

As printed in

REPORT ON BUSINESS

Management key in rise of small caps

DEBORAH YEDLIN – January 6, 2003

Investors who piled into shares of Cequel Energy Inc. a year ago posted a tidy 400-per-cent return when the year closed out last Tuesday. And if you bought the stock in December, 1999, and held it through to the end of 2002, you'd be looking at a tech-like gain of 746 per cent.

The secret to Cequel is not all that complicated.

Like many junior oil and gas companies fuelling the current oil patch renaissance, Cequel is being run by a team that has already shown investors what it is capable of.

In this case, it's the self-effacing Donald Archibald and his group that started Cypress Energy in 1996, building the company from the ground up to one worth \$790-million when it was sold to PrimeWest Energy Trust in February, 2001.

Not that anyone should have doubted the likelihood of Cypress's success in the first place: One of Mr. Archibald's backers was a guy who had already done well in the oil patch -- former Chauvco Resources chief executive officer Guy Turcotte.

Mr. Archibald, a native of Medicine Hat, is neither an engineer nor an accountant but learned the oil patch ropes on the banking side after graduating from the University of Western Ontario with an MBA. He took a slow and disciplined approach to building Cypress, not unlike what he is doing with Cequel.

"They've bought well and they've drilled well," says Peter Linder of Delta One Energy, an energy-focused hedge fund that holds a position in Cequel.

But, as Mr. Linder points out, it's not just Cequel that is turning the adage of yesterday's winners being today's losers on its ear.

In oil patch terms, yesterday's winners are the folks that have boot-strapped themselves into new ventures and are doing today what they have done before: making investors money.

And that's why the institutional investors, after staying away from the junior companies, are venturing back into the small-capitalization stocks and paying for the talents of management teams that have already been through a cycle.

The end result has been strong market performance by such companies as Progress Energy, led by the former Encal Energy guys, which gained 102.5 per cent in the year; Blue Mountain Resources, where former Cimarron Petroleum CEO Randy Pawliw hangs his hat, was up 215 per cent; Niko Resources, which produces natural gas in India, rose 225 per cent; Peyto Exploration finished the year ahead almost 181 per cent and Tusk Energy added 171 per cent. The folks at Crescent Point Energy, which gained 200 per cent, were formerly at Startech, and Petrobank Energy finished the year 148 per cent ahead of where it began.

By comparison, the best performing large-cap company was Petro-Canada, ending the year more than 24 per cent ahead of where it began, while Talisman lost 6 per cent.

While seasoned management teams are one ingredient for success, a quick survey reveals that another ingredient, under current market conditions, is a weighting toward natural gas.

Even though oil prices are touching highs not seen in more than two years, oil remains a global commodity while natural gas is subject to North American fundamentals.

And right now that means only one thing: supply destruction.

Storage levels of natural gas heading into what is the highest demand period of the year are 19 per cent lower than this time last year and expectations are that inventories will be at record lows at the end of the winter heating season. The concern over how much can be reinjected into storage over the summer months is arguably being reflected in current prices, which are more than double the \$2.75 (U.S.) for 1,000 cubic feet of natural gas posted last January. Add to that a colder than average January forecast for the entire United States and the result is that prices could easily average north of \$5 for 1,000 cubic feet this year.

All this points to the biggest bang for investors coming from companies able to meaningfully add natural gas volumes and therefore take advantage of the higher pricing environment.

Things look so good, in fact, that some veteran investors are cautiously musing that 2003 is starting to look a lot like 1993, the last time there was a boom at the junior end of the market.

The difference is that back then most of those management teams were novices. Today the teams might be the same but they have packed on a decade of experience and have the grey hair to show it.

With share prices trading at rich cash flow multiples not seen for quite a while, the challenge for 2003 is for those management groups to add value and backfill those heady market caps. And even though the hotter commodity might be natural gas, the big wins could just as easily come from companies weighted toward oil because, at the end of the day, it's not just about the assets: it's about the people who manage those assets.

Copyright (c) 2002 Bell Globemedia Interactive Inc. All Rights Reserved.



www.frontstreetcapital.com
1-800-513-2832