Feature

Energy—Part 1

We have seen so much speculation regarding the energy market lately, for many it must be difficult to know which way to turn or what to invest in. We have taken this opportunity to review the situation in the different energy classes and look at some companies that may benefit more yet.

'*Only 70 days supply left'* was the message that confronted me the other day. This was referring to the number of days of oil supply, that the US had based on it's strategic reserves. I had previously read elsewhere that China is busy filling up its reserves and building new storage facilities to increase them further.

However we look at it, there is suddenly a growing realization that demand is not going to go away, but in fact is actually growing. The world is certainly running out of the cheaper oil, which was easily won. Here we take a thorough look at many of the energy classes, starting with the most basic and most abundant.

Coal

Seen as the dirty fuel, we reviewed this sector in November last year. When we did so Peabody BTU (NYSE) was trading at $41.30 (now $68.18), Consol Energy CNX (NYSE) was trading at $62.87 (now $87.59), Arch coal was trading at $80 (now $100) and UK Coal UKC was trading at 133p (I did suggest you steered clear of this one at the time, which is probably just as well as it fell to 123p but is now 165p!).

I would suggest you read my November article for more on coal. In terms of outlook for the longer term, regardless of how dirty it is supposed to be, we are sure that as natural gas prices rise and crude becomes a non starter, that coal will still be one of the favourites to generate power.

Many long term contracts will, if not already, be coming to an end allowing coal producers to renegotiate their prices, in some cases significantly. We should see this reflected in the bottom line in the long term. Of course we should also be aware of companies that increase their cost to get at more difficult reserves. I still like the stocks listed above and may have to add UK Coal based on them renegotiating contracts at more beneficial rates.

Oil Shale

Oil shale is rather like the oil sands of Alberta was in terms of popularity when we covered it back in November 2003, i.e. no one was really interested, believing it was too expensive to produce. I will cover that below, first I shall look at what could be a substantial resource subject to approval.

Whilst referred to as oil shale, it is neither oil nor shale as such, instead the 'oil' is mainly kerogen which has a high organic content and the shale is often a hard rock called marl. The kerogen can easily be converted into oil which is not as good a quality as upper grades of conventional oil but on-par or better than many of the lower grade oils.

It is the cost of the process that has been off-putting, particularly whilst oil was selling at $25 per barrel. There are many ways of processing the raw material although the most conventional is by mining and heating the shale or by drilling wells and heating the surrounding ground. Historically these have both been expensive although new technology and techniques have come on a long way, with American Oil Production claiming that costs will be in the region of $15 to $20 per barrel. Shell has developed a patented system which they claim will allow them to produce oil relatively economically and as important in an environmentally acceptably.

As with the oil sands the process uses a significant amount of energy to produce the finished product. Current estimations put this at 1:3.5 (one unit of energy used produces 3.5 units of finished products).

Now here is the good news, oil shale can be found in Australia, Brazil, Canada, China, Estonia, France, Russia, Scotland, South Africa, Spain, Sweden and the USA amongst others. Even better news for the USA is that they sit on around 2 trillion barrels. Yes a lot!. In fact around 60 percent of the worlds total reserves. That gives them more oil than Saudi Arabia. Some 1.5 trillion barrels of this is under public land in Colorado. Note some reports I have read (from the same agency!) put the US reserves at 800 billion barrels, but whatever there is quite a bit there!

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The US sits on the world's largest deposits of Oil Shale, which is estimated to contain some 2 trillion barrels of oil.

Whilst we are talking energy here, I would like to remind you of the potential for companies supplying the tools and know-how should also benefit. Burlington Northern Santa Fe was up from $65 to around $80 as I write.

Kym Watson

Feature

Alternative fuels (cont)

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US Congress has only just approved their energy bill which has resulted in some 19 applications for leases on the land which was previously held as a strategic military reserve.

Realistically, even if the go ahead is given tomorrow, it will take until around 2010 before we see any meaningful production. The initial costs will be high but the government may step in with grants in one form or another.

There was a rush of companies back in the 1970's that started extracting oil, but it was not long before oil prices fell back to levels which made their efforts non viable. It was back in May 1982 when the last company, Exxon, pulled out after spending $5 billion.

From the original 10 applicants, eight have been short listed this time around. These are;-

- Chevron Shale Oil Company
- EGL Resources, Inc (EAGL—NASDAQ)
- Exxon Mobil Corp (XOM—NYSE)
- Oil-Tech, Inc (Private)
- Oil Shale Exploration, LLC (private)
- Shell Frontier Oil & Gas (three applications)

Profits from these projects could be some time coming, although now is the time for the speculative investment.

Natural bitumen / oil sands

Probably the most known and certainly the biggest reserves of oil sands are found in Alberta Canada. We first covered this source way back in November 2003. Our chosen company at that time was Suncor (SU) which was trading at just over $20 (It currently trades at just under $90).

Removing the oil from the bituminous deposits was left to a few specialized companies which at that time just scrapped a reasonable return. But at that time oil was trading for about $30 a barrel. Their costs sit around the $20 level which means they are currently doing quite well! There may be some more legs in Suncor's stock price, it will certainly be boosted if oil carries on its way to $89 plus.

Another of the stocks we covered still looks good value is Encana Corporation (ECA) which was trading at $20.65 (currently trades at $51.78 although taking into account a 2:1 stock split this would be equal to around $103!)

Coal bed Methane

For years the methane produced in coalmines has been a potential killer. The gas has previously shut down mines as they became too dangerous to operate in. Coal bed methane (CBM) is simply methane found in coal seams. It is most often trapped within coal by water.

There are a number of ways to collect this gas which is relatively abundant and a good market for it. During my research I came across a potential ten bagger. This Canadian company has just signed a deal with the Zhengzhou Coal Industry Group in China to extract around 12.3 trillion cubic feet of gas.

Zhengzhou has had major problems trying to extract coal from a large mine due to the high amount of CBM. There is further good news for this Canadian company as the mine sits next to Zhengzhou which is a fast growing city located between Shanghai and Beijing, thus there is a market on their doorstep.

The company's name is Verona Development Corp and it trades on the Canadian stock market under ticker VDC. The stock currently trades at Cn$1.64 and can be traded using the Interactive brokers platform. It is very speculative at present as no profit will be made for a while form this project.

Ethanol

Kevin wrote about Ethanol in the March edition of the newsletter so I will not go into a lot of detail. Only a brief update on a partnership which looks set to make a good profit. Ergon Ethanol Inc, a private company specializing producing ethanol has signed a deal with Bunge North America (BG—NYSE) to produce the largest Ethanol plant in the Southeastern States. Bunge is a leading grain originator in North America. The proposed plant will require some 121 bushels of corn each year to produce 60 million gallons of ethanol.

Next month

Well I hardly got started and have run out of space. Next month I will hopefully cover all or most of the other 14 energy sources and review a stack of companies poised to benefit from them.

It is not surprising that companies are falling over themselves to build ethanol plants in the US, refiners are being paid a 51cent per gallon subsidy!

Some US companies and sectors that will benefit from the ethanol production are as follows;-

Ethanol producers
Archer Daniels—ADM
Andersons—ANDE
Pacific Ethanol—PEIX
O2 Diesel Corp—OTD
MGP Ingredients—MGPI

Seeds
Delta & Pine Land Co—DLP
Monsanto—MON

Fertilizers
Terra Industries—TRA
Mosaic Company—MOS
Terra Nitrogen—TNH

Tractors & farm machinery
Deere & Co—DE
Agco—AG
CAT—CAT
CNH Global—CNH

Kym Watson