The Round-Up: June 27th 2007

Posted by Stoneleigh on June 26, 2007 - 10:46pm in The Oil Drum: Canada
Topic: Miscellaneous

Oilman bullish on Canada

> *'Essential to grow oilsands supply'*
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> Cost overruns, policy uncertainty, environmental concerns, labour shortages -- they're some of the spoilers that made investors skittish about the oilsands in the past year.
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> Henry Groppe, the star U.S. oil forecaster who has been following world oil supplies, politics and prices for more than half a century, remains a believer -- and he's not shy about telling Canadians to get a grip.
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> In fact, the founder of Houston-based Groppe, Long & Littell is so convinced Canada's deposits are now the only source of growing oil production in the world he's helping launch a unique effort aimed at Canadian investors -- the first mutual fund, Oilsands Canada Corp., to invest exclusively in companies in the business. It will hold more than 40 names.
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> "Canada, Alberta, because of the oilsands, is the only producing source for which we forecast continually increasing production as far into the future as we can see," Mr. Groppe said in an interview in Calgary last week, where he was marketing the investment with fund manager Middlefield Capital Corp.
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> "Whatever problems arise -- whether they be political, physical or resource-related -- are going to be resolved ultimately, because it's essential to grow that oilsands supply for the world."
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> He said his firm stopped using reserves to forecast future production in its early days because it found it was a "dismal failure." He remains skeptical about how much oil will ultimately be extracted with new technologies, which often take a long time to be productive.
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> "So you have got a trillion barrels of oil in this oil shale in Colorado. What does that mean? There is no correlation between the volume of reserves or the volume of production or the rate at which production increases," he said.
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> "The better method is to examine very carefully all of the past exploration and drilling activity and the production that it has produced, and look at the depletion rates and look at how much additional production is provided with additional drilling, and use those facts as a basis for projecting what the trends in production will be," he said.

Oil companies borrowing by the billions

> Information emerged Monday about three Calgary-based oil companies issuing bonds or securing new credit, worth a total of about $2.4-billion, primarily to fund their share of capital costs for oilsands projects.
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> The largest borrowing was made made by Western Oil Sands Inc., which said it had closed a new $805-million, five-year revolving bank credit facility. "The debt will be used to finance our share of capital requirements for the first phase expansion of the Athabasca Oil Sands project and for general corporate purposes," said a Western statement. There was no word either on the spread or financing rate for the facility.
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> The project is a fully-integrated expansion of the existing Athabasca facilities in northern Alberta to add 100,000 barrels per day of production by 2010. The debt was arranged by RBC Capital Markets and replaces Western's existing $340-million revolving credit facility.
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> The announcement comes after Western CEOJim Houck reiterated that all options are being kept open to "maximize value" from the company, interpreted widely as putting itself up for sale. And Opti Canada Inc. announced that it would stage a US$750-million bond issue as part of a financing plan to fund its term-loan facility and the Long Lake project at Athabasca. The firm also said that it has delayed by two months the commissioning and startup of its steam-assisted gravity drainage facilities for the oilsands project. However, it will not impact full production, due by early 2009.

Oil patch loads up on cheap debt

> Attractive bond rates appear to be the trigger for a small avalanche of new debt that swept into the oil patch Monday, most of it apparently destined to finance oil sands development.
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> Western Oil Sands Inc. said it has closed a new $805-million five-year credit facility, replacing and greatly enlarging on an existing $340-million facility, while Opti Canada Inc. announced a new financing for up to $750-million U.S. in senior secured notes to be issued by way of a private offering.
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> Add these to a Bloomberg News report Monday morning that Suncor Inc. plans to sell as much as $750-million in bonds as early as today, and the total works out to more than $2.25-billion (U.S.) in new debt announced in a single day.
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> The bond market is so hot right now . . . it's not surprising to me that that's happening, Opti Canada investor relations manager Alison Trollope said of the busy day in oil-patch debt raising when reached at the company's head office in Calgary.

US demand for Canadian oil seen doubling in 8 yrs

> U.S. demand for Canadian oil is expected to double in the next eight years, and domestic use could jump 44 percent as Alberta's oil sands output surges, the Canadian oil industry's main lobby group said on Monday.

However, that production growth could be tempered by the same problems that have plagued the oil sands industry throughout this decade -- labor shortages and inflation in the cost of materials like steel, the Canadian Association of Petroleum Producers said.

U.S. refiners could use 3.1 million barrels a day of Canadian crude by 2015, a volume that exceeds the country's current oil output by 29 percent, the association said in its annual crude oil forecast.

Canada is already the biggest foreign oil supplier to the United States, ahead of Saudi Arabia and Venezuela, shipping about 1.6 million barrels a day in 2006, CAPP said.

"This is the first time we went out and did a review of refineries and found many of them looking more to the North than they had in the past. We heard more talking about refinery reconfigurations,"CAPP Vice-President Greg Stringham said.

"I think that in itself is caused by their realization that the oil supply is going to be growing ... they're saying even that gives them the momentum to start making the adaptations they need to do to their refineries."

Lester Brown Speaks to Senate on Biofuels Blunder

Lester Brown, Earth Policy Institute president and author of Plan B 2.0 yesterday briefed the U.S. Senate Committee on Environment and Public Works on the potential implications of a continued rush towards corn ethanol. The paper Lester Brown submitted to the Committee begins thus:

The escalating share of the U.S. grain harvest going to ethanol distilleries is driving up food prices worldwide. Investment in fuel ethanol distilleries has soared since gasoline prices jumped at the end of 2005. Once completed, distilleries now under construction could double U.S. ethanol output, turning nearly 30 percent of next years U.S. grain harvest into fuel for automobiles. This unprecedented diversion of the worlds leading grain crop to the production of fuel will affect food prices everywhere, risking political instability.

The world is only 57 days away from a major humanitarian disaster in food supplies, and, given the unpredictable nature of weather patterns in recent years, and predictions of worse to come, the potential for crop failures are on the increase.

Against this backdrop, Washington is consumed with ethanol euphoria. President Bush in his State of the Union address set a production goal for 2017 of 35 billion gallons of alternative fuels, including grain-based and cellulosic ethanol, and fuel from coal. Given the current difficulties in producing cellulosic ethanol at a competitive cost and given the mounting public opposition to coal fuels, which are far more carbon-intensive than gasoline, most of the fuel to meet this goal might well have to come from grain. This could take most of the U.S. grain harvest, leaving little grain to meet U.S. needs, much less those of the hundred or so countries that import grain.

The stage is now set for direct competition for grain between the 800 million people who own automobiles, and the worlds 2 billion poorest people. The risk is that millions of those on the lower rungs of the global economic ladder will start falling off as rising food prices drop their consumption below the survival level.

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Peak Suburbia - Kunstler

> The latest statistical work by Dallas geologist Jeffrey Brown over at The Oil Drum.com, suggests that something else is happening, something that was not anticipated: an imminent oil export crisis. This Export Land Theory states that exporting nations will have far less oil available for export than was previously assumed under older models. (Story Here.) The theory states that export rates will drop by a far greater percentage than net production decline rates in any given exporting country. For example, The UK's portion of the North Sea oil fields may be showing a nine percent annual decline for the past couple of years. But it's export capacity has declined 60 percent.
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> Something similar is in store for Saudi Arabia, Russia, Mexico, Venezuela in short, the whole cast of characters in the export world. They are all producing less and they are all using more of their own oil, and have less to send elsewhere.
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> Brown's math suggests that world oil exports will drop by 50 percent within the next five years, certainly enough to trigger a systemic breakdown in market allocation, meaning serious supply shortages among the importing nations. That's us. We import two-thirds of all the oil we use.
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> The implication in all this is that the activities that have become "normal" for us during the post World War Two era will very shortly become untenable. An economy based on suburban expansion and incessant motoring is on the top of the list of supposedly "normal" activities that will not be able to continue. I would maintain that even if we had 20 years, no combination of bio-fuels and other alternatives would enable us to keep suburbia running. But this latest work indicates that we have much less time to adjust.

Canada can't afford to meet Kyoto goal, energy analysts say

> *Cutting emissions or buying credits too costly*
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> Energy sector analysts in British Columbia said Friday they agree with Prime Minister Harper's contention that Canada cannot afford to comply with Kyoto protocol requirements that came into force this week.
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> A Liberal private member's bill committing Canada to Kyoto compliance was given royal assent in the Senate Friday, but B.C. analysts Jock Finlayson and Aldyen Donnelly said they do not believe the government is willing to burden taxpayers with the tens of billions of dollars it would cost to carry out.
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> The protocol calls on Canada to reduce carbon dioxide emissions below their 1990 levels.
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> "It's not clear to me that there's going to be any new measures introduced in the short term around greenhouse gas reductions beyond those that Environment Minister John Baird released in April," Finlayson, executive vice-president of the Business Council of B.C., said in a telephone interview.
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> "The latest Environment Canada estimate is that Canadian emissions in 2005 were 747 million tonnes of CO_2 equivalent. They've gone up from 596 million tonnes in 1990.
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> "Our Kyoto target is 563 million tonnes. The reduction is almost 200 million tonnes.

"You could take every vehicle off the road in Canada, every car, every truck, every bus, every motorcycle, as well as throw in lawnmowers and barbecues tomorrow morning all the way through 2012 and that still would be nowhere near enough to achieve that target."

Scarce water and population boom leads California to 'perfect drought'

No rain forecast in south of state until September Sprinklers and car washing could be stopped

A typical summer's day in Los Angeles: temperatures nudge the nineties, the sun blazes high in the sky, palm trees sway in the ocean breeze, and sprinklers spray a fine mist of water into the scorching air. But if the predictions of climatologists, environmentalists, city planners and the head of the water board are correct, the sprinklers and many other of the comforts that have made southern California habitable may have to be turned off.

Experts across the city concur that the conditions are ripe in southern California for the "perfect drought". Los Angeles has recorded just 8.15cm (3.21in) of rain in the year ending June 30, making it the driest year on record since 1877. According to the National Drought Mitigation Centre, southern California faces "extreme drought" this year, with no rain forecast before September. One climatologist referred to the temperatures in Los Angeles as "Death Valley numbers".

The Sierra Nevada mountains, which typically provide Los Angeles with 50% of its water, have provided just 20% of their normal volume this year, and the snowpack is at its lowest for 20 years. Pumping from an aquifer in the San Fernando Valley was stopped this month because it was contaminated with chromium 6.

Greenland ice may melt much faster: U.N. scientist

New research shows that man-made climate change could cause the Greenland ice sheet to break up in hundreds, rather than thousands, of years, the chair of a United Nations panel of scientists said on Monday. Its entire collapse would raise sea-levels globally by around 7 meters (23 feet), they said.

The U.N. Intergovernmental Panel on Climate Change (IPCC) published its five-yearly report earlier this year, and described threats from global warming including sea-level rise of up to 79 centimeters this century.

It said that the entire Greenland ice sheet would melt over a period of thousands of years, if temperatures remained around 2 degrees centigrade (3.6 Fahrenheit) or more above the levels predating wholesale industrialization in the developed world. But the new research, not considered by the IPCC, could change that view, according to Bert Metz, a senior IPCC member.

"No models that predict sea level rise include this," he told Reuters on the fringes of a climate change conference hosted by Chatham House in London on Monday. "It's plausible that the whole thing could disintegrate in hundreds of years, an order of magnitude faster."

[Housing not just their headache]

It might be easy for Canadian investors to laugh off the housing-market woes that continue to grip the United States. But when those woes send the S&P/TSX composite index into a triple-digit tailspin, you have to wonder if the laughter is justified.

The S&P/TSX composite index fell 144.17 points, or just over 1%, yesterday. This month, there have been four trading days when the Canadian benchmark index has fallen 1% or more, making it the most volatile month of the year.

Are oil prices plummeting? No. Crude oil prices held steady at just over US$69 a barrel in New York yesterday, putting oil at a nine-month high. Did bad economic news surface? No. In fact, bond yields declined a little, easing concerns about rising borrowing costs. A sudden change in the outlook at the Bank of Canada? Again, no.

Instead, investors are getting jittery again about the state of the U.S. housing market and its potential to spill into the wider U.S. economy -- which, of course, is not good news for Canada.

Yesterday, the National Association of Realtors reported that the U.S. median home price in May was 2.1% below the average price in May, 2006.

This marked the 10th consecutive year-over-year price decline in the United States and showed that the much-anticipated bottoming of the market could be further into the future than many observers had hoped.

"With an unprecedented amount of supply on the market, home prices look likely to continue declining after registering their 10th straight month in negative territory on a year-over-year basis,"said Benjamin Reitzes, an economic analyst at BMO Capital Markets, in a note to clients.

"This gloomy picture will probably be corroborated by Tuesday's new home sales release."

[BIS warns of Great Depression dangers from credit spree]

The Bank for International Settlements, the world's most prestigious financial body, has warned that years of loose monetary policy has fuelled a dangerous credit bubble, leaving the global economy more vulnerable to another 1930s-style slump than generally understood.

"Virtually nobody foresaw the Great Depression of the 1930s, or the crises which affected Japan and Southeast Asia in the early and late 1990s. In fact, each downturn was preceded by a period of non-inflationary growth exuberant enough to lead many commentators to suggest that a 'new era' had arrived", said the bank.

The BIS, the ultimate bank of central bankers, pointed to a confluence a worrying signs, citing mass issuance of new-fangled credit instruments, soaring levels of household debt, extreme appetite for risk shown by investors, and entrenched imbalances in the world currency system.

[Banks Fight to Postpone Day of Reckoning]

> Bear Sterns is a leading provider of services to hedge funds; it is also one of the largest originators of subprime backed Collateralized Debt Obligations (CDOs). CDOs are what their name implies: a security backed by collateral. CDOs are created when mortgages with various risk profiles are grouped into different tranches or segments. Amongst others, Bear Sterns would create a CDO in a bundle according to a clients specifications. Indeed, Bear Sterns would work with a rating agency, such as Moody's, to obtain the desired rating (a practice likely to face more scrutiny as some allege that Moody's no longer acts as an independent rating agency, but as a syndicator in the offering).
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> The explosive demand in this sector has attracted ever more creative structures. Investors should have grown concerned when dealmakers started suggesting that one can create a higher grade security by grouping together a couple of lower grade securities; it is rare that 1+1 equals 3.
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> As these instruments have grown more complex, the clients buying these instruments often do not have a full understanding of what they buy.
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> How do you make a bestseller better? You introduce leverage. Not only can leverage be introduced in the credit derivatives that define some of these securities, but brokers eager to attract hedge fund business may also accept CDOs as collateral to lend money. The hedge fund now attracting so much attention is Bear Sterns High-Grade Structured Credit Strategies Enhanced Leverage Fund; it was launched only 10 months ago; it shall be noted that Bear Sterns did not put much of its own money into the fund, but supplied many of the CDOs. $600 million in invested capital was boosted with borrowings of about $6 billion.
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> The collateral provided by the fund had the highest ratings by Moodys. However, a high rating does not assure that the CDOs are liquid, i.e. that they can be sold off on short notice. This became painfully clear as bets of the fund were creating heavy losses and some lenders asked for more collateral for the loans extended; in the industry, this is called a margin call. Bear Sterns told other lenders, including Merrill Lynch, J.P. Morgan and Citigroup that the fund was unable to provide more collateral. On a side note, it is rather grotesque that Merrill, J.P. Morgan and Citigroup are amongst the larger investors in a fund managed by Bear Sterns; Bear Sterns put little of its own money into the fund.

[Bear's Big Loss Arouses SEC Interest]

> *The SEC is inquiring into the near-collapse of its fund, and Bear Stearns CEO James Cayne's reputation may be on the line*
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> Bear Stearns (BSC) may have a lot of explaining to do about a big restatement of losses at one of its troubled hedge fundsand not just to its investors. BusinessWeek has learned that the Securities & Exchange Commission recently opened a preliminary inquiry into the near-collapse of Bear Stearns' High-Grade Structured Credit Strategies Enhanced Leveraged Fund. People familiar with the inquiry say regulators are interested in learning how the Wall Street investment firm came to dramatically restate the April losses for the 10-month-old fund, which invested heavily in securities backed by subprime mortgages, or home loans to consumers with shaky credit histories.

> As BusinessWeek first reported, Bear Stearns told investors May 15 that the Enhanced Leveraged fund which raised $642 million last summerhad lost 6.5% in April. But three weeks after that estimate, the investment firm shocked investors on June 7, telling them that the fund's actual April loss was 18.97%, or 23% for the year.
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> The restatement, and the prospect that other hedge funds could face the same situation, has sparked widespread concern on Wall Street about the subprime housing market and the opacity of prices for assets underlying many of the securitized mortgage bonds that have flooded the market in recent years. In the June 7 letter to investors, Bear Stearns provided no explanation for the discrepancy, but added "we do not currently have any reason to believe that the returns will change materially." At the same time Bear Stearns was serving up that sobering news, the Wall Street firm quickly moved to suspend investor redemptions, fearing the hedge fund would not able to liquidate enough bonds to satisfy the demands of investors or the other Wall Street banks that had lent the fund billions of dollars.

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