

# NICKLE'S DAILY OIL BULLETIN

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## Government's Oilsands Revenue Expected To Eclipse Natural Gas

By **Richard Macedo**

Oilsands royalties are for the first time expected to eclipse natural gas as the largest source of Alberta's resource revenues thanks to stronger oil prices, higher production and amended royalties while natural gas revenue - the traditional powerhouse of provincial government revenues - will continue to struggle as North American prices are held back by growing supplies of shale gas.

Natural gas royalties made up over 70% of the Alberta government's resource revenue in 2002/2003 and 2003/2004. But as natural gas production continues to fall sharply and prices remain weak, yesterday's provincial budget projects that oilsands royalties will make up nearly 50% of resource revenue by fiscal 2012/13 while natural gas will comprise just 22%.

The shift clearly shows how important natural gas has been to the province's financial prosperity, noted industry officials.

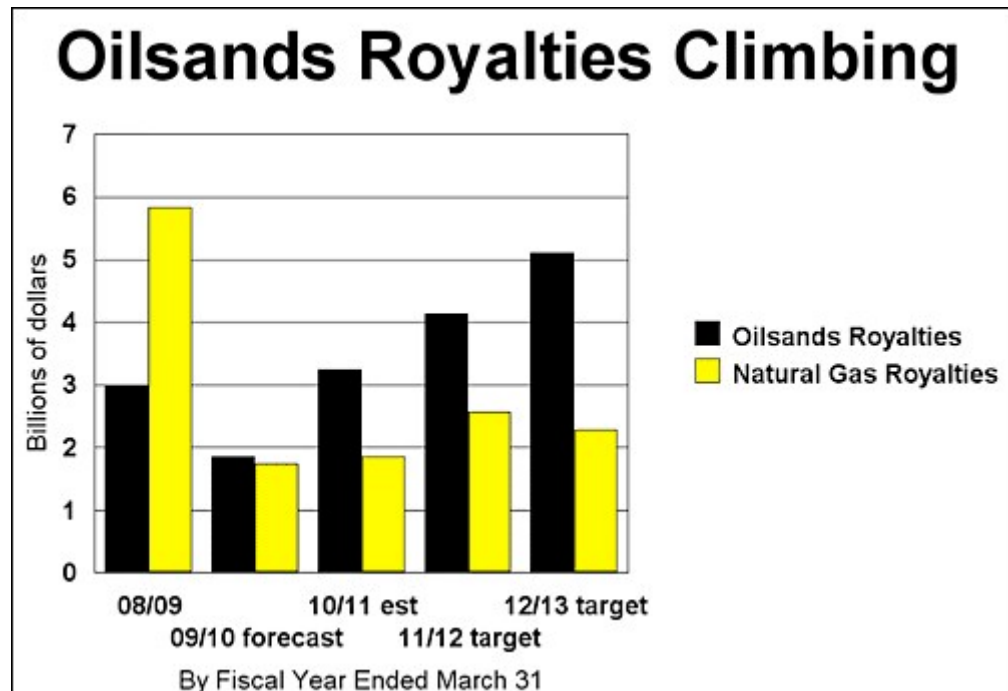
**Gary Leach**, executive director of the **Small Explorers and Producers Association of Canada**, said the shift to oilsands as the leading contributor is likely permanent due to climbing production from the province's bitumen regions.

"It also illustrates why we have to focus on improving the investment situation for the conventional oil and natural gas sectors; this is what the competitiveness study is all about," he told the Bulletin.

Details of the government's competitiveness review are expected in early March at the latest. During a conference call discussing the budget on Tuesday, Finance Minister **Ted Morton** wouldn't say whether royalties would be reduced following the competitive review. While recommendations from the report haven't been figured into the budget announced yesterday, changes can be accommodated later on, he noted.

"The purpose of the competitiveness report, which will include the royalty review, is to stimulate and increase investment in the oil and gas sector in this province," he said. "In other words, it's to grow the pie. If the pie grows and we take a smaller slice, our revenue situation still should be good."

Leach added that the cliff-like drop in natural gas royalties is a big reason the government opened up dialogue with the oil and gas industry to address the problem.



"I don't think Alberta is too far behind to catch up (to B.C. and the United States)," he said. "We still have a large resource endowment in Alberta and it's not clear yet that shale gas in the northeast U.S. will be able to avoid challenges and delays from opponents," he said.

**Greg Stringham**, vice-president of oilsands and markets with the **Canadian Association of Petroleum Producers**, said the situation with natural gas over the past year clearly shows how important it is to provincial revenue and jobs.

"The natural gas supply dynamic has drastically changed with the new shale gas discoveries and this has had an impact on Alberta's ability to attract investment," he said. "The natural gas industry and many thousands of Albertans whose livelihood depends on natural gas activity have been dealing with this for the last year.

"(It's) less a wake-up call than a clear recognition that things have changed and the need to be competitive in the new marketplace."

From industry's perspective, competitiveness is about three key elements, Stringham said: the fiscal regime (both royalty and taxes), the regulatory process (maintaining strong standards while finding a more efficient way to administer them) and technology development to continue improving environmental performance and to unlock further resources, like the Pembina/Cardium and new in situ technology in the oilsands.

"Industry needs to do its part, continuing to drive down costs and demonstrating improved environmental performance," he said. "The investment community is watching closely so Alberta knows it needs to be competitive to support long-term growth to grow the pie."



The province, which promised to hold the line on taxes, remains on a path of red ink with deficits of \$3.6 billion in 2009/2010 ending this March 31, then \$4.7 billion and \$1.1 billion the following two fiscal years before returning to a surplus of \$505 million in 2012/2013, part of Premier **Ed Stelmach's** plan to be "back in the black" by 2013.

These deficits will be covered by the sustainability fund, which will sit at only \$2.8 billion by the end

of 2012/2013. Assets in the fund were \$16.8 billion in fiscal 2008/2009.

**Danielle Smith**, leader of the upstart Wildrose Alliance, criticized the budget, saying the province needs to control costs. The Alliance will present and discuss its budget initiatives at the Legislature today at 1 p.m.

Non-renewable resource revenue is expected to fall to \$6 billion in fiscal 2009/2010, roughly half of the previous fiscal year as the recession hammered government coffers. In 2010/2011, resource revenue is expected to climb to \$7.3 billion.

After falling to \$5.8 billion in 2008/2009, natural gas royalties are expected to plunge further to collapse to \$1.7 billion in 2009/2010, then rise slightly to \$1.9 billion the following fiscal year. Prices are forecast to average \$3.40 (Cdn.) per gigajoule in 2009/2010 and \$4.25 the following year.

In a continuing trend, total production is forecast to drop to 4.7 tcf in 2009/2010 from 4.9 tcf the previous fiscal year. The budget projects the fall in gas production will continue to 4.3 tcf in 2010/2011, four tcf in 2011/2012 and 3.9 tcf in 2012/2013.

Synthetic crude and bitumen royalties brought in nearly \$3 billion in fiscal 2008/2009, and after an anticipated decline to \$1.9 billion in 2009/2010 revenues recover to \$3.2 billion the subsequent year.

Royalties for conventional crude are forecast to be relatively flat at \$1.8 billion for the fiscal year ending next month, then should rise to \$2.1 billion in 2010/2011.

Prices for oil are estimated to average \$69.95 (U.S.) per bbl in 2009/2010 and \$78.75 in 2010/2011, while the province pegs bitumen prices at \$49.36 (Cdn.) and \$56.38 per bbl during the same periods.

After hitting 1.5 million bbls per day in 2009/2010, raw bitumen production is expected to average 1.7 million bbls per day in 2010/2011, then 1.9 million bbls in 2011/2012 and 2.1 million bbls in 2012/2013.

Conventional crude has been declining for many years in Alberta and is expected to fall to 454,000 bbls per day in 2009/2010, eventually dropping to 419,000 bbls by 2012/2013.

A \$1 drop in oil would cut revenue by \$186 million in 2010/2011, while a 10-cent drop in natural gas prices will impact revenue by \$93 million, the government noted.

There may be potential in Alberta to slow or even reverse the decline of conventional oil production, Leach said.

"The impact of oil resource plays and horizontal multi-stage fracturing on Alberta's conventional oil production volumes will not be fully understood for a while," he said. "The early reported results are certainly drawing in capital and plenty of interest."

Bonuses and sales of Crown leases are forecast to hit \$847 million in 2009/2010, up from the original forecast of \$631 million. Land sale revenues are expected to drop to \$630 million for 2010/2011.

The economy is forecast to grow 2.6% in 2010 and 2.9% the following year as a result of rising energy demand, commodity prices, employment and investment growth. The province warns, however, that recovery south of the border remains slow, making forecasting difficult.

"Natural gas prices remain low," Morton said. "Canadian and U.S. stimulus funding will end with unknown impact."

"Our largest trading partner is \$12 trillion in debt and the outlook for commercial real estate is unsettled."

Corporate income tax is forecast at \$3.1 billion in 2010/2011, \$187 million below 2009/2010. With improving economic conditions and energy prices, corporate tax revenue is expected to climb to \$4.4 billion by 2012/2013, averaging 19% growth per year.

Drilling stimulus initiatives are expected to cost \$441 million in 2009/2010, down from the budgeted \$842 million, and \$732 million the following fiscal year.

Spending plans of interest to the oil and gas industry include:

- . The Lower Athabasca and South Saskatchewan regional land-use framework plans, the first to be developed, will be completed in 2010/2011. Funding for the land-use secretariat will be over \$13 million in 2010/2011;

- . As part of the 20-year comprehensive plan for the oilsands, the government will earmark \$400 million over three years for infrastructure within the urban services area of Fort McMurray. This will support continuing construction of a new bridge over the Athabasca River, new interchanges at Thickwood Boulevard and Confederation Way and the Parsons Creek and Saline Creek housing developments;

- . In terms of the climate change strategy, the budget includes \$100 million in 2010/2011 and \$500 million over three years for CCS projects. The government entered letters of intent to participate in four major projects, committing nearly \$2 billion in funding over 15 years. This includes \$745 million in provincial funding to support the \$1.35 billion Quest project to capture up to 1.2 million tonnes of carbon dioxide a year from

**Shell Canada's Scotford upgrader;**

. Last November, the **Climate Change and Emissions Management Corporation** invited 30 organizations to submit detailed proposals for funding under the climate change and emissions management fund. Successful proponents will be announced in June. With \$78 million in payments expected from industry in 2010/2011, over \$318 million will have been collected since the fund was established in 2007/2008;

. Through various Canada ecoTrust for clean air and climate change initiatives, support will be provided for projects that have a strong potential to reduce greenhouse gas emissions, including clean energy research and waste-to-energy conversion. Nearly \$46 million is budgeted for ecoTrust initiatives in 2010/2011;

. Also, in addition to \$63 million in capital support, \$25 million in operating funds will be provided in 2010/2011 to continue implementation of the water for life strategy;

. With \$30 million in one-time funding, the reclamation of orphan wells was significantly accelerated in 2009/2010, the province said. This reduced the number of wells to be reclaimed by about 20%. The budget will continue the orphan well abandonment program, funded by industry through the **Energy Resources Conservation Board** at \$13 million per year.

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