovery with more than 100 billion cubic feet (Bcf) of reserve potential—and Wild River, a light-oil and gas discovery which may have 5- to 10 million barrels of oil in place and about 50 Bcf of gas, including all the uphole zones.

"We operate almost all our wells and are much more focused than we were at Berkley," says Rose. "The major areas we're in are all geologically contiguous; that allows operations to be run with a smaller staff. In fact, we run all of our field operations out of just one office, in Fort St. John in northeast British Columbia."

In addition, the exploration-focused junior oil, with a market cap of C\$420 million, has staffed up in tandem with its growth rather than growing, then having to scramble for more hands. "Also, as the result of having the best of the Berkley staff, we've learned from our past mistakes—we're more patient and better at predicting where our reserves and production are going to be."

Applying new frac technology to its tight-sand gas wells is also helping the company grow output. Says Rose, "In many cases, it has meant the difference between not producing anything and having commercial wells."

Not relying solely on repeatable development opportunities, Duvernay's inventory of 50 to 60 planned wells this year includes 13 to 15 high-impact exploratory wildcats in its core areas.

"With the well-defined exploration and development program we have, we can easily see ourselves growing core-area daily production beyond 10,000 BOE within the next 18 months," says Rose.

"After that, there's still lots of oil and



J.C. Anderson launched Anderson Energy Ltd. shortly after selling Anderson Exploration Inc. to Devon Energy Corp.

gas to be found in western Canada, including the largely unexplored Northwest Territories, from Fort Liard all the way up to the Mackenzie Delta. The number of large, new-pool discoveries there is quite high relative to the number of wells drilled."

Eschewing acquisitions

Another seasoned explorationist who knows his way around western Canada is J. C. Anderson, chairman of privately held Anderson Energy Ltd., a 2002 entrant to the Calgary E&P scene.

Anderson is the former head of Anderson Exploration Inc., a producer that itself was private for some 20 years before going public in 1988. That's when its growth through the drillbit in the Western Canadian Sedimentary Basin really took off. In October 2001, the Nebraska-born Anderson sold his namesake company—then producing

"We think that natural gas is the game to play."

*J.C. Anderson,
Anderson Energy Ltd.*

about 210,000 BOE per day—to Devon Energy for C\$7.1 billion, including the assumption of debt.

"However, when we sold to Devon, I didn't feel like I was done playing the exploration game—not when there were still plenty of drilling opportunities left in western Canada," says Anderson.

"On top of that, there were some super, like-minded people from Anderson Exploration who felt we could pull together a successful new E&P company."

By May 2002, Anderson Energy Ltd. got off the ground with C\$80 million of funding. Among the founding shareholders were seven former senior Anderson Exploration executives and directors including Brian Dau, the new company's president and chief executive officer; Darlene Wong, its chief financial officer; Anderson himself; and two executives who joined the firm from other oil

companies. Collectively, this group owns a 28% stake in the upstream start-up.

Other financial backers include additional members of the Anderson family who hold a 16% interest, Canadian and U.S. institutional investors which have a 34% interest, and friends and associates who have a combined 22% stake.

"When we started Anderson Energy, all of us thought that we were going to spend about half the raised capital on acquisitions because a number of the larger oil companies were then selling off properties," says Anderson.

"However, the prices that were being paid for oil and gas properties by Canadian royalty trusts just ballooned out of sight, so we chose not to compete. Very simply, we're not interested in annuities."

As a result, the company's strategic emphasis shifted almost exclusively to growth through exploration drilling.

The core focus: the Sierra and Chinchauga areas in northeast British Columbia where gas prospects are in Devonian carbonate sediments, 5,000 to 10,000 feet deep; an 1,800-foot shallow-gas play in northeastern Alberta focused on Devonian carbonates and Cretaceous sands; a 3,000- to 4,000-foot gas play northwest of Edmonton involving Cretaceous and Triassic sands; and Mississippian-subcrop and Cretaceous channel-sand oil prospects, down to 8,500 feet, south of Calgary.

"We think that natural gas is the

game to play," says Anderson. "Commodity prices have gone up significantly and are likely to stay there. The fact is, North American producers are having a hard time replacing production—and that bodes well for future gas prices."

While the company's current production is only 1,500 BOE per day, it fully expects daily output to ramp up significantly by 2005.

"We've just come off a successful winter drilling program, primarily in northeast British Columbia, but we're in the early stages of exploration and those wells which successfully found natural gas won't be on production until next year," Anderson says. "So our numbers are going to change significantly."

He cautions, however, that current and future drilling successes won't be one-well wonders or out-of-the-park home runs.

"As a general rule, we expect our finds to be the sort that give us plenty of room to run after a discovery is made, in terms of being able to drill a lot of development wells to grow our production base."

What is also going to help the start-up efficiently grow not only production, but also reserves, is its use of horizontal drilling, 3-D seismic and well-stimulation technologies.

"These are all things that make smaller targets—which were uneconomic 10 to 15 years ago—very much economic today," he says. "With these technologies, we're able to more fully explore a particular zone with fewer rigs, get the kind of deliverability we need, and keep finding and development costs low."

Will this newcomer ultimately grow to the size of Anderson Exploration? "Right now, I'm just interested in seeing us, two or three years out, increase daily production to 10,000 BOE or more," he says.

Big-barrel target

Bill McCaffrey, president and chief executive officer of privately held MEG Energy Corp., also brought a lot of upstream knowledge to the table when he and two other partners—Dave Wizinsky and Steven Turner—formed their March 1999 start-up.

During his prior 18 years with Amoco Canada, McCaffrey was at one point responsible for the growth of the company's largest oil-sands project in western Canada—the Primrose project in northeastern Alberta's Cold Lake

**"Additional sources
of [oil] supply are in
decline plus demand
throughout the world
continues to grow,
particularly in China."**

*Bill McCaffrey,
MEG Energy Corp.*

area, south of the Athabasca Fairway.

"At the time we formed MEG, oil prices were around US\$10 per barrel, and most people felt prices were going to remain low for a long time," says McCaffrey. "We saw this as an opportunity at a countercyclical point in the industry to link our experience with a very large growth prospect close to U.S. markets."

That not unfamiliar growth prospect is the Athabasca Fairway, which has one of the largest oil-sands deposits in the world. According to U.S. Geological Survey estimates, the bitumen deposits there contain more than 175 billion barrels of recoverable oil reserves.

Taking aim at that resource potential, the start-up firm in 1999 acquired within that fairway 5,000 acres, on which existing wells identified the presence of oil-sands deposits. Since then, the company has greatly enlarged its Athabasca Fairway oil-sands lease position, to 33,000 acres—100% owned and contiguous.

This holding is adjacent to EnCana Corp.'s Christina Lake thermal-oil-recovery project, which has initial daily oil production of 5,000 barrels.

"Meanwhile, we've also drilled 68 core holes on this lease which have helped us characterize its resource potential and allowed us to begin identifying where the best pay zones are located," says McCaffrey.

"In tandem, we've also shot more than 22 miles of 2-D seismic and 12 miles of 3-D in order to put together a geologic model of the oil-sands-bearing formations."

The company's aim is to begin commercial development of the lease in 2007—using steam-assisted gravity drainage (SAGD) technology—and to produce 25,000 barrels of oil per day by 2008.

The SAGD process involves drilling a series of horizontal well pairs—parallel to each other—down through the overburden into the oil-sands formation, which in this case is some 1,200 feet below the surface, explains McCaffrey.

Steam from a central surface facility is then injected into the upper horizontal well, creating a steam chamber and allowing the heated oil in the formation to drain down to the lower horizontal well. Lift mechanisms are then used to get the heated oil in the lower well out of the ground into separation, tank-battery and pipeline facilities.

To ensure sufficient funding is available for such an ambitious, capital-intensive drilling project, the private start-up this February got the cross-border backing of New York-based Warburg Pincus, which is providing C\$59 million of private equity.

"The fact that we had already built up a strong leasehold position, have a strong management team in place and enormous resource growth potential in front of us were clearly factors attractive to Warburg," says Dale Hohm, MEG chief financial officer.

Attractive, too, is the composition of MEG's board. It includes Alan Archibald, formerly a senior executive with Anderson Exploration before successfully growing Westpoint Energy and Tripoint Energy—two other private Calgary producers.

Also on MEG's board is Paul Rady, chairman and chief executive officer of Denver's Antero Resources Corp., another Warburg Pincus-backed private operator; Whitney Ward, a former global partner with Invesco in Denver; and Lloyd Swift, a former vice president with Nesbitt Burns in Calgary.

McCaffrey believes the fundamentals for continuing high oil prices in North America are very strong. "Additional sources of supply are in decline plus demand throughout the world continues to grow, particularly in China."

While an initial 25,000 barrels per day of oil output from the company's planned drilling program would catapult it to the ranks of an intermediate Canadian producer, "we see significant upside beyond that as we advance through further phases of development on our lease," McCaffrey says. □

Resource plays. They set us apart.



Our asset base, our core competencies, our track record and our culture, they all come together in our resource plays* - a foundation of our production growth potential.

Our resource play assets typically have a long life, low production costs and low decline profiles and have provided steady, reliable and highly profitable production growth. Resource plays make up the majority of our North American assets.

With an enterprise value of approximately US\$25 billion, EnCana is one of the world's leading independent oil and gas companies and is driven to be the industry's high performance benchmark in production cost, per-share growth and value creation. EnCana common shares trade on the Toronto and New York stock exchange under the symbol ECA.

* Resource play is a term used by EnCana to describe an accumulation of hydrocarbons known to exist over a large areal expanse and/or thick vertical section, which when compared to a conventional play, typically has a lower geological and/or commercial development risk and lower average decline rate.

www.encana.com

Alberta's CBM

Like to western Canada's south, operators are finding ways to economically produce shallow coalbed methane.

ARTICLE BY PEGGY WILLIAMS

The development of coalbed methane (CBM) in Canada centers in Alberta, and this year promises to be the province's busiest yet in this expanding source of gas. At year-end 2003, some 780 CBM wells had been drilled in Alberta, another 80 wells targeted a mixture of coals and sands, and 155 existing wells were recompleted as CBM wells, reports the Alberta Energy & Utilities Board (EUB).

The top play—the target of 80% of the total wells—is in south-central Alberta's Upper Cretaceous Horseshoe Canyon/Belly River coals, part of the Drumheller coal zone. Located northeast of Calgary and stretching to Edmonton, this prospective area features low-rank coals that occur in discontinuous seams at depths between 1,000 and 3,000 feet. Significantly, these coals produce very little to no water, a tremendous attribute that greatly reduces operating costs and environmental issues.

The two most active players in the Horseshoe Canyon have been EnCana Corp. and Quicksilver Resources Inc. The companies initially had a joint venture in the Palliser area but dissolved that partnership early in 2003.

Last year, following the success of a 35-well pilot project that produced 3 million cubic feet of gas per day, EnCana drilled 270 wells in its Palliser program. It approaches these coals much like it does a conventional shallow-gas play, using the same rigs and multi-zone fracturing techniques.

In 2004, EnCana plans to drill about 300 wells on its 700,000 acres of prospective properties, raising production by year-end to 30 million cubic feet per day. During the next five years, it estimates that its CBM production from this play could reach 200 million cubic feet per day.

Fort Worth-based independent Quicksilver, which operates in Canada through its MGV Energy Inc. subsidiary, also continues to aggressively develop CBM production in the area.

"We and our partners have drilled more than 200 wells and we believe we have defined a significant fairway for coalbed methane," Glenn Darden, president and chief executive officer, said at a recent IPAA-sponsored investment conference.

Currently the company is producing 22 million cubic feet of CBM gas per day in Canada from a series of joint ventures with partners including ConocoPhillips, Enerplus, NCE Petro-

fund, Burlington Resources and Murphy Oil. Quicksilver operates 95% of these projects, and altogether holds 525,000 net acres of leases.

The company booked proved reserves of 132 billion cubic feet from these properties at year-end 2003, and it expects to double that number in 2004, Darden said. This year, Quicksilver will drill 285 net CBM wells in Alberta and expects to exit 2004 with Canadian CBM production of 35 million cubic feet per day.

"This project now, we can clearly see, can be a trillion-cubic-foot project for us. And with luck we can double that number."

The rates of return in the Horseshoe Canyon play are compelling: the shallow CBM wells, which average production rates of 140,000 cubic feet per day and reserves of 450 million cubic feet, deliver 60% rates of return at gas prices of US\$4 per thousand cubic feet, and post nearly 100% return at prices of US\$5 per thousand.

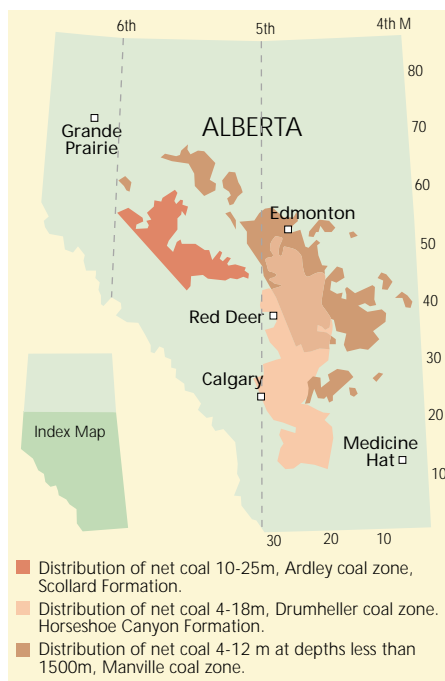
Apache Canada also has an active CBM campaign in the same play, centered in its Nevis Field area northeast of Red Deer, where it holds 250 sections of land. It drilled 16 wells during first-quarter 2004, raising its total number of CBM wells to 121 and its related production to 16 million cubic feet of gas per day. During 2004, it expects to drill about 250 wells in the play.

While the economic viability of CBM production from Alberta's dry coal zones is now established, the same cannot yet be said for the province's extensive wet coals.

Of these more problematic targets, interest is focused on coals in the older Mannville Group and in the Ardley coal zone, a younger coal that is part of the Scollard Formation.

About 140 wells have been drilled to test the Mannville coals, which produce copious amounts of saline water. These seams are coincident with part of the Drumheller coals and also extend farther east.

Less than 50 of the Mannville tests are producing gas, reports the EUB. And, the Ardley coals, which occur to the north and west of Calgary, have been very lightly tested to date. About 60 wells had been drilled to the Ardley zone through 2003, and only a handful of these are on production. Like the Mannville, the Ardley coals produce water, but the volumes and salinities can vary widely.



The two most active players in the Horseshoe Canyon have been EnCana Corp. and Quicksilver Resources Inc.



CANADIAN SUPERIOR
ENERGY INC.

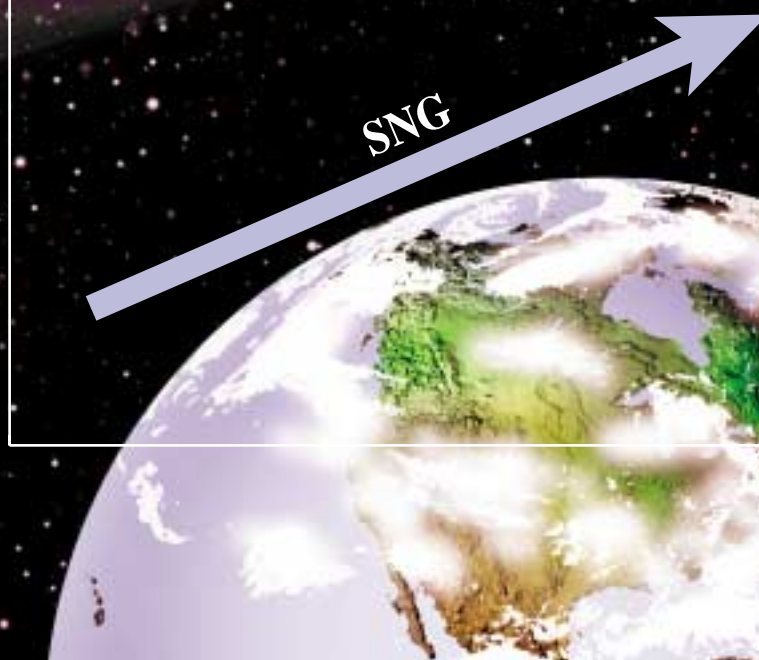
The Emerging Exploration and Growth Company of 2004

- *Focused Western Canadian Operations*
- *Large World-Class Offshore Nova Scotia and Trinidad Prospects*
- *Strong Balance Sheet*
- *Experienced Management Team*



Growth In:

-  *Financial Results*
-  *Production*
-  *Reserve Value*
-  *People (Talent)*
-  *High Impact Plays*



Canadian Superior Energy Inc.
Suite 3300, 400-3rd Avenue S.W.
Calgary, Alberta
Canada T2P 4H2

Phone: 403-294-1411
Fax: 403-216-2374
Stock Symbol - SNG: TSX, AMEX
Website: www.cansup.com

Canadian Juniors

Publicly held entrepreneurial E&Ps merge or are bought out, and new ones keep popping up. Here's how to evaluate them as investments.

ARTICLE BY PETER KNAPP

Canadian junior oil and gas companies are exciting to watch, and even more exciting to participate in. Investors who do their homework by researching company fundamentals, growth prospects and the caliber of management can make money in this sector. More than 70 publicly listed juniors are focused on exploration and production in western Canada, mostly from a base in Calgary.

This year some of them will see their share price double, triple and do better. There will also be some disappointments. A number of companies will be ac-

The fate of the junior sector will undoubtedly be tied to the intermediate royalty trust sector.

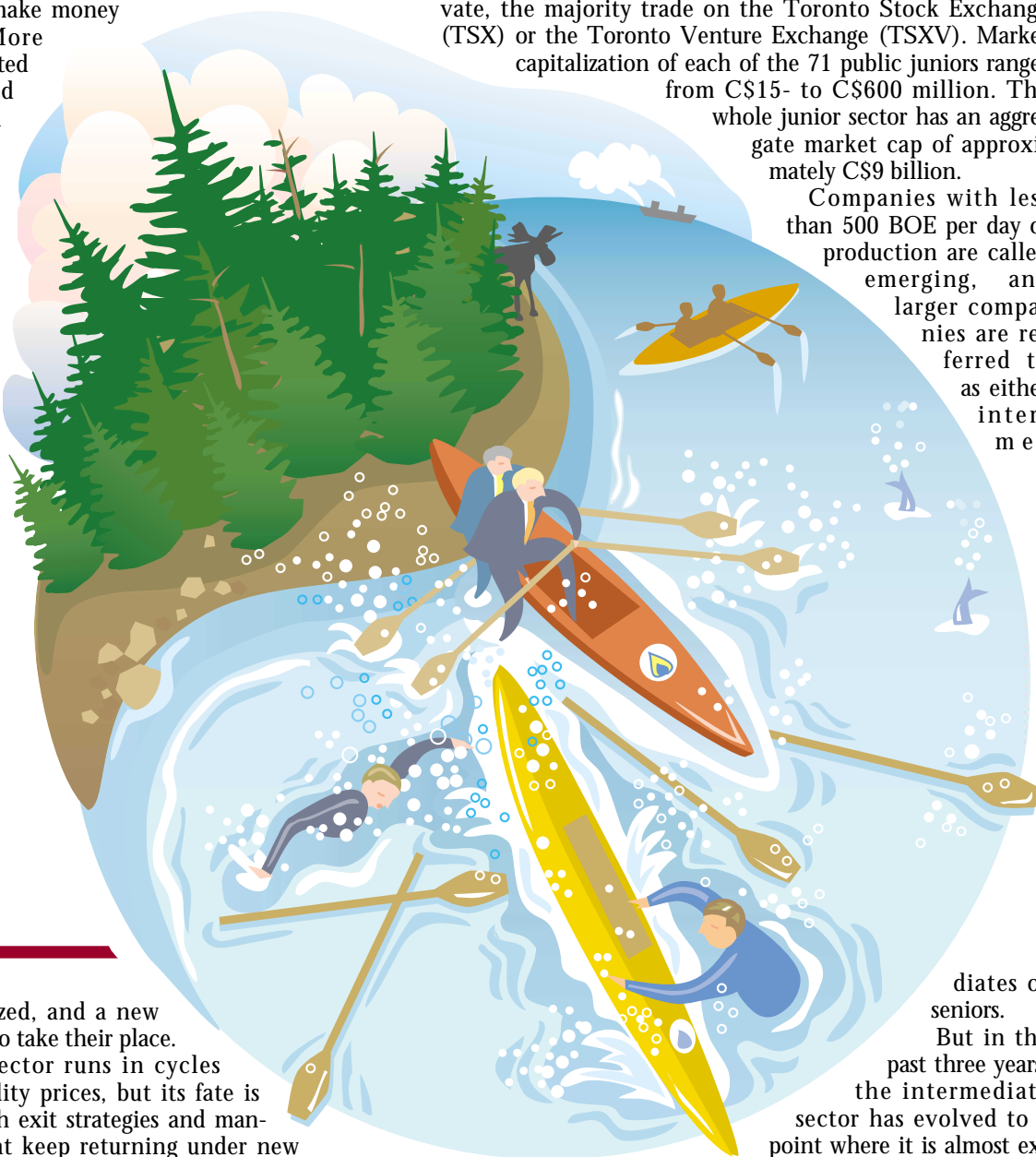
quired or reorganized, and a new crop will continue to take their place.

This thriving sector runs in cycles driven by commodity prices, but its fate is also connected with exit strategies and management teams that keep returning under new company names. These teams don't just enjoy the game of building small oil and gas companies to a point where they can sell them; they can also make a significant amount of money doing so.

Fortunately, so can shareholders.

We define juniors as those with production averaging between 500 and 15,000 barrels of oil equivalent (BOE) per day. Although a number of companies in this range are private, the majority trade on the Toronto Stock Exchange (TSX) or the Toronto Venture Exchange (TSXV). Market capitalization of each of the 71 public juniors ranges from C\$15- to C\$600 million. The whole junior sector has an aggregate market cap of approximately C\$9 billion.

Companies with less than 500 BOE per day of production are called emerging, and larger companies are referred to as either intermediate



diates or seniors.

But in the past three years, the intermediate sector has evolved to a point where it is almost exclusively populated by royalty trusts. Because they continually distribute a large percentage of their cash flow to unit-holders, they are much less active as explorers and aggressive drillers than intermedi-

ate companies have been in the past.

This has helped the juniors rediscover their niche as they have been picking up the slack. They have also become feedstock for the trusts that use their tremendous access to capital to buy up junior companies at a rate of five to 10 per quarter.

As a group, the juniors seem to favor gas production over crude oil. Gas can be produced with comparably lower operating costs, while the prices received are often relatively higher than those received for oil. Some of the companies that had the highest proportion of their fourth-quarter 2003 production weighted to gas include Hawker Resources (Toronto: HKR) at 100%, Ketch Resources (Toronto: KER) at 94% and Diaz Resources (Toronto: DZR.A) at 88%.

One company that has found success while bucking this trend is Blackrock Resources (Toronto: BVI) with 100% of production made up of heavy oil.

An extended period of high commodity prices has benefited the Canadian juniors and their investors. During 2003, juniors showed an average return of 63.5%. Only 15% experienced a share-price decrease, while one in four saw its share price rise 100%.

By comparison, the 17 Canadian energy trusts that make up the intermediate sector had total returns, including distributions, averaging 49% for 2003. That included an 18% average return from distributions paid during the year as well as a 31% average gain in unit prices.

In the first four months of 2004, the market for juniors appeared to be catching its breath, with only a 2% average share-price increase during this period.

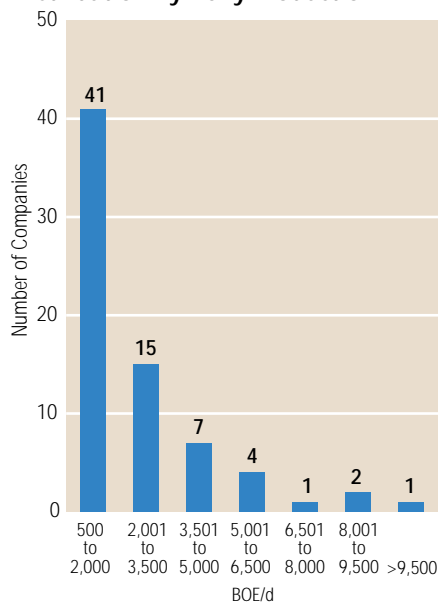
Valuations, key metrics

Investors in junior companies, and often the executives of these companies themselves, frequently compare companies' financial and operating results against each other to make more informed investment decisions.

However, in a recent survey Iradeso Communications found that the quality of the management team is the most important factor for investment decisions. Of course, this is impossible to objectify, although a past record of success or failure is as close as one can come.

Another key factor that cannot be found in the comparison of investment ratios or multiples is the quality of future growth prospects. This means some companies end up trading at much

Canadian Juniors
Distribution By Daily Production



During 2003, juniors showed an average return of 63.5%....[and] one in four saw its share price rise 100%.

higher multiples because future growth is already factored into their share price.

Reserves volumes and present values are evaluated by third-party engineering firms and reported by Canadian juniors on an annual basis. However, some companies are starting to report reserves quarterly to recognize growth and lower the chance of any surprises.

Starting with year-end 2003 reporting, the Canadian Securities Administrators implemented National Instrument 51-101 to ensure consistent reserve definitions are used across the board by public Canadian oil and gas companies, while attempting to enhance investor confidence in Canadian capital markets.

Under the definitions of reserves set out by NI 51-101, a company's reserves should have a 90% probability of being greater than the proved reserves assigned to the company, and a 50% probability of being greater than the proved plus probable reserves assigned.

Of the 71 juniors currently operating, 55 had released their year-end 2003 re-

sults at press time. For those 55 companies we were able to calculate a blow-down net asset value by taking the 10% discounted net present value of reserves, adding C\$100 per acre for undeveloped land, adding working capital and subtracting debt.

After dividing this by the number of shares outstanding, we found that as of April 30, 2004, 80% of companies were trading at a premium to our blow-down net asset value (NAV) calculation. This high percentage could be a result of conservative pricing forecasts used to calculate the present value of reserves. It could also be a result of investors attributing value to strong management teams and post-2003 growth prospects.

Using the year-end reserve reports, we can compare the enterprise value (market cap plus net debt) less undeveloped land value, attributed to each BOE of reserves. This calculation gives us an average value of C\$24.45 per BOE of proved reserves and C\$17.53 per BOE of proved plus probable reserves.

Companies that appeared to offer good value using this measure include Ranchgate Energy (Toronto: ROG) at C\$7.52 per BOE, Purcell Energy (Toronto: PEL) at C\$8.39 and Con-nacher at C\$8.43 (all on a proved-plus-probable basis).

Cash flow multiples are also a favorite valuation tool. Rather than use a straight share price, or market cap multiple of cash flow, it is more effective to use enterprise value multiples, which incorporate net debt. Otherwise a company that carries a comparably large amount of debt could appear falsely undervalued to potential investors. Cash flow multiples can be monitored quarterly and also be projected into the future with a forecast of cash flow.

On a historical basis, by the end of April, companies were trading with an average enterprise value 14.3 times their 2003 cash flow. A more valuable measure will be the enterprise multiple of cash flow for first-quarter 2004 annualized. It is likely that companies that had a low enterprise multiple of cash flow for 2003 will continue to report this in 2004 and therefore will look like a strong potential investment. These companies include Devlan Exploration (Toronto: DXI) at 4.7 times, Case Resources (Toronto: CAZ) at 5.4 and Energy North (Toronto: ENI) at 5.8.

Debt levels are monitored by investors as another multiple of cash flow. Most companies strive to have net debt



The bank of energy

has an extensive knowledge of the industry

is a powerful ally through economic swings

executes complex transactions with agility and expertise

customizes financing around your specific needs

puts its full energy behind each and every deal.

Invest in you™

UNION
BANK OF
CALIFORNIA®

Energy Capital Services

Dallas - (214) 922-4200

Carl Stutzman, Senior Vice President

Randall L. Osterberg, Senior Vice President

Damien Meiburger, Senior Vice President

Calgary, Canada Branch* - (403) 264-2700

James G. Chepyha, Vice President

Dustin Gaspari, Vice President

Mezzanine Finance**

Michael Ross, Vice President, (213) 236-6061

©2003 Union Bank of California, N.A. Member FDIC

*Union Bank of California, N.A., does not accept deposits from the public in Canada and is not a member institution of the Canada Deposit Insurance Corporation.

**Mezzanine loans are made pursuant to a Department of Corporations California Finance Lenders License by UnionBanCal Equities, Inc., an affiliate of Union Bank of California, N.A.

of less than 1.5 times annualized cash flow, and companies carrying higher debt than this are often penalized by the market. Among the cycles experienced by the sector is availability of capital. The past year has been good for access to capital, as many junior companies have been able to successfully conduct secondary share offerings.

Exit strategies

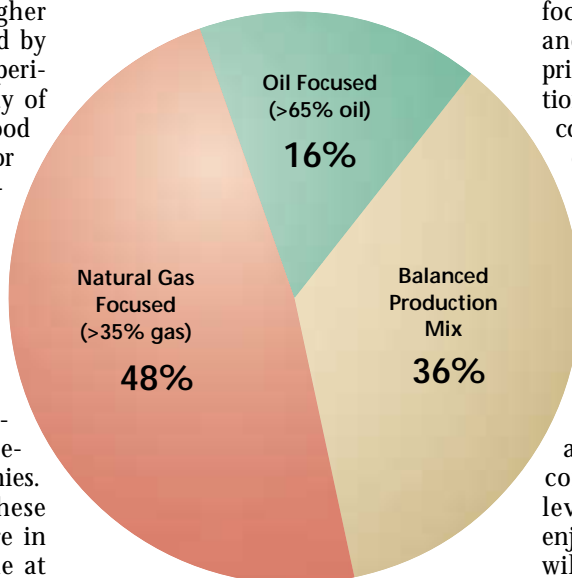
Iradesso's quarterly report on Canadian junior companies attempts to compare all companies that meet the criteria. The last report, issued at the beginning of December 2003, included 68 companies. In the last four months, 13 of these companies have disappeared or are in the process of disappearing, while at least 15 new companies have filled the void. This translates into a turnover rate of approximately 20% in less than half a year.

The 13 companies that most recently disappeared have all been acquired, mostly in friendly takeovers by royalty trusts, or they have converted to a royalty trust.

The usual life-cycle of a junior in western Canada is three to five years, with production growth from zero to 1,000 or 2,000 BOE per day. After this time, the company is often acquired or merged with another. The management normally parachutes out of the transaction and starts again. In recent years, this has been done through a spin-off company that takes some of the more growth-oriented assets as a starter kit.

The spin-off transaction seems to have been mastered by the management team led by Paul Colborne. This team began this type of transaction when Startech Energy was sold to ARC

Commodity Focus of Canadian Juniors



As a group, the juniors seem to favor gas production over crude oil.

Energy Trust in early 2001 and spun off Impact Energy. Most recently, when Crescent Point Energy merged with Tappit Resources to form Crescent Point Energy Trust (Toronto: CPG.UN), shareholders received shares in a new spin-off, Starpoint Energy (Toronto: SPN).

Selling the company to a royalty trust hasn't always been the most common exit strategy for juniors. During 2000, there was a cycle involving U.S. exploration and production companies

acquiring Canadian companies with a focus on securing access to junior oil and gas reserves. In 2001, when gas prices declined, many of these acquisitions started looking expensive, so U.S. companies have shied away from acquiring Canadian juniors since.

What's next?

As any investor in the oil and gas sector should know, the next phase of the cycle is often determined by what happens to commodity prices.

The fate of the junior sector will also be tied to the intermediate royalty trust sector. If oil and gas prices continue to stay at historically high levels, these trusts will continue to enjoy exceptional access to capital and will use that to buy up juniors to replace their reserves and production. Conversely, if commodity prices were to weaken for a sustained period, the royalty trusts would need to deal with lower distributions to unit-holders and lower cash flow.

This could lead to a period of consolidation within the royalty trust sector, while junior oil and gas companies maintain themselves on their own cash flow. A shake-out of the junior and intermediate sectors could be healthy, and those that make it through a lower-price cycle will be much stronger coming out the other side.

Another possibility presumes American companies once again make their presence felt by acquiring Canadian companies. This has happened approximately every few years in the past, and the time may be due for this trend to emerge once again.

The model for building a junior oil and gas company will undoubtedly continue to evolve. It may do so to take advantage of new technologies available to smaller companies such as those involved in producing coalbed methane or shallow oil sands. They may also evolve to take advantage of new and improved financial structures, such as the case was for royalty trusts.

Canada's junior sector is filled with growth stories and competent management teams, and will continue to be a fascinating (and hopefully profitable) sector to watch.

Peter Knapp is president of Iradesso Communications Corp., a Calgary-based investment research, investor relations and corporate communications firm. The firm represents some of the companies mentioned in this article.

Researching Canadian Juniors

For more information on the Canadian junior oil and gas sector, you may wish to visit the following web sites:

- Canadian Association of Petroleum Producers (CAPP): www.capp.ca
- Oilpatch Updates: www.oilpatchupdates.com
- System for Electronic Document Analysis and Retrieval (equivalent to EDGAR in the U.S.): www.sedar.com
- Small Explorers and Producers Association of Canada (SEPAC): www.sepac.com
- Alberta Securities Commission (disclosure standards): www.albertasecurities.com
- TSX Group: www.tsx.com
- Iradesso Communications Corp.: www.iradesso.com
- Canada Stockwatch: www.canada-stockwatch.com

The View from Calgary

Upstream activity in Canada's Western Sedimentary Basin is at full throttle.

INTERVIEW BY BRIAN A. TOAL

With so much uncertainty today surrounding the stability of global oil and gas supply, Canada is being viewed more and more as a safe harbor for the U.S., in terms of meeting rising energy demand, particularly as that demand relates to natural gas.

Indeed, Canada is the largest foreign gas supplier to the U.S., currently exporting 3.4 trillion cubic feet (Tcf) of gas annually to the Lower 48. Put another way, about 15% of all the natural gas consumed in the U.S. comes from Canada.

Meanwhile, during this time of turmoil in Iraq and other parts of the Middle East, security of oil supply is also looming as a much larger issue for the U.S. There again, Canada has the potential to allay much of that concern, given its massive oil-sands deposits, recently estimated at 175 billion barrels. These petroleum deposits are, in fact, the largest in the world behind those of Saudi Arabia.

To find out more about Canada's current and future hydrocarbon supply picture and the breadth of its recent upstream activity, Oil and Gas Investor recently met with Greg Stringham, vice president of markets and fiscal policy for the Canadian Association of Petroleum Producers (CAPP) in Calgary.

A nearly 20-year veteran of the Maple Leaf oil patch, Stringham began his career with Syncrude, the 12-company consortium that runs the giant Canadian oil-sands project in northeast Alberta. He also worked several years for the Alberta provincial government on energy-policy issues before joining CAPP eight years ago.

Investor What was the level of drilling activity in Canada last year and what's the outlook for it this year?

Stringham Canadian rig activity in 2003 reached record levels. Overall, there were nearly 20,000 wells drilled, most of them for natural gas. Comparatively, first-quarter drilling this year was up 37% from the same prior-year period and up 91% from the comparable 2002 period.

In 2004, gas drilling will still dominate the rig count, accounting for some 15,000 wells out of an expected 20,000-total well count.

Investor What about annual production growth?

Stringham Gas output was down slightly in 2003 from the average 6.3 Tcf we produce in Canada annually. However, as



Greg Stringham, vice president, markets and fiscal policy, Canadian Association of Petroleum Producers (CAPP) in Calgary, says it would take—at current production rates—about 400 years to deplete western Canada's known oil-sand reserves.

the result of record drilling activity in first-quarter 2004, we see annual gas output this year climbing back to around 6.3 Tcf.

Investor And on the oil side of the equation?

Stringham Our average crude oil output—2.5 million barrels per day—was up slightly last year because a major oil-sands project, Shell Albion in northeastern Alberta, came on-stream. In fact, by the end of 2003, 1 million barrels per day of crude output was coming from Canadian oil-sands production alone.

This year, we expect Canada's overall daily crude output to grow further, in no small part propped by increasing oil-sands production, which is expected to reach 1.8 million barrels per day by 2010.

One should remember that in western Canada, there's an estimated 175 billion barrels of oil-sands reserves in the ground. To put this immense reserve base in perspective, it would take—at current production

rates at our existing oil-sands operations—about 400 years to deplete those reserves.

Investor On the gas side, where is most of the drilling in western Canada taking place?

Stringham The highest gas-producing wells are being drilled right along the Foothills Front in northern Alberta and northeast British Columbia; however, the largest number of gas wells—about 65% of the 15,000 wells I mentioned—are being drilled in the shallow-gas regions of southwestern Alberta and southwestern Saskatchewan.

Investor What's the remaining gas resource base in Canada?

Stringham There's an estimated 363 Tcf of remaining gas resource potential. Importantly, this figure does not include an estimated 167 Tcf of untapped natural gas potential from Canadian coalbed-methane (CBM) resources.

Fewer than 800 CBM wells have been drilled in Canada in the past 20 years; however, there's likely to be 1,150 wells drilled in 2004, ramping up to 1,500 in 2005.

Investor What has the recent Canadian gas-export picture looked like, with respect to the U.S.?

Stringham On average, we export annually to the U.S. some 3.4 Tcf of gas—more than half our yearly domestic output of 6.3 Tcf. Last year, however, those exports were down slightly due to several factors.

Align your Resources Capitalize on your Energy

We bridge the Energy Sector, bringing investors and industry players together with the right advice and the best service.

- We help Energy Companies raise private capital and complete sound mergers and acquisitions.
- We offer Capital Providers solid investment strategy and execution.



COSCO
CAPITAL MANAGEMENT LLC
www.coscocap.com

New York • Hartford • Houston
Tulsa • Oklahoma City • Calgary

To Capitalize on your Energy, contact:

Cameron O. Smith

Sr. Managing Director, New York NY
212-889-0206 cos@coscocap.com

William E. Weidner

Managing Director, Avon CT
860-677-6345 wew@coscocap.com

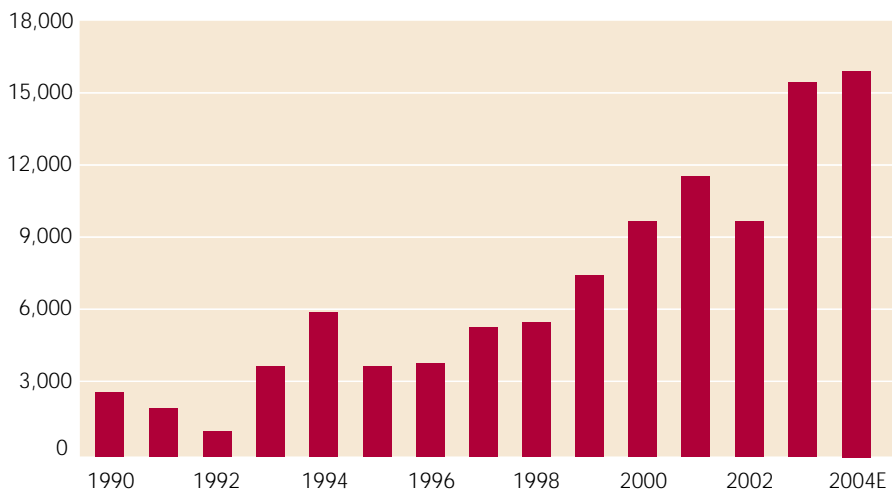
Lane W. McKay

Managing Director, Calgary AB
403-237-9462 lwm@coscocap.com

T. Prescott (Scott) Kessey

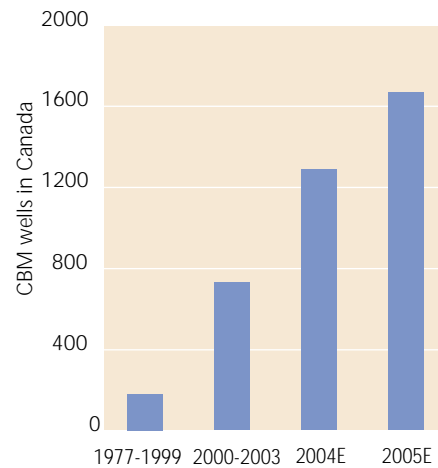
Principal, Houston TX
713-654-8080 tpk@coscocap.com

Natural Gas Wells Drilled in Western Canada



Since 1990, the number of natural gas wells drilled in western Canada has steadily climbed and should account for 15,000 of the total 20,000 wells expected in 2004.
Source: CAPP

Coalbed Methane Wells (NGC) Drilled in Western Canada



There are likely to be 1,150 CBM wells drilled in 2004, ramping up to 1,500 in 2005.
Source: CAPP

First, overall U.S. gas demand was down about 5% in 2003 at the same time Canadian gas production was also down slightly. Meanwhile, with the start-up of the Kern River Pipeline from the U.S. Rockies, some of the Canadian gas that would normally go into California went into storage in Canada by mid-year.

This past winter, however, that supply came back to meet the severe cold snap in the U.S. Northwest. So the capacity is there to meet U.S. gas demand—not just now but in the future—from the resource potential I've already mentioned.

I would also point out that prospects for pipelining Arctic gas from Canada's Mackenzie Delta into the vast Canadian and U.S. pipeline network look promising. An application for a pipeline through the Mackenzie Delta is expected in mid-2004, with gas flowing by late 2008 or early 2009.

Investor What about oil exports to the U.S.?

Stringham Of the overall 2.5 million barrels per day produced in Canada, some 1.6 million barrels is exported to the U.S. I would add that we expect conventional oil production off Canada's East Coast—currently 330,000 barrels per day—to grow to nearly 500,000 daily barrels by 2006 when White Rose joins the existing Hibernia and Terra Nova projects.

Investor What's the biggest challenge currently facing the Canadian oil and gas industry?

Stringham Access to resources, timely regulatory processes and implementing new technology to lower costs are, of course, key factors for Canadian pro-

ducers. But equally important is access to markets—ensuring sufficient pipeline capacity for oil and gas to get where those commodities are needed.

For natural gas, current pipeline capacity is sufficient and diversified enough that Canadian gas can move to markets domestically and in the U.S., as market demand changes. For oil, while a few small pipeline expansions are under way, the anticipated huge growth in oil-sands production that I mentioned between now and 2010 is leading to significant analysis as to what markets this growth will be targeted.

While the U.S. is an obvious market, we've also had inquiries about directing some of our growing oil-sands supply to places like China, Taiwan and Korea.

Investor How much capital infusion or upstream spending are you seeing within the Canadian E&P sector?

Stringham Investment in the Canadian oil and gas sector is close to, if not at, record levels. For instance, in 2003, we saw some US\$20 billion invested in the upstream—most of that coming from the cash flows of producers; the balance, from the Canadian financial markets.

Investor Do you see any step-up in M&A activity this year, particularly crossborder transactions?

Stringham We had a very large influx of U.S. investment around 2001 with Burlington acquiring Canadian Hunter, Anadarko acquiring Berkley and Devon acquiring Anderson. Future activity like that, however, depends on many factors, including one's perception of the maturity of Canada's western basin.

We view the basin as relatively young versus the U.S., at least on the

natural gas side. In fact, if one compares Canada's western basin with the Anadarko Basin, the Permian Basin and the onshore U.S. Gulf Coast, we're about 12 to 15 years behind, in terms of maturity.

Also, crossborder M&A activity depends on currency-exchange rates, the prospects for CBM, oil-sands development and the timing of bringing on Mackenzie Delta gas—from an initial 1 billion cubic feet (Bcf) per day to as much as 1.8 to 2 Bcf per day.

But let's not forget, although much of the publicized crossborder M&A deals in recent years has spotlighted U.S. producers acquiring Calgary operators, the deal flow works the other way as well, as we saw this April with EnCana Corp.'s agreement to buy Tom Brown Inc. for US\$2.7 billion.

Investor What's the biggest thing you think North American producers and investors should understand about the Canadian oil and gas industry?

Stringham That Canada is, and will continue to be, a vital part of U.S. energy supply. Natural gas exports from Canada to the U.S. have, in fact, doubled during the past decade and while they've flattened out recently, don't assume they're going to be falling off.

Canadian CBM and Mackenzie Delta gas output have not even been touched yet. Also, as I mentioned, oil-sands production in northern Alberta is growing quickly.

The important thing to note is that the oil and gas trade between Canada and the U.S. is working very well. It is, in fact, a model from which other countries can learn a great deal. □

The Canadian Association of Petroleum Producers' (CAPP) annual Oil & Gas Investment Symposium takes place each June in Calgary, Alberta. It provides an unrivalled opportunity for institutional investors to meet senior management from Canada's leading oil and gas producers as well as the emerging companies that generate so much interest in the sector.


**OIL & GAS
INVESTMENT
SYMPOSIUM**
June 14-15, 2004



This year, we have made BIG changes.

We value your feedback.
communication@capp.ca
and www.capp.ca

2100, 350 - 7 Avenue SW
Calgary, Alberta
Canada T2P 3N9
Telephone: (403) 267-1100
Fax: (403) 261-4622

230, 1801 Hollis Street
Halifax, Nova Scotia
Canada B3J 3N4
Telephone: (902) 420-9084
Fax: (902) 491-2980

905, 235 Water Street
St. John's, Newfoundland
Canada A1C 1B6
Telephone: (709) 724-4200
Fax: (709) 724-4225

After extensive research and polling, we have reinvigorated the conference to ensure that it is a must-attend event. We have enhanced the networking opportunities, added roundtable discussions with corporate executives and a CEO issues forum. Improvements will continue in 2005.

CAPP is the voice of Canada's upstream petroleum industry and Investment Symposium is where our members tell their stories.

CAPP represents 150 companies that explore for, develop and produce more than 98 per cent of Canada's natural gas and crude oil. CAPP also has 125 associate member companies that provide a wide range of services that support the upstream oil and natural gas industry. Together, these members and associate members are an important part of a \$75-billion-a-year national industry that affects the livelihoods of more than half a million Canadians.

 **CAPP** CANADIAN ASSOCIATION
OF PETROLEUM PRODUCERS