

WHY ARE COALBED METHANE STOCKS RED HOT?

A Conversation with Eric Nuttall
Coalbed Methane Analyst, Sprott Asset Management

Part One of a Two-Part Interview



Alberta, Canada's Horseshoe Canyon is the primary focus for Canadian coalbed methane companies

Summary: Eric Nuttall talked with StockInterview.com about the red-hot Coalbed Methane (CBM) sector. He explained why CBM could continue to attract legions of investors and a wider audience over the next few years. More importantly, he told us which are his favorites in the CBM sector.

StockInterview:

Why are Coalbed Methane (CBM) stocks attracting investors right now?

Eric Nuttall:

Coal bed methane (CBM) is perhaps one of the last significant natural gas resources available in Canada. With the maturing of the Western Canadian Sedimentary Basin, the potential for elephant sized discoveries has been greatly reduced. Higher natural gas prices have also greatly improved the economics for CBM exploitation. We at Sprott Asset Management are quite excited about the prospects for companies with coal bed methane assets so long as natural gas prices remain above \$6 per Mcf (thousand cubic feet). The economics would be very skinny under \$6.

StockInterview:

But there may be elephant sized discoveries in CBM?

Eric Nuttall:

Well in Canada, CBM is called the "oil sands of natural gas." The analogy is that it's a very large resource. The Alberta Energy and Utilities Board has assigned 71 trillion cubic feet of gas in place for Horseshoe Canyon and 239 Tcf of gas in place for the Mannville coals. Those are very large potential resources. They fit the definition of an unconventional resource: definable in aerial extent, predictable in nature and repeatable. In contrast to the oil sands, which are only found in Alberta, emerging CBM plays exist in many areas of the country, such as in Nova Scotia (Stealth Ventures), Southern British Columbia (Storm Cat Exploration), and even in Northern Ontario (Admiral Bay).

StockInterview:

Can you explain why everyone refers to CBM as an unconventional resource, when methane is the key constituent of "conventional" natural gas?

Eric Nuttall:

Coal bed methane is referred to as an unconventional resource, because it requires different techniques and approaches than the exploitation of natural gas from a conventional reservoir. One such difference is the need to fracture the reservoir, often using air or nitrogen, due to the lower permeability of coal versus a conventional reservoir. This fracturing can often be equal to the cost to drill a coalbed methane well, depending on the number of coal seams. Also, CBM wells typically come on at lower rates than conventional wells, yet have many of the same fixed costs, in addition to the added costs of fracturing and compression. So it makes sense that in order for the economics to be equal, the CBM well would require a higher natural gas price.

StockInterview:

Where is the strongest area for CBM exploration in Canada?

Eric Nuttall:

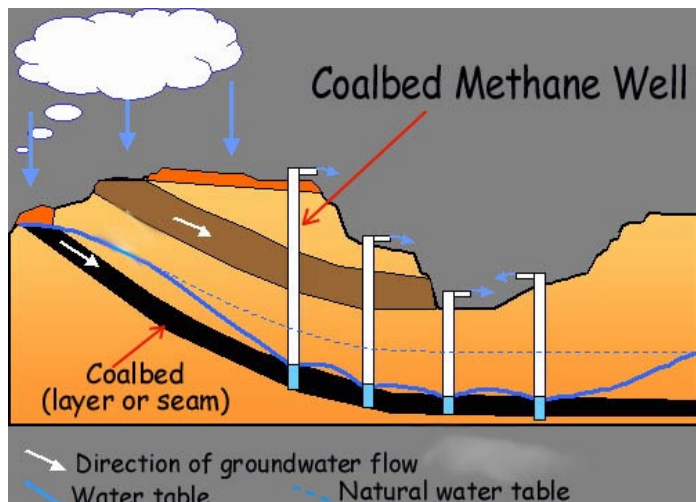
For the past four years, Horseshoe Canyon (province of Alberta, Canada) has been the primary industry focus. Horseshoe Canyon coals are almost always dry, are relatively shallow, produce sweet gas, and can be drilled with basic drilling rigs. The Horseshoe Canyon Trend is generally known, and exploration risk is fairly minimal. The primary risk is not whether the coals will contain gas, but rather whether there is enough natural cleating to allow for an economic rate of gas production.

StockInterview:

But there appears to be more excitement in Alberta's Mannville area?

Eric Nuttall:

The Mannville coals are a deeper and more complex target. The allure of the Mannville coals is they are thicker and contain much more gas than the Horseshoe Canyon coals. However, they contain large amounts of water. A joint venture between Nexen (TSX: NXY) and Trident in mid-2002 began a 40 vertical well pilot project. They found that the coals were taking over two years to dewater and reach commercial gas rates. Such a long dewatering time greatly reduced the economic viability of the play. In August 2004, rumors of a successful horizontal Mannville well began to circulate, with gas rates of over 1MMcf/d mentioned. These rumors eventually turned out to be true, and marked a shift in Mannville CBM exploitation towards the use of horizontal wells. Operators have found that it takes months, not years to dewater the coals. The average stabilized rate is approximately 200 to 300mcf/d, an economic rate in a robust natural gas environment. Another pivotal event that served to increase interest in Mannville CBM was a recent Mannville acreage Crown land sale on December 14, 2005. EnCana (NYSE, TSX: ECA) spent \$159 million dollars to purchase rights to approximately 270,000 acres. This was their most costly land acquisition since spending \$930 per acre in Cutbank Ridge. EnCana is a pioneer in the exploitation of Horseshoe Canyon CBM. I think this recent purchase demonstrates EnCana's belief that Mannville CBM is both technically vi-



able and economic. I expect data from many wells that have been on tight hole status to become publicly available this year, and will further increase enthusiasm towards the play.

StockInterview:

How does the Sprott Asset Management team feel about investing in CBM?

Eric Nuttall:

We have significant investments in several coalbed methane companies, in addition to companies with exposure to other unconventional resources, such as tight gas. I have many that I continue to monitor. We get quite excited over companies that have large resource potential and it's very difficult to find that in Alberta and British Columbia now, because the basin is so mature. We look for multi-baggers at Sprott, so we look for opportunities that have well in excess of 100 percent potential upside on our investment.

StockInterview:

Sprott Asset Management appears to be betting on an ongoing energy crisis, does it not?

Eric Nuttall:

Absolutely. It's a very strong macro view of Sprott Asset Management, that due to the world having peaked in its ability to produce meaningfully more oil, we are in an environment of sustainably high energy prices, whether they are natural gas, oil, coal, or uranium.

StockInterview:

Which are some of your favorite CBM investments?

Eric Nuttall:

The most interesting one to us currently is Canadian Spirit Resources (TSX: SPI). We own about 15% of the company. It is a significant player in an emerging CBM play in Farrell Creek, which is north of Hudson Hope in northeastern British Columbia. What's unique



Eric Nuttall specializes in researching Coalbed Methane companies for Sprout Asset Management, one of North America's most successful and respected money managers.

about Canadian Spirit is the company's president Phil Geiger worked at Chevron between 2002 and 2003 at a time, when Chevron was deciding whether to pursue CBM development. Natural gas prices were low and Chevron decided not to pursue CBM. Phil Geiger was then able to leave with all of the data that he had accumulated over that time in which he evaluated potential CBM plays across the country. Farrell Creek was the one project he decided to pursue. Last year, Sproule Associates, the premier CBM reserve engineering company, assigned a contingent resource of 9 to 14 Bcf of gas in place per section, based on 46 sections. The company now sits on almost 60 net sections. Sproule is set to release a new report evaluating the entire Gething Formation. I think the assigned gas in place number could easily double. With gas content confirmed, the next risk was economic productivity. On March 15th of this year the company, after refining their frac job, released a stabilized rate of 250 - 300mcf/d from only part of the formation in one well. This is in my opinion clearly an economic rate. Should Canadian Spirit Resources be able to replicate this rate on future wells, the company could be sitting on over 1 Trillion cubic feet of net recoverable gas, with a Duke gas pipeline running right through their property with 100MMcf/d of spare capacity. Though it would take many years to develop, if one were to value Canadian Spirit on a take-out basis I do not think it unreasonable to place a value of \$1 per Mcf of recoverable gas, suggesting a market capitalization of \$1 billion, roughly 7X larger than today's. It is important to note that the play is still in its infancy. Significant risk still remains. But this story possesses the type of upside that we look for, hence our significant ownership in the company.

StockInterview:

Is there a favorite CBM company in Alberta's Mannville area?

Eric Nuttall:

Ember Resources (TSX: EBR) is the only pure play Mannville CBM company in Canada, and has approximately 219,000 acres of potential Mannville exposure. Half of their Mannville acreage offsets the Nexen/Trident Manville Project that was declared commercial in July of 2005, and whose partners plan on investing \$400 million over the next year and a half to prove up the productivity of the acreage. Expectations of companies pursuing Mannville are that each section will recover approximately 3.6Bcf. Ember has over 340 net sections that are prospective. So their potential could be quite large, though it will take many years to prove up their resource potential. An investor should apply an appropriate risk factor to their acreage. I wouldn't be surprised if Ember were to be acquired at some point in the future, since it is extremely difficult to accumulate such a large contiguous area of prospective acreage.

StockInterview:

Can you share another favorite with us?

Eric Nuttall:

Another company would be Rockyview Energy (TSX: RVE), which was a spin-out out of APF Energy Trust. They were one of the first energy trusts to pursue coalbed methane. The management team is solid. Steve Cloutier, the President, was one of the cofounders of APF Energy Trust and was able to bring along his CBM technical team from the Trust to Rockyview. Rockyview has both existing conventional and CBM production, and is trading at roughly industry multiples on a cash flow basis. However, the company sits on significant Horseshoe Canyon and Mannville acreage, with 132 net sections of HSC and 55 net sections of Mannville exposure. On a risked basis, the company could have 160Bcf of unbooked resource potential. At a NPV of \$1.50 per Mcf in the ground, would suggest the possibility of appreciation of over 100%. I think Rockyview would be a great take-out candidate for a Trust seeking low decline assets. I wouldn't be surprised if the company is not around in a year from now.

StockInterview:

Are there many pure plays?

Eric Nuttall:

It's difficult to find pure CBM plays. There is Ember, Canadian Spirit, Rockyview, many others I wouldn't necessarily recommend. Maholo Energy (TSX: CBM) is an exciting story I believe has significant upside potential. But their primary growth asset is not in Canada, it's in Oklahoma, targeting a CBM horizon, but also an emerging shale play in the Caney/Woodford Shale.

StockInterview:

Do you ever look outside North America to invest in CBM?

Eric Nuttall:

There really aren't many coalbed methane plays that I'm aware of outside of North America other than in China. A few companies have chased CBM in Australia, but they have not to my knowledge had a tremendous degree of success. I think anyone who has invested in an Australian coalbed methane story has not had a very pleasurable experience. We're invested in a few Chinese CBM companies. We're invested in Pacific Asia China Energy (TSX: PCE). We're also in a private company called Terrawest, which will be going public later this year. We've found in general investments in Chinese CBM companies to have been somewhat challenging. It can take an extraordinarily long amount of time to sign a production sharing agreement with either CUCBM or with one of the state oil and gas companies. The wheels of bureaucracy move slightly slower in China than in North America. Thankfully, future investors in Terrawest won't have to endure the wait that we had to go through. I expect over the next year that China will become a hotbed for natural gas exploration, and would encourage investors to seek companies that have already signed production sharing agreements. Both Pacific Asia China Energy and Terrawest have such agreements.

About...

Eric Nuttall, Research Analyst

Eric Nuttall is a Research Analyst with Sprott Asset Management Inc. He joined the firm in February 2003 after beginning his career with CIBC World Markets. Eric supports the investment managers with the development and analysis of investment ideas for all Sprott Funds, with a primary focus on oil and gas stocks. Eric graduated with high honors from Carleton University with an Honors Bachelor of International Business.



Pacific Asia China Energy (TSX: PCE) drilling on its Boatian-Qinshan property in the Guizhou Province of China. Sproule International estimated a production capacity with a “most likely scenario” of slightly more than 5.2 trillion cubic feet.

Websites and Trading Symbols of featured companies :
<u>EnCana (NYSE, TSX: ECA)</u>
<u>Canadian Spirit Resources (TSX: SPI)</u>
<u>Ember Resources (TSX: EBR)</u>
<u>RockyView Energy (TSX: RVE)</u>
<u>Pacific Asia China Energy (TSX: PCE; Other OTC: PCEEF)</u>

StockInterview.com is an independent information website with the goal of empowering investors. StockInterview.com publishes securities reports, news and comments of individuals and organizations whose opinions are deemed of interest to our readers. StockInterview.com does not itself endorse or guarantee the accuracy or reliability of any information, statements or opinions expressed by these individuals or organizations. Stockinterview.com does not provide an analysis of a company's financial position. Information on this website does not constitute a solicitation or offer to buy or sell securities. StockInterview.com has not independently confirmed the accuracy, correctness or truthfulness of statements made by company officials, analysts or outside spokespeople. StockInterview.com employees will never invest or trade securities of companies featured on this website. StockInterview.com will never accept securities as an advertising fee. StockInterview.com presents information from company officials and freelance writers, which is believed to be reliable, but its accuracy can not be guaranteed. Past Performance does not guarantee future results. Companies who have paid an advertising fee to be featured on the StockInterview.com website, are listed on the disclaimer page, see <http://www.stockinterview.com/disclaimer.html> for details. Any comments made by company officials, outside spokespeople, or analysts should be directly verified with the company by the reader. Information about publicly listed companies and other investor resources can be found at the Securities and Exchange Commission website: www.sec.gov. Investing in securities is speculative and carries risk. Investments in any security should be made only after consulting with your registered investment advisor, and especially after reviewing company financial statements and company news releases. Only sophisticated investors should consider investments in micro-capitalized companies as an investment strategy and only as a highly speculative portion of his/her investment portfolio. All investors are urged to review company filings with the United States Securities and Exchange Commission, and pay special attention to any and all RISK FACTORS announced by the company in its SEC filings.

FORWARD LOOKING STATEMENTS:

Certain information contained on the StockInterview.com website may contain “forward looking statements” made by the featured company, its management, employees or those with alliances to the company and information within the meaning of Section 27 of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934, including any statement regarding expected continual growth of the featured company. In accordance with safe harbor provisions of the Private Securities Litigation Reform Act of 1995, that statements contained herein that look forward in time, which include other than historical information, involve risks and uncertainties that may effect actual results of operations. Such forward-looking statements involve known and unknown risks, uncertainties and other factors, which may cause the actual results, performance or achievements of the Company, or industry results, to be materially different from any future results, performance, or achievements expressed or implied by such forward-looking statements. Such factors include, among others, the following: risks inherent in restrictions of foreign ownership; uncertainties relating to carrying on business in foreign countries; the Company's history of operating losses and uncertainty of future profitability; dependence upon joint venture partners; the size and growth of the market for the company's products; the company's ability to fund its capital requirements in the near term and in the long term; pricing pressures, etc. Any statements that express or involve discussions with respect to predictions, expectations, beliefs, plans, projections, objectives, goals, assumptions or future events or performance may be forward looking statements. Forward looking statements are based on expectations, estimates and projections at the time the statements are made that involve a number of risks and uncertainties which could cause actual results or events to differ materially from those presently anticipated. Forward looking statements may be identified through the use of words such as expects, will, anticipates, estimates, believes, or by statements indicating certain actions may, could, should or might occur. Investors should be cautioned that the Company may be unable to continue its projected growth rate, may be unable to fully implement its business strategies, or be unable to successfully integrate the operations of its various acquisitions. Investors should be further cautioned that any forward-looking statements made by the Company are not guarantees of future performance.