



How to Profit From Canada's Next Oil Boom

Description

Over the past few years, a handful of oil and gas explorers have been quietly accumulating massive tracts of land in a little-known area of western Alberta.

Early estimates show this small, oil-rich region could contain 443 trillion cubic feet of natural gas and 62 billion barrels of oil, making it the second largest oilfield in the country.

And their bet is paying off. Many of the area's big oil producers just reported blowout earnings from their drilling operations in the region. And this may only be the beginning.

Is this Alberta's next big oil play?

As longtime readers know, the Duvernay is a natural gas-rich shale located along the edges of the Canadian Rockies. The play covers an area about 62,000 square miles in size — twice the size of the infamous Texas Eagle Ford.

Early drilling results have been impressive. Last year **Encana** (TSX: ECA)(NYSE: ECA) spent \$600 million in the region drilling 13 test wells. One well produced a remarkable 1,400 barrels per day, or bpd, of condensate and four million cubic feet per day, or mmcf, of natural gas 30 days after completion.

Other companies are producing encouraging results as well. **Talisman** (TSX: TLM)(NYSE: TLM) continues to evaluate its acreage with five appraisal wells. Two wells were completed during the third quarter of 2013, with seven-day average production rates of 2.8 mmcf and 730 bpd of condensate for the first well, and 1.6 mmcf per day and 365 bbls per day of condensate for the second well.

And in spite of the high drilling costs, drilling in the Duvernay is exceptionally lucrative. Thanks to high concentrations of natural gas liquids, the typical well is generates a 142% internal rate of return at current commodity prices, according to a report from Dundee Capital Markets.

Here's how to profit

Unfortunately for investors, the Duvernay's bounty is not spread equally across the field. The play's payzone is much thicker in the Kaybob area compared to fields further south like Willesden and Edson.

Another important factor is the concentration of natural gas liquids. Today, condensate is one of the most valuable hydrocarbons in the world selling for a 10% premium to West Texas Intermediate in Canada. Acreage in the liquids-rich window of the field are vastly more profitable.

This means that not all Duvernay producers are created equally. Investors cannot blindly back any company. Rather they must carefully dig through the acreage position of each producer.

Imperial Oil ([TSX:IMO](#)) has missed this sweet spot to a large extent. Although it has scattered acreage in the liquids-rich window, the company's largest land positions are in the dry gas part of the play.

Chevron and **Royal Dutch Shell** both hold large land positions in the sweet spot of the field. However, with market capitalizations both north of \$200 billion, the Duvernay is unlikely to move the needle for any of these firms.

The Duvernay could, though, provide a big bump for a mid-size producers like Encana and Talisman. Both companies own 253,000 and 352,000 net acres in the liquids rich window respectively — sizeable enough to move the stocks if the Duvernay proves commercially viable.

Finally, investors looking for a Duvernay pure-play should consider small-cap **Trilogy Energy** (TSX: TET). The company plans to allocate 40% of its \$375 million 2014 capex budget to the play. And with a market capitalization of only \$4 billion, success in the Duvernay could result in substantial upside for the stock.

Trilogy also has a unique advantage over other producers in the Duvernay since the firm has a liquids processing agreement with an extraction plant in Chicago. This gives the Trilogy access better product pricing in Illinois and they don't have to finance expensive separation facilities.

Foolish bottom line

Investors cannot declare victory in the Duvernay yet. We need to see a steady stream of strong drilling results and further declines in well completion costs. However, if operators can deliver, the Duvernay could be Canada's next oil boom.

CATEGORY

1. Investing

TICKERS GLOBAL

1. TSX:IMO (Imperial Oil Limited)

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