

Signs of Renewed Life

— DANIEL S. CHENG, CFA, PORTFOLIO MANAGER

Nothing speaks to potential future performance in the energy sector like land sales and drilling activity. During the first quarter, signs of renewed life—encouraged by the late 2009 recovery in natural gas and crude oil prices—appeared across Western Canada. Here are some of the indicators we’re tracking and tapping for the MFi Energy Fund:

Drilling Activity

- First quarter drilling rig utilization rates in the Western Canada Sedimentary Basin (WCSB) were up 53.0% year over year. The count of 425 active rigs marks progress, but remains below the five-year average of 520 rigs.
- During the first quarter, oil wells accounted for 50.0% of wells drilled in the WCSB region. This level, unseen since 1997, highlights a significant shift in the allocation of resources. Prompted by strong prices, companies are moving capital to oil opportunities and we expect this trend to continue through the rest of the year.

Land Sales

Generally, the number of land postings in the WCSB continues from last year’s lows. Land bonuses in the region recovered somewhat in 2009 reaching \$277 per acre, but remain well-below the five-year average of \$300 per acre. At an average of \$191 per acre, land sale prices for Q1 remain the lowest since 2004, but we’re seeing a significant range in prices depending on the play in question. Looking at the various provinces:

- British Columbia remains the primary benefactor of Alberta’s *New Royalty Review* announced in 2007. For example, Q1 land bonuses in British Columbia averaged \$929 per acre as compared to Alberta’s \$161 per acre.
- The latest *Alberta Competitiveness Review*, which provides improved visibility on the province’s royalty structure, set an encouraging tone, enabling oil and gas companies to develop longer-term capital programs.
- In Saskatchewan, while 2009 land sale prices were slow as compared to the 2008 frenzy, an April 2010 sale raised \$190 million (approximately \$660 per acre), the fifth highest sale yield on record and second highest total for an April land sale in Saskatchewan. We believe continued interest in the Bakken Formation drove the strong returns.
- Manitoba’s competitive royalty regime and large inventory of oil-bearing prospects are attracting growing attention, particularly the Tourquay and Amaranth plays. The latter is said to have similar geological attributes to the Bakken and less than 3.0% of the estimated 1-2 billion barrels of original oil in place has been recovered to date.

Our Approach

We’re taking strategic advantage of the current environment, focusing on oil-weighted and service companies with exposure to oil and natural gas resource plays. For instance, we’ve been adding oil-weighted companies such as Arcan Resources Ltd., Wild Stream Exploration Inc. and Legacy Oil + Gas Inc. to the MFi Energy Fund. We expect capital and drilling activity will continue to be directed towards oil-focused plays and liquids-rich natural gas plays as oil prices hover in the \$80 per barrel range and natural gas prices linger near \$4 per thousand cubic foot. We remain interested in the Cardium, Viking and Pekisko plays from a drilling as well as a merger and acquisition activity perspective. We believe the MFi Energy Fund is well-positioned to benefit from further signs of renewed life. ■



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