Weekender
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## THE BEST WAY TO PLAY CRUDE OIL RIGHT NOW

Dr. Kent Moors writes: As I've been noting for some time now, making money in the energy sector is no longer pegged to higher crude oil prices.

In today's environment, picking winning oil stocks is more about where a company drills, how it manages its assets and operations, as well as the broader flow of supply and demand.

In this case, it's all about selecting the right target – companies that are built to weather the inevitable dips in the price of crude.

Of course, geopolitical events are still going to be the ultimate wildcard.

For instance, the impending entry of Turkey this morning into the broadening crisis in Iraq and Syria will create some jitters and instability certain to influence oil prices.

But, at least in the short-term, this is quickly becoming a very different oil market.

Yesterday marked the first time in almost a year and a half that crude oil prices in New York fell below $90 a barrel. Meanwhile, the Brent price in London mirrored the decline, closing below $93.

The spread between the two is also narrowing. That will have some interesting effects on how traders arbitrage paper barrels (futures contracts) and wet barrels (actual consignments of oil for shipment).

As I've discussed many times before, the emergence of massive unconventional oil reserves in North America and the rest of the world (over 80% of extractable unconventional reserves are outside of North America) are changing the energy landscape.

However, one thing that is not going to happen is a collapse in oil prices.

Already this morning, WTI and Brent are clawing their way back from the recent lows. Much of the move higher has been driven by a Saudi decision to cut back on production. What's more, there is the winter demand cycle that's kicking in for heating fuel and diesel.

The key from this point forward is balance. We are going to be trading in a narrow range for a bit, where the differentials in price will primarily be caused by local markets balancing the available supply with the projected demand.

I expect the near-term trading range to be between $85 and $95 a barrel. That will still provide ample space for some nice profits in the right companies.

But it's going to require a bit more circumspection. Now is not the time to buy a company and hold it until your grandchildren retire.

**The Keys Finding the Right Kind of Sizzle**

The security and reliability of certain small producers in the U.S. and Western Canada provides a ready-made list of good investment targets.

As I've observed before, these producers have the advantage of known reserves, stable markets, lower operating costs, fully developed infrastructure, and significant experience in basins and regions they know well. These types of companies make for a nice offset to the uncertainty found abroad.

In addition, as pricing remains range-bound, other elements in the upstream-to-downstream process will benefit, including select pipeline and midstream service providers, along with partnerships and related structures that control critical assets.

First among the "critical asset" category are the limited partnerships established by larger U. S. refineries that own and run transport, gathering, terminal, and storage facilities for the huge volume of crude being shipped to the main processing locations.

This category of refinery asset spinoffs and restructuring reflect a newer phenomenon, especially when it comes to the crude oil transport between Canada and the U.S.

As the lower forty-eight moves toward essential energy independence, Canada will be providing more crude oil on the import side. And the difference here is staggering.

From having to import almost 70% of its daily needs just a few short years ago, it is believed that American crude oil imports will drop to only about 30% within the next decade (or even sooner by some estimates).

That sets the stage for continued increases in transit by rail for Canadian crude headed south and a growing use of internal transport by rail tanker cars inside the U.S., especially with major refinery networks serving as collective end users.

There are also some interesting opportunities developing internationally (i.e., outside North America).

The focus here is going to be on

where the company is located, rather than where it is drilling. For example, operators whose stock is traded on the London Stock Exchange -especially the LSE's AIM (Alternative Investment Market) – with field projects in the Caspian basin, East Africa, and other global locations are going to see a nice pop.

Normally, these opportunities are beyond the reach of the average American retail investor. But not for long. In fact, I will have some exciting news on this front coming shortly. So stay tuned.

But once again, putting geopolitical uncertainties aside, the crude oil balance will dictate specific targets in this kind of investment environment.

Don't Sleep on the Opportunities in Natural Gas

It's another story entirely on the natural gas side. Despite the expanding global reserves of shale, tight gas, and coal bed methane, gas prices are moving up. Once again, over 80% of extractable reserves worldwide are found outside of North America.

In fact, while the attention remains fixed on the shale revolution underway in the U.S., latest figures indicate there is more volume available in China, Argentina, and Algeria than in the U.S.

With natural gas, the NYMEX price is now above $4 per 1,000 cubic feet (or million BTUs) as we move into a winter heating cycle that should push prices closer to $4.50.

That means there is a range of profitable moves about to hit. Natural gas normally doesn't have the sizzle that crude oil has among investors. Of course, making money tends to change that real fast.

What makes the gas picture different are appreciable increases emerging on the demand side. From the rise of U.S. liquefied natural gas (LNG) exports to both Europe and Asia beginning in 2015 to the transition well underway from coal to gas in the generation of electricity, the ability to produce more unconventional gas is being met by a rise in the demand curve.

So despite a dip in crude oil prices, there are still plenty of places to make money in energy.

## WHY ALBERTA PRODUCERS WON'T FEEL THE FALLOUT OF PLUNGING OIL PRICES UNTIL NEXT YEAR

The recent plunge in oil prices could signal a major slowdown in global demand as overall growth weakens — but the impact on Canada's economy is unlikely to be significant.

Oil prices may be buckling on weaker global economic conditions, a stronger U.S. dollar, a faltering Chinese economy and a supply glut in the U.S., but that doesn't rule out a bullish outlook for Canadian producers

The price of crude has dropped about 20% in just a few months, initially blamed on excess supply along with ebbing economic growth in China and Europe's slide back into a recession.

Now, there are concerns over a possible pricing war —led by Saudi Arabia, the largest producer in the Organization of Petroleum Exporting Countries — that is aimed at curbing production of competing energy sources, such as U.S. shale oil, which would cut into profits and limit expansion.

At the same time, U.S. crude oil producers could also lower their production levels and shut down rigs in response to lower OPEC prices.

"OPEC appears to be gearing up for a price war," Eugen Weinberg, head of commodities research at Commerzbank in Frankfurt, said in a report, adding that prices will not stabilize "until this impression disappears and OPEC returns to coordinated production cuts."

The price of West Texas Crude, the U.S. benchmark, closed at US$91.01 on Thursday, up US28¢ on the day. But oil hit an intraday level of US$88.18, the lowest since April 23, 2013.

The head of the International Monetary Fund on Thursday said the agency expects "continued weakness in the global economy."

"Countries are still dealing with the legacies of the [economic] crisis, including high debt burdens and unemployment," Christine Lagarde said during a speech in Washington.

"Only a modest [global] pickup is foreseen for 2005 as the outlook for potential growth has been pared down."

The IMF previously lowered its 2014 forecast to 3.1% from 3.4%. It expects global growth of 4% in 2015.

Jayson Myers, president and CEO of Canadian Manufacturers & Exporters, said he doubts there has been "a fundamental shift in the internal dynamics of the oil industry."

As for any impact of weaker oil prices on the Canadian economy, Mr. Myers said: "I don't think so."

Nevertheless, Canadian oil producers have been operating in a challenging price environment for a few years, said Greg Stringham, vice-president of oil sands and markets at the Canadian Association of Petroleum Producers.

The international Brent benchmark price has fallen from about US$112 in June to US$93.75 on Thursday, while the West Texas Intermediate (WTI) spot price has gone from US$104 to US$91.40 over the same period. Meanwhile, Mr. Stringham said, Western Canadian Select (WCS) has traded in the $85 range throughout that time period.

Still, the price differential between WCS and WTI — which has hurt Canadian oil companies' cash flows during the past two years — has narrowed, Mr. Stringham said.

Data from FirstEnergy Capital Corp. showed the gap between the two North American indices was $14.75 on Wednesday, compared with $32.55 a year before.

Randall Bartlett, senior economist at TD Economics, said he sees oil "trending lower."

"But, at the same time, we're still expecting it to stay relatively elevated compared to, maybe not recent history, but the longer history," he said.

Mr. Bartlett forecasts oil to stay around the US$85-US$90 range. "We don't foresee any significant shocks on the horizon at all," he said.

Matt Parry, senior oil market analyst at the International Energy Agency, said the growth in global oil supply during the next five years is expected to outpace the growth in oil demand.

As a result, Mr. Parry said, "that suggests oil prices have another US$10 to fall over the next five years or so."

A drop in the price of oil will have an effect on oil producers drilling decisions, potentially as early as next year.

"The U.S. supply adjustment can happen at a much faster pace," Mr. Parry said. "We haven't seen any evidence of that yet because the price hasn't fallen enough."

In Canada, proposed oil sands projects are most at risk of being delayed should the current drop in world oil prices persist over the longer term.

Dinara Millington, vice-president of research at the Canadian Energy Research Institute, said the WTI oil price necessary for a new oil sands mine with upgrading capacity to earn a return in Alberta is US$100 per barrel.

The oil price for a steam-assisted gravity drainage oil sands project to earn a return on investment is US$75, Ms. Millington said.

"What this means is that prices need to be at a level of US$75 or higher to make a return on [oil sands producers'] capital projects," she said. If there was a further and long-term collapse in oil prices, Ms. Millington said, oil sands projects that have been proposed but not commissioned could be delayed or cancelled altogether.

## BEAR HEAD PROJECT AIMS TO BE CANADA'S FIRST LNG EXPORTER

The Bear Head LNG project aims to be the first in Canada to export liquid natural gas, says the company's project director and chief operating officer.

John Godbold recently told a Canadian LNG conference in Calgary about his desire to become a commercial exporter by 2019.

"The next morning, the headline in one of the main LNG trade magazines was 'Bear Head LNG to be first LNG exporter from Canada,' which is certainly the goal that I want to have," Godbold told a crowd gathered in Baddeck on Thursday for the Cape Breton Partnership's Investor Summit.

"We finally have done the acquisition from Anadarko, which took a while to go through all the due diligence and the stock purchase agreement," Godbold told The Chronicle Herald.

"(That) now is allowing us to assemble our team, which we are in the process of doing, as well as updating the various different permits that are already in place for the Bear Head project."

Bear Head officials estimate the construction of a marine terminal and necessary liquefied natural gas storage will create up to 700 jobs, with another 45 to 70 direct jobs at the facility and up to 175 indirect jobs related to the venture.

The three-year construction project, near Port Hawkesbury, is estimated to cost $2 billion to $8 billion.

The Bear Head project was first given the go-ahead a decade ago. Construction of the LNG facility began in 2005 but would cease within a year when Anadarko Petroleum Corp. of Texas failed to secure a natural gas supply to import to the terminal.

In August, Liquefied Natural Gas Ltd. of Australia signed an $11-million contract with Anadarko Petroleum to purchase the Bear Head project.

The West Perth company has since said the Marcellus shale formation — crossing at least three American states — holds promise for bringing the necessary LNG into their proposed exportation hub.

Godbold said past work to clear the LNG site and install two tank foundations have also given the project a leg up.

"The natural gas will come in, we'll refrigerate at -260 degrees, which takes natural gas and puts it into a liquid state, which means the volume goes down by 600 times. Then we can store it in the large LNG storage facilities — so we'll have two tanks that are both 180,000 cubic metres — when a ship comes in … we will off-load the LNG into that ship and then ship will take it to the international market."

But just where exactly the liquefied natural gas will be brought remains to be seen.

"Most people will know that Nova Scotia is closest to Europe, of any other place in North America, so that's an obvious market," said Godbold. "Another big LNG market is Argentina. Nova Scotia is the closest to Argentina of any other place in North America. Then one of the biggest-growing LNG markets in the world is India, and Nova Scotia is also the closest location to India of anywhere in North America. So we are certainly looking at those, as well as (other) Asian countries."

Once the necessary permit modifications are secure, he said, project officials will file an export application with the National Energy Board.

## PETRONAS THREATENS 15-YEAR DELAY OF CANADA LNG PLANT IF NO TAX DEAL

Malaysian state-owned oil and gas company Petronas said on Monday it could delay its planned $11 billion liquefied natural gas plant on Canada's Pacific Coast by as long as 15 years unless it can reach a favorable tax deal by month's end.

Petronas said in a statement that the economics of the plant are marginal and without a favorable tax arrangement with the province of British Columbia and Canada's federal government to lower costs, it could shelve the project for a decade or more.

"Petronas needs to secure consensus on key principles vital to the success of this project by the end of October," the company said in a statement. "Missing this date will have the impact of having to defer our investments until the next LNG marketing window, anticipated in 10-15 years."

British Columbia is drafting a tax regime for its nascent LNG-export industry and is now negotiating the details of its plan with the companies looking to supply the Asian market. Christy Clark, the province's premier, said last week she was "very confident" that Petronas would agree to go ahead with the planned facility and expects tax legislation will be unveiled in the provincial legislature later this month.

However, Petronas said the proposed fiscal package and slow regulatory pace in Canada threatens the future of its Pacific NorthWest LNG plant, especially since construction costs in northern British Columbia are already high.

It said it wants to make a final decision on whether to go ahead with the project by mid-December.

## CANADA'S EXPORT RECOVERY STALLS AS OIL PRICE FALLS

U.S. trade deficit narrows with help of domestic oil boom

Canada's trade balance with the world shifted from a surplus to a deficit in August, as exports stalled and the pace of imports picked up.

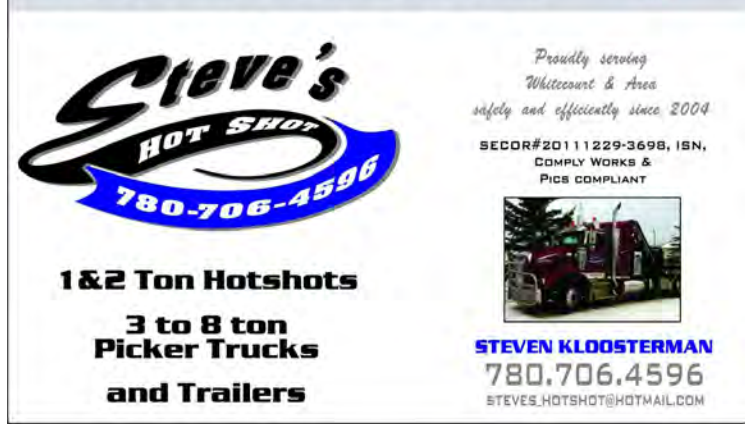
That is a sharp contrast to the U.S., where the trade deficit narrowed to $40.1 billion US, compared to a revised $40.3 billion in July, mainly because of improved exports.

In Canada, there was a deficit of $610 million Cdn in August, compared to an adjusted surplus of $2.2 billion in July.

The recovery of Canadian exports, which economists had counted on because of the lower loonie, faded in August.

Exports were down 2.5 per cent to $44.2 billion, mainly because of weakness in auto parts and energy products.



The falling price of crude oil helped contribute to the downturn as producers are getting 4.9 per cent less per barrel. New York contracts fell from a high of $104 US a barrel in July to hover just above $95 in August, and they've fallen further to as low as $88 this month.

Imports rise in Canada

Meanwhile Canada's merchandise imports rose 3.9 per cent, with a spike in imports of precious metals and their alloys and crude oil and energy products.

Imports from the United States rose 1.4 per cent to $29.7 billion, while exports fell 2.5 per cent to $33.3 billion, shrinking the trade surplus with that country to $3.5 billion in August from $4.8 billion in July.

The strengthening U.S. economy was meant to boost Canada's export potential, but the recovery has been spotty.

The August trade numbers were "a bit of a cold shower," Export Development Canada chief economist Peter Hall said, though he was optimistic about the rest of the year.

"Even though we've taken a one-month hit here, it certainly is a pause in a very strong trend," he said in an interview.

Hall said exports have expanded by 10.5 per cent since the previous year.

U.S. deficit narrows

U.S. exports continue to edge upwards despite the higher U.S. dollar.

Exports increased 0.2 per cent to a record $198.5 billion, aided by increased sales of petroleum, telecommunications equipment and industrial engines. Imports also rose by a smaller 0.1 per cent to $238.6 billion.

The U.S. oil and gas boom continues to improve its trade outlook. For petroleum products, the trade deficit fell by $1.4 billion, partly as a result of falling prices and stronger exports. U.S. exports of petroleum were up 2.2 per cent to $14.1 billion while petroleum imports fell 3.8 per cent to $27.2 billion.

"The dynamics in this month's trade report can almost entirely be viewed from a petroleum vs non-petroleum perspective," TD economist Andrew Labelle said in a note to investors.

"Ex-petroleum, the deficit significantly rose, however it was more than offset by a sharper drop in the deficit for petroleum products. This story is expected to continue going forward, as gains in U.S. shale energy production will be at least partly offset by higher imports owing to robust domestic demand."

Labelle warned that the rising U.S. dollar and the muted outlook for global growth risk threatening this improvement in the U.S. trade deficit.

## WHY CANADIAN OIL PRODUCERS WILL BUCK THE DESCENT IN PRICES

Oil prices may be buckling on weaker global economic conditions, a stronger U.S. dollar, a faltering Chinese economy and a supply glut in the U.S., but that doesn't rule out a bullish outlook for Canadian producers.

Recent declines in crude prices — due in large part to a tepid demand outlook — are weighing on Canadian integrated oil companies, but the weakening loonie and tightening crude differentials versus global benchmarks should act as a buffer against further weakness for the commodity.

These factors prompted Citi Research on Wednesday to upgrade Suncor Energy Inc. to buy from neutral; bringing its recommendation in line with that of Canada's three other major integrated oil producers: Cenovus Energy Inc., Husky Energy Inc. and Imperial Oil Ltd.

Analyst Mohit Bhardwaj expects the group will grow production by roughly 7% per year between 2015 and 2020 and generate an average free cash flow yield of about 8%. That compares to a free cash flow yield forecast of approximately 5.6% for the global oil majors.

"We believe the free cash flow inflection for Canadian oil is 6-18 months away compared with Big Oil where the key inflection is 24-36 months away," he said in a report.

Even though Citi's commodities team cut its oil price forecasts, Mr. Bhardwaj noted that Canadian producers should benefit from tighter price differentials as the Flanagan South oil pipeline from Illinois to Oklahoma starts up and Enbridge's Line 9B reverses.

The analyst also highlighted the importance of rail shipments, which continue to act as a buffer until the Keystone XL, Energy East and the Transmountain Expansion pipelines come online.

He noted that Suncor has enhanced the returns on its existing $25-billion of capital-in-place oil sands assets over the past 18-24 months.

The company is also streamlining its operations to lower sustaining capital spending and operating expenses, while producing more from its existing projects.

Suncor has lowered its 2014 capex by about $1-billion, but Mr. Bhardwaj estimates further cuts to annual spending of $500-million to $1-billion annually through 2020 should generate another 20% to 25% in free cash flow. That should allow the company to achieve its return on capital employed (ROCE) goal of 15%.

"We believe the potential increase in ROCE is a free option on Suncor stock," Mr. Bhardwaj said, adding that the company has more than doubled its dividend since Q1 2013.

He also suggested that Suncor could use an income fund to house its midstream assets in order to fully realize their value.

But it's not just large caps that are getting more attention these days. Mid-sized energy producers could also see an upswing after a rough ride in the third quarter.

One such name is Enerplus Corp., whose shares plummeted 24% between early July and mid-September. Much like many of its peers, Enerplus gave up most of the gains earned during an impressive first half of the year.

Heading into Q4, analysts are predicting an end to the bloodletting as the company has posted better-than-expected upward revisions to production and cash flow per share estimates in recent months.

TD Securities analyst Aaron Bilkoski said the company has several potential catalysts, including possible asset dispositions that could fund an additional drilling rig at Fort Berthold in North Dakota's Bakken region.

"After speaking with the company and a series of institutional investors, we do not believe that there is a fundamental reason driving the recent sell-off," he said in a recent report. "Moreover, we foresee positive catalysts over the next quarter that could once again result in Enerplus' outperformance."

Mr. Bilkoski is one of 10 sell-side analysts who have a buy rating on the stock, while four of the 14 who cover it have hold recommendations. Their average price target is $28.79, representing a potential upside of more than 30%.

Bechara Haddad, an analyst at Palos Management Inc. in Montreal, is also bullish on the stock.

In a recent commentary to clients, he noted Enerplus' strong organic production growth, solid balance sheet and attractive valuation.

He said the company's recent decision to suspend its share-purchase program is positive for the stock and he is impressed with the company's management.

"ERF management's recent purchase of shares in the open market demonstrates the company's alignment with its shareholders and provides reassurance in an already compelling story," Mr. Haddad said, noting that Palos has increased its exposure as a result.

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| | Active | Down | Total | % Active |
| Western Canada | | | | |
| AB | 278 | 286 | 564 | 49% |
| SK | 88 | 68 | 156 | 56% |
| BC | 47 | 16 | 63 | 75% |
| MB | 12 | 11 | 23 | 52% |
| WC Total | 425 | 381 | 806 | 53% |
| Eastern Canada | | | | |
| QC | - | 1 | 1 | 0% |
| Canada | 425 | 382 | 807 | 53% |