

# Investor's Digest

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## My Montney shale-gas pick: Canadian Spirit

By Craig Stanley

As the price of natural gas continues to tick higher off recent lows, the focus on shale-gas plays continues to gather steam. These plays were ignored in the past due to poor economics, but advances in fracturing and completion technology, resulting in increased recoveries, have made these targets a hot commodity.

Though U.S. plays such as the Eagle Ford, Haynesville and Marcellus get a lot of the press, an equally exciting opportunity exists in the Montney formation in northeast British Columbia. **Talisman** (TLM-TSX, \$17.97), for example, noted at a recent analyst day that it plans to spend \$450 million this year on developing its Montney land focused at the town of Farrell Creek. The company has four rigs turning and is looking to exit 2010 at 40-60 million cubic feet per day (mmcfpd). Its plan to expand the Farrell Creek processing facility to ~120 mmcfpd by the third quarter indicates the success Talisman is having throughout the area.

And just last week, **ARC Energy Trust** (AET.UN-TSX, \$22.04) announced its intention to purchase **Storm Exploration** (SEO-TSX, \$14.75) for \$680 million, combining ARC's Dawson and Sunrise/Sunset projects with



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Storm's Parkland field, all in the Montney.

In addition to a competitive royalty regime, oil and gas infrastructure in the Montney includes **Spectra Energy's** (SE-NYSE, \$21.96) pipeline and a gas plant at Fort Nelson where the com-

pany is expanding capacity to 790 mm cfpd. As well, Apache Energy and **EOG Resources** (EOG-NYSE, \$113.75) have a 51-49 interest respectively in the proposed Kitimat liquefied natural gas (LNG) terminal 650 kilometres north of Vancouver.

**Canadian Spirit Resources** (SPI-TSX/VEN, \$1.18) is a well funded, small-cap exploration firm that gives investors leverage to the Montney along with near-term news flow. Led by experienced oil men Don Gardner and Phil Geiger, the company is focused on its large land package near Farrell Creek.

Canbriam Energy, a private exploration firm funded by ARC Financial and U.S. private-equity firm Warburg Pincus, has a 65 per cent working interest in SPI's 47 sections of deep rights that include the Montney. SPI is carried on the initial capital up to C\$29 million, with Canbriam having the option to increase its working interest to 70 per cent by spending an additional C\$21 million.

According to a resource report completed by Sproule, a Calgary-based petroleum engineering

firm, and dated April 2010, total gross discovered and undiscovered natural gas resources were calculated to be between 3.6 and 8.4 trillion cubic feet (tcf). Using an estimated 25 per cent recovery factor, SPI's net interest is 315 to 725 billion cubic feet (bcf).

### Lower Montney

A horizontal well at the c-A48-I location is currently being fracture stimulated and tested. The purpose of the test is to determine the economics of exploiting the lower portion of Montney. If the results are positive, it will only add to SPI's significant upside potential given Talisman has essentially derisked the Upper Montney in the area with its extensive drill and frac program to date at Farrell Creek. Results for c-A48-I are expected in July. Management would like to announce the results prior to the July 9 expiration of 1.2 million warrants at an exercise price of \$1.40; if the results can move these warrants into the money it could bring \$1.7 million into SPI's coffers.

Drilling of a horizontal well targeting the Upper Montney at c-18-I is imminent with fracture stimulation and testing expected in August. A second horizontal is also planned at c-18-I in addition to a well at c-A48-I, plus the construction of a 10-20 mm cfpd production facility.

In addition to its Montney activities, SPI also has a 100 per cent

interest in 55 sections of shallow rights (surface to the base of the Cadomin/Nikanassin Formations) that Sproule has estimated holds 1.8 tcf of discovered and undiscovered natural gas resource initially in place.

Shell Canada recently decided not to proceed with pooling of its shallow rights in the area with SPI's rights, thereby giving SPI seven wells currently tied into the Spectra Energy pipeline, as well as an expandable 1.1 mm cfpd pilot gas facility and a pipeline capable of up to 60 mm cfpd connecting the plant to the Spectra pipeline. SPI also gets a right-of-first-refusal on 95 additional Shell sections contiguous to the SPI lands. Management plans to talk with potential partners in the near future about how to best monetize these assets.

SPI has 54 million shares outstanding (58 million fully diluted), with three shareholders accounting for over 40 per cent: Elmag Investments, Pinetree Capital and Sprout Asset Management. The company has \$12 million working capital and is in the process of raising \$4.2 million through the issuance of three million flow-through shares at \$1.40/share. Management is working on moving the shares to the TSX for the fall.

*Craig Stanley is Vice President, Research, at Pinetree Capital Ltd. Both Pinetree and the author own shares of SPI.*