

FINANCIAL POST

Monday, July 07, 2008

Oil too costly? Start a well

John Greenwood, Financial Post

Published: Monday, July 07, 2008

Presented by

NP Network
Blogs



Chris Graham for National Post

For more than 30 years, Terry Johnston has been scraping out a living from a stretch of arid, pancake-flat prairie in southeastern Saskatchewan, land that his family has been farming for more than a century. But that is set to change after Mr. Johnston joined a growing number of individual investors so entranced by rising oil prices that they bought their own wells.

Mr. Johnston contracted a big triple rig to drill down about 1,500 metres on a patch of grain field in April and pumped his first crude on Thursday afternoon.

Baring a sudden drop in world oil prices or problems at his pump, the 55-year-old farmer will soon enjoy a dramatic uptick in his personal cashflow. "We're not going to be celebrating yet, we're going to wait and see," said Mr. Johnston, a lean, weathered man with a wry sense of humour.

So far the venture has set him back about \$1.8-million which he financed with a bank loan and help from friends.

While he knows there aren't many farmers who own oil wells, he's betting it will pay off.

Mr. Johnston said he is hoping to have his investment paid back after two years, though with oil prices still on the rise, it could be a lot sooner. And while the jury is still out on exactly how long the well will keep pumping out oil, he's optimistic it could have a life of 25 years or more.

One thing that gives him confidence is that this part of Saskatchewan is the focus of an oil boom that has attracted numerous oil and gas companies. For the past few years they have been tripping over themselves to sink wells into the region, most of which end up producing plenty of sweet-smelling crude for their owners. Farmers such as Mr. Johnston, who has about 40 oil company wells on his land, also benefit because they collect rent from the companies.

But Mr. Johnston figures the modest rent he collects will pale in comparison to the profits from owning his own well.

He's hoping it will produce as much as 150 barrels a day. Because the oil is good quality, there is a minimum of processing-- all he needs to do is pump off the water before trucking it to a nearby Enbridge Inc. terminal, where

it's sent through a pipeline network to a refinery for processing.

"Coming from a farming background, you know about taking chances -- you're at the mercy of the environment, so you're taking risks every day," he said in a phone interview from his farm near the town of Kisbey, near the North Dakota border. "This is less risky to me."

The idea of a grain grower getting into the oil business may seem far-fetched, but Mr. Johnston is only the latest example of an emerging trend in the oil patch, according to Alan Tambosso, president of Sayer Energy Advisors in Calgary.

"There are more and more individuals who historically have no experience in the oil industry and who are now entering it either through drilling wells or through buying assets," said Mr. Tambosso.

As a provider of consulting services to energy companies involved in mergers and acquisitions, Sayer Energy has a ringside seat on the market for oil well properties.

"With the price of oil going up, they just want to own physical assets," said Mr. Tambosso, who notes that so far most of these players are still in the process of locating suitable properties.

Oil soared to a record high of nearly US\$146 last Thursday, a jump of more than 50% since the end of 2007. Meanwhile, many analysts predict it will climb over the \$200-mark in the next six months, propelled by concern over declining world supplies.

Robert Crump, the head of a private medical clinic in Calgary, decided last year he wanted to own oil wells. He teamed up with a group of like-minded doctors and together they formed MD Energy Ltd., a private company with 12 shareholders, and set out with \$2.7-million in capital to hunt for properties. Today MD Energy owns 11 wells in southwestern Saskatchewan.

"The first thing was to identify an opportunity where we could reduce the risk of capital to an acceptable level," Mr. Crump said from his clinic, which doubles as headquarters for MD Energy.

Their idea is that as the oil patch has matured, resources are becoming depleted, leaving companies holding a lot of marginally producing wells. The group believes that many corporate owners will seek to sell off such properties, believing that their capital is better deployed on opportunities elsewhere. While such wells might not be worth much to a big company, they could still provide a decent living for leaner players such as Mr. Crump and his group.

The plan for the company was hatched by Mr. Crump and Dr. Terry Stewart, a pediatric anesthesiologist who now serves as company chairman.

One day early last year, Dr. Stewart saw Mr. Crump looking over some oil industry information, and they quickly discovered a mutual interest.

None of MD Energy's wells are producing yet, but the doctors hope to be on-stream by August. According to Mr. Crump, they are low-pressure wells, meaning production will be modest. Still, he says, the investment will be paid back within the first 12 months. Given that such wells enjoy a typical lifespan of about 14 years, his investors will likely be hankering for action soon.

"We have more property that needs to be developed; we will raise as much as we need," Mr. Crump said. James Deis of Medicine Hat

is another new oil-patch player. A long-time employee of an oil well servicing company, Mr. Deis, 42, dreamed of owning his own well almost since he began his career about 17 years ago. Two months ago he finally took the plunge and bought his first property. Today he has nine, scattered across Saskatchewan, producing both natural gas and oil.

Perhaps not surprisingly, he is reluctant to talk about financial details. "Let's just say you need about \$150,000 to own nine wells," he said, explaining that the more oil that comes out, the higher the price the buyer has to pay.

"It took me 10 years to figure out how to do all this stuff and if you don't have the background, it can be, ah, risky. You have to have connections, you need to know people so you can pick their expertise."

Mr. Deis, who is married with four young daughters, has become acquainted with plenty of industry experts over the years, but even so the learning curve has been steep.

Fortunately, he still has his regular day job to help pay the bills. After coming home in the evening, he sits down to deal with paperwork from his oil business.

"There are sacrifices, but as time goes on, you start having cash flow," he says.

In reality, he admits, most of the money is still going to the banks that lent him the money to start his business. However, if oil prices stay high and his wells don't suddenly go dry, he reckons he'll soon be in the black. That doesn't mean he'll be an instant tycoon -- though he's already planning to take his family to Disney Land in the spring.