

November 29, 2012

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Equity Research Report

Mercom Oil Sands Plc

RATING: SPECULATIVE BUY

TARGET PRICE: 3.3 PENCE RISKED (40.5 PENCE WHEN UNADJUSTED FOR RISK)

CURRENT PRICE: 1.6 PENCE

SUMMARY

Mercom Oil Sands Plc (Mercom) is an early stage oil exploration company. In fact, it is only planning to become one, subject to it obtaining a working interest in an oil sands project in Alberta – the Chard project. The project is estimated to hold about 240 million barrels of heavy oil, but further exploration is needed to book any reserves and to estimate its economic feasibility. In addition, there are uncertainties regarding Mercom's ability to obtain a working interest in Chard due to a stall in negotiations with Chard's owner, which is currently the largest risk for Mercom and its investors.

The main opportunity lies in the potential payout if exploration proves a success. At the same time, it is highly speculative and there is no assurance that oil exists in the ground in expected quantities or that it can be profitably extracted. There are a number of other important risks, including lack of diversification, access to funding, environmental risks and other.

Our valuation suggests that Mercom's potential value is \$245.2 million¹ (\$0.64 or 40.5 pence per share), if the Chard project is acquired and developed successfully, with current fair value (adjusted for risk of failure) of \$20.1 million, or \$0.05 (3.3 pence) per share.

¹ All \$ amounts in this report refer to Canadian dollars, unless otherwise noted.

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HIGHLIGHTS

Contingent resources estimated

The Chard project is estimated to hold approximately 240 million barrels of oil (MMbbl), according to a study by DeGolyer and MacNaughton Canada Limited, with about 70 MMbbl considered exploitable at this stage, which, at 40% recovery, translates into about 28 MMbbl contingent resource (best case estimate).

Of course, these estimates are only preliminary, with much work needed to provide a more precise reserve estimate and determine the economic feasibility of oil extraction.

Development program in place

Mercom has a development program drafted that envisages drilling 8 exploration wells to book the Chard reserves. The program is estimated to cost \$2.5 million and last for two years.

Favorable oil market outlook

Oil is a key energy resource, with limited alternative options. Despite attempts to switch to alternative energy sources, oil remains one of the main energy commodities, along with coal and natural gas. At the same time, economic growth in developing countries is continually raising the demand for oil and in the future, this demand is only going to strengthen, helping to keep oil prices strong. Moreover, as oil is a finite resource, its availability is inevitably going to diminish, adding to the price pressure.

Favorable project location and infrastructure

The Chard project has access to the main infrastructure elements necessary for successful production: pipelines, roads, railroad. The property borders other projects, some of which are producing, which not only ensures access to infrastructure, but also adds to the project's chances of success. On a larger scale, the Chard project is located in Canada, which is a stable and mature economy, unlike many other oil-producing countries, and thus represents significantly lower political risk.

RISKS

Lack of certainty that working interest will be obtained

Currently, it is not clear whether Mercom will be able to earn any working interest in the Chard project. Apparently, discussions with the owner have broken down and the farm-in agreement signed in February no longer has any significance. Our valuation is contingent upon Mercom obtaining a 100% working interest in Chard, but at the moment, there is no assurance that it will be successful.

No reserve estimates

Although the Chard project has some estimates of oil content, these are preliminary and thus uncertain. The project must undergo an appraisal drilling program in order to provide a reserve estimate (proven, probable, possible reserves) and assess the economics of oil extraction with a greater degree of certainty. There is no assurance that this program will confirm the presence of recoverable resources or that their volume will be confirmed to be of the same magnitude as estimated in preliminary reports, on which we based our valuation.

Funding

In order to obtain any working interest in the Chard project, Mercom will have to make a payment, and it is currently unknown what the amount is likely to be. Originally, the company had the obligation to commit over \$3 million to earn a 50% working interest, but since this initial agreement appears to have been invalidated, one can only guess. In addition, Mercom will need to raise more funds in the future to move the project towards production (if the exploration program proves economic feasibility of further development). There is no guarantee that Mercom will be able to raise the necessary funds, and any fundraising initiatives are likely to lead to stock issuance and dilution of current shareholders' holdings.

Lack of operational infrastructure

Mercom has no specialist staff (geologists, drilling specialists etc.) or equipment and all operations on the Chard project were to be carried out by its partner Norwegian Oil Sands Corp. pursuant to the original farm-in agreement. In addition, all project information had been supplied by Norwegian and thus Mercom's success partly depends on the quality of this information.

Just one project

Mercom has just one project, participation in which remains questionable. If the Chard project proves unsuccessful, lack of other projects will mean total loss of any investment in the company. And even if production begins, it may be lower than expected or may experience other issues that may prevent the company from realizing the full expected value, with no other projects to absorb the shortfall.

Mercom has stated that it intends to look for additional properties to add to its portfolio, but this requires time and money and thus the mere intent does not reduce the risk at this stage.

Environmental risks

Extracting oil carries significant environmental risks. Any damage to the environment (e.g. spills or other pollution, fires) caused by the company could lead to significant penalties, fines and bad publicity. The potential extraction method (SAGD) also relies on large quantities of water to produce steam, which can affect water resources in the area.

It is worth noting that EU authorities are considering labeling oil from Canadian oil sands as the most polluting due to the impact of its extraction on the environment and on indigenous communities, which may affect the price of this oil.

COMPANY OVERVIEW²

Mercom Oil Sands Plc (Mercom) is registered in the UK. The company went public on London Stock Exchange's AIM market at the end of May 2012 and trades under the symbol of MMO.

The IPO raised the company £3.35 million before placing fees from issuing 33.5 million shares at 10 pence per share. The company intended to use the proceeds to fund the exploration and the farm-in of the Chard project (see below), as well as for acquisition of other oil sands projects.

Mercom's current focus is to develop the Chard oil sands project in Alberta, Canada, to turn it into a fully producing and economically viable project and then sell it or farm it out to a third party, although independent exploitation of the project is not excluded.

At the moment, Mercom has no operational infrastructure of its own, except a small management team.

CHARD PROJECT

Ownership

In February 2012, Mercom signed a sale and purchase (farm-out) agreement with Norwegian Oil Sands Corp. (Norwegian) for a 50% working interest in the Chard project (the "initial farm-in agreement"). Norwegian is a 100%-owned subsidiary of Nordic Petroleum ASA (Nordic). Norwegian's 100% ownership of the project is subject to a 2.5% gross overriding royalty to previous owners, and thus, Mercom's working interest will also be subject to a 2.5% royalty. Property leases expire in 2021.

In accordance with the initial farm-in agreement, to earn the 50% working interest, Mercom needed to make the following payments:

- \$100,000 to Norwegian at the signing of the farm-out agreement.
- \$600,000 to Norwegian on completion of the interest transfer to Mercom;
- Contribute the first \$2.5 million towards the capital costs of the appraisal program for the project.

Mercom and Norwegian also signed a Joint Operating Agreement (JOA), according to which Norwegian was the initial project operator.

² We must point out that all information about the company and its projects was provided by Mercom.

However, in November 2012 Mercom made several announcements, which suggest that the initial farm-in agreement is no longer valid: after negotiations with Nordic (the ultimate owner of Chard), the parties have failed to reach an agreement and Nordic accused Mercom of breach of contract. It is our understanding that currently Mercom has no legal rights for the Chard project, since there is no evidence that any payments have been made pursuant to the initial farm-in agreement.

In addition, at the end of November 2012, Mercom announced that one of its minority shareholders intended to attempt to acquire Nordic and sell 100% of Chard to Mercom. Mercom points out that “There is currently no arrangement or understanding between Mercom and Mr Zambrano” (the minority shareholder), and thus the likelihood of Mercom successfully acquiring the ownership of the Chard project is uncertain.

Location and infrastructure

The Chard project represents 31 sections with a total area of 19,610 acres (7,936 hectares) in the Athabasca oil sands Chard area in central Alberta, 180 km southeast of Fort McMurray and 466 km northeast of the city of Edmonton.

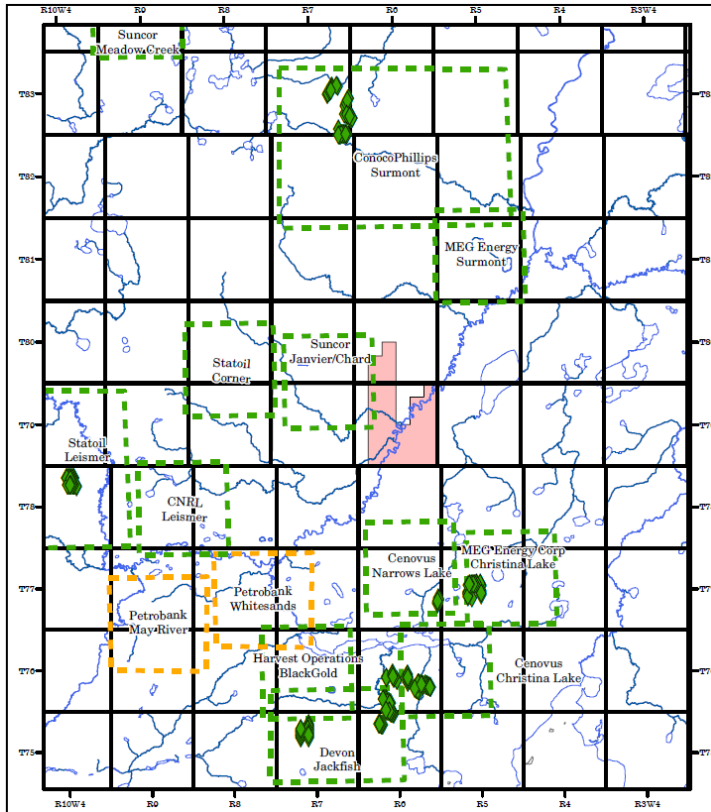
Chard has good access to infrastructure, with pipelines running through the property, paved public roads and railroad infrastructure.

Geology

Geological and mineralogical assessment comes primarily from a report prepared by DeGolyer and MacNaughton Canada Limited (DGMN), who report that the Chard area “produces primarily gas from Wabiskaw and McMurray Formations”, while the McMurray Formation also has “thick bitumen deposits within this area”.

The project is located close to other properties owned by large companies with existing commercial operations:

Other companies' properties near the Chard project:



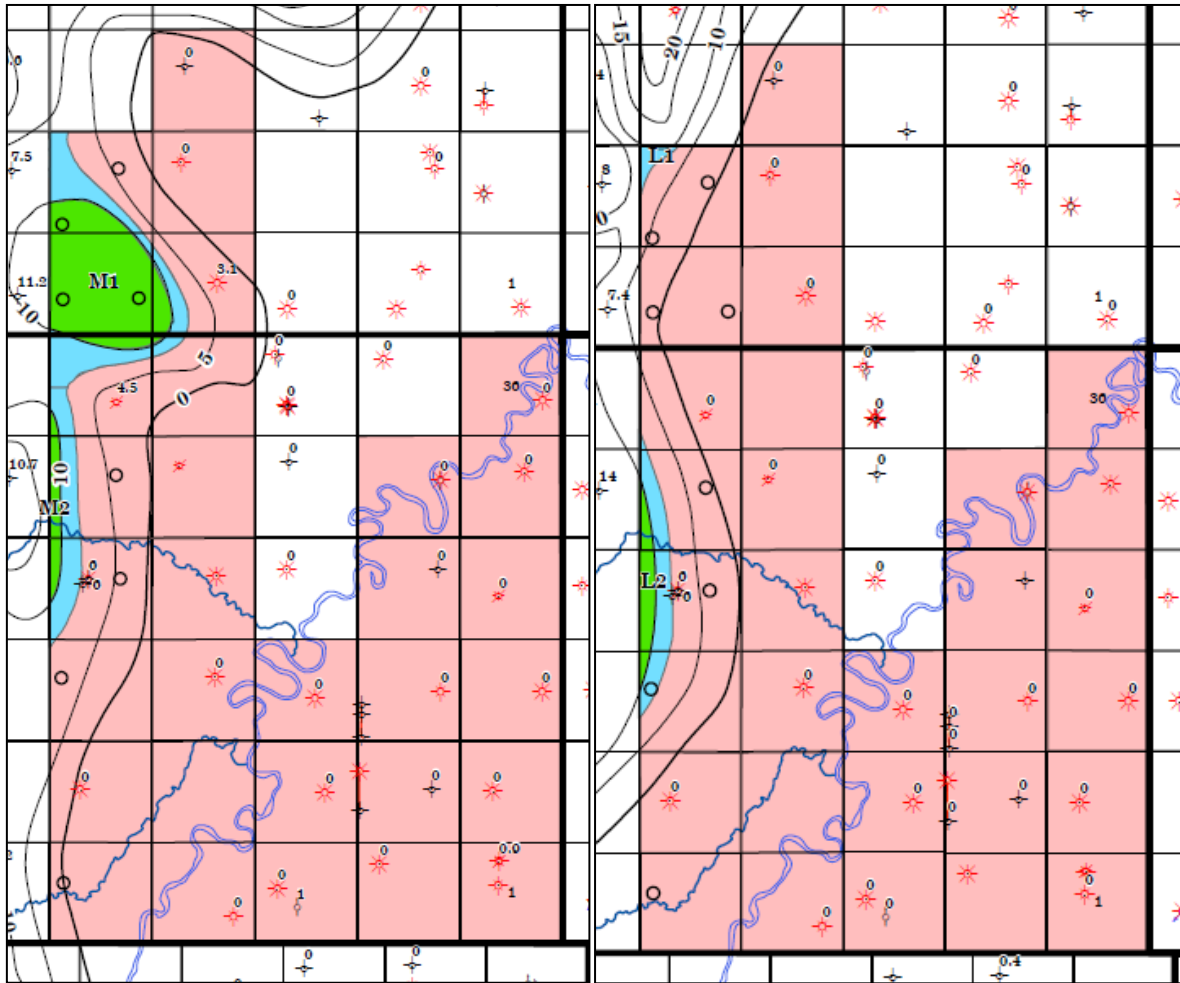
Source: DeGolyer and MacNaughton.

120 wells have been drilled within and around the project, mostly targeting gas, with less than 20% of wells drilled for oil sands assessment purpose. The oil sands potential evaluation work was based on these wells, with the McMurray Formation being the main target for exploring oil sands in this region.

DGMN reports that in terms of geology, the project has three main sand layers (from top to bottom):

- The upper channel, with average sand thickness of 5-7m, believed to contain gas.
- The middle channel, with sand thickness between 3m and 30m, containing bitumen and little gas. Bitumen is present mainly on the northwest corner of the property and a narrow strip of land along the western edge (M1 and M2 zones in the image below). Original bitumen in place is estimated to be 172 million barrels of oil (MMbbl).
- The lower channel, with sand thickness of between 10m and 50m. Bitumen is believed to be located along the western edge of the property (L1 and L2 zones in the image below). Original bitumen in place is estimated to be 67 MMbbl.

Bitumen location – Middle channel (M1, M2) and Lower channel (L1):



Source: DeGolyer and MacNaughton.

The table below details DGMN's estimates of bitumen in place at different net pay cutoff thicknesses:

Oil in place at various net pay thickness cutoffs (>0m, >5m, >8m, >10m):

Bitumen in Place Greater than 0 meters Thickness						
Area Name	Data Area (Ac)	Rock Volume (m ³)	Avg Thickness (m)	Sw	Phie	Bitumen in Place (Mbbbl)
Total Middle Channel	5,035	124,293,405	6.1	0.33	0.35	172,370
Total Lower Channel	2,699	50,569,419	4.6	0.30	0.32	67,490
Total Chard	7,734	174,862,824				239,860
Bitumen in Place Greater than 5 meters Thickness						
Area Name	Data Area (Ac)	Rock Volume (m ³)	Avg Thickness (m)	Sw	Phie	Bitumen in Place (Mbbbl)
Total Middle Channel	2,965	104,163,440	8.7	0.33	0.35	144,450
Total Lower Channel	1,161	35,947,178	7.7	0.30	0.32	47,990
Total Chard	4,127	140,110,618				192,440
Bitumen in Place Greater than 8 meters Thickness						
Area Name	Data Area (Ac)	Rock Volume (m ³)	Avg Thickness (m)	Sw	Phie	Bitumen in Place (Mbbbl)
Total Middle Channel	1,771	73,021,968				102,420
Total Lower Channel	484	18,409,294				24,590
Total Chard	2,255	91,431,262				127,010
Bitumen in Place Greater than 10 meters Thickness						
Area Name	Data Area (Ac)	Rock Volume (m ³)	Avg Thickness (m)	Sw	Phie	Bitumen in Place (Mbbbl)
Total Middle Channel	1,002	44,760,040				62,770
Total Lower Channel	131	5,583,397				7,450
Total Chard	1,133	50,343,437				70,220

Source: DeGolyer and MacNaughton.

Exploitable bitumen in place is limited to pay thicknesses of 10 meters (for low and best case) – 70.2 MMbbl, or 8 meters for the high scenario (127 MMbbl). Furthermore, DGMN estimates that 40% of exploitable bitumen in place could be recovered in the best case (27.6 MMbbl), with the low and high cases quoting 31% (21.3 MMbbl) and 48% (60.4 MMbbl) recovery, respectively. The best and low cases are based on exploring only net pay thicknesses of 10m and higher, while the high case considers net pay thicknesses of 8 meters and higher.

Best case contingent resources:

Chard Best Case Contingent Resources (10m Cut-Off)								
Area Name	Data Area (Ac)	Rock Volume (m ³)	Avg Thickness (m)	Sw	Phie	Bitumen in Place (Mbbbl)	Technical Recovery Factor*	Technically Recoverable Oil in Place (Mbbbl)
Block M1	882	39,518,086	11.1	0.329	0.345	55,420	39.1%	21,669
Block M2	120	5,241,955	10.8	0.329	0.345	7,350	39.1%	2,874
Total Middle Channel	1,002	44,760,040				62,770	39.1%	24,543
Block L1	-	-				-	41.6%	-
Block L2	131	5,583,397	10.5	0.295	0.316	7,450	41.6%	3,099
Total Lower Channel	131	5,583,397				7,450	41.6%	3,099
Total Chard	1,133	50,343,437				70,220	39.4%	27,642

Source: DeGolyer and MacNaughton.

DGMN considers that there is only a small chance for significant increase in the oil in place estimates due to the large number of wells already drilled in the area, although admitting

that there are areas with little exploration, which may hold resources (but need exploration).

Technology

Since the Chard property contains heavy oil (bitumen), it cannot be extracted using conventional methods, as it simply would not flow into a conventional well due to high viscosity. Open pit mining is also not an option due to the depth at which oil sands lie. Of the existing “in situ” technologies that deal with heavy oil, the Steam Assisted Gravity Drainage (SAGD) and the Cyclic Steam Stimulation (CSS) methods are being proposed for the Chard project (with the latter being recommended by DGMN due to relatively thin formation of bitumen-bearing sand). These technologies use auxiliary wells to pump steam and chemicals into ground to warm up the oil and make it less viscous to allow it to flow into a well.

SAGD is generally feasible mostly in oil-bearing sand thicknesses of at least 10 meters, and while the company mentions the possibility of “production of layers 5m + in thickness”, DGMN points out that there is no certainty about this. There are also other alternative techniques, but these are very new and thus their applicability to the Chard project is questionable at this time.

DGMN notes that Chard could benefit from “stacking” of deposits, where middle channel oil sands are on top of lower channel, potentially reducing costs.

There could also be significant natural gas quantities, according to the geologists, which could either be used to power the project or could be sold, although Mercom has not expressed any intentions regarding this gas (gas resource also has not been evaluated).

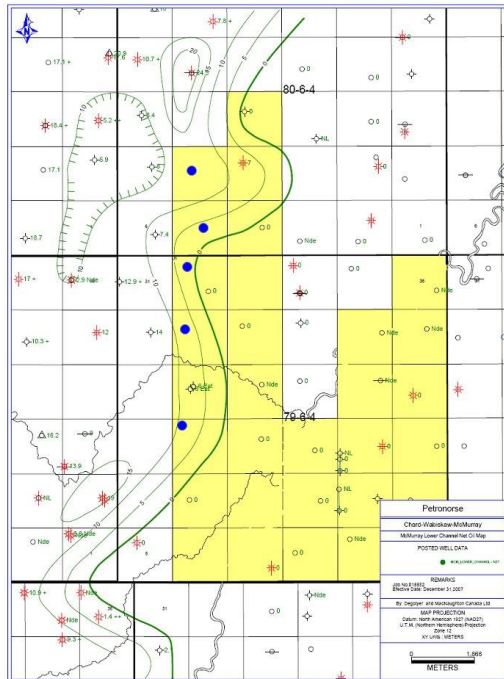
Development programme

Total oil in place is estimated at 239.9 MMbbl; however, this is a preliminary estimate and the project must undergo an appraisal program to evaluate the oil reserves, which will give a much clearer picture of the potential economics of the project.

Mercom envisages an 8-well exploration drilling program worth \$2.5 million, estimated to run for two years, to better understand the resources, their shape, volume and physical properties (API gravity etc.), and to determine the most appropriate extraction technology.

The map below shows proposed exploration locations.

Lower sand body (with exploration target locations):



Source: Mercom.

The exploration program should provide data necessary to identify reserves, production targets, and necessary facilities, and to determine project economics.

Mercom notes that before the completion of drilling, there will be an evaluation of existing technologies.

MANAGEMENT

John Zorbas – CEO

Mr. Zorbas was appointed as Mercom's Joint CEO in June 2012 and became the CEO when the previous CEO Kim Berkov stepped down shortly after. He is the Executive Chairman and managing Director of NWT Uranium Corporation, an emerging company focused on uranium where he is responsible for NWT's international asset portfolio. He is also a director of Stratton Capital Corp and ZoCrop Holdings. He is an economics graduate of the University of Toronto.

Kyle Appleby – CFO, Director

Mr. Appleby is a Chartered Accountant and President and CEO of CFO Advantage Inc., a company that provides CFO and other financial, accounting, and compliance services to companies in various industries including junior mining, manufacturing and distribution. Mr. Appleby obtained his Chartered Accountant designation in 2001 and is currently a member of the Institute of Chartered Accountants of Ontario and the Canadian Institute of Chartered Accountants. He is currently CFO for Renforth Resources Inc., Legend Gold Corp., Mukuba Resources Limited and Xylitol Canada Inc.

Patrick Cross, Non-Executive Chairman

Dr. Cross is the Non-Executive Chairman for Empyrian Energy Plc and has international experience in corporate finance, organisation structures, marketing and joint venture operations. His previous positions include 25 years with BP specialising in marketing, strategic planning and business development across different cultures. He worked for two years as President of Cable & Wireless Japan, and six years as Managing Director of BBC World Ltd. He has operated in South America, Asia, Europe and the United Kingdom establishing relationships at senior levels with major companies, governments and the European Commission. Dr. Cross holds a PhD in Microwave Telecommunication and a BSc (Eng.) in Electrical Engineering, both from University College, London.

Albert Taubi – Non-Executive Director

Mr Taubi is the Managing Director of Merchant and Commercial Confirmers Ltd, an oil trading company with activities in the Middle East and Southern Africa. He is also a director of Intellego Ltd, a health management consultancy firm providing services to the public sector in the UK (NHS) and to various organisations in Qatar. Mr. Taubi has also held other operational positions in Wealth Management for 12 years with Republic National Bank of New York and Union Bancaire Privee in Geneva. Mr. Taubi holds a Business Administration bachelor degree from ASSAS University in Paris.

VALUATION

At this stage in the company's development cycle, any valuation will be highly speculative. The company's only project – Chard – does not have any proven, probable or possible reserve estimates, and the company does not even have a working interest in the project. Therefore investors should understand that this is a highly risky investment, and only securing a working interest and developing the project can reduce the risks.

OUR ESTIMATES

We built our valuation model based on information from Mercom, DGMN and our own assumptions. This valuation is built on the premise that Mercom will acquire 100% of Chard with the help of the minority shareholder as described above.

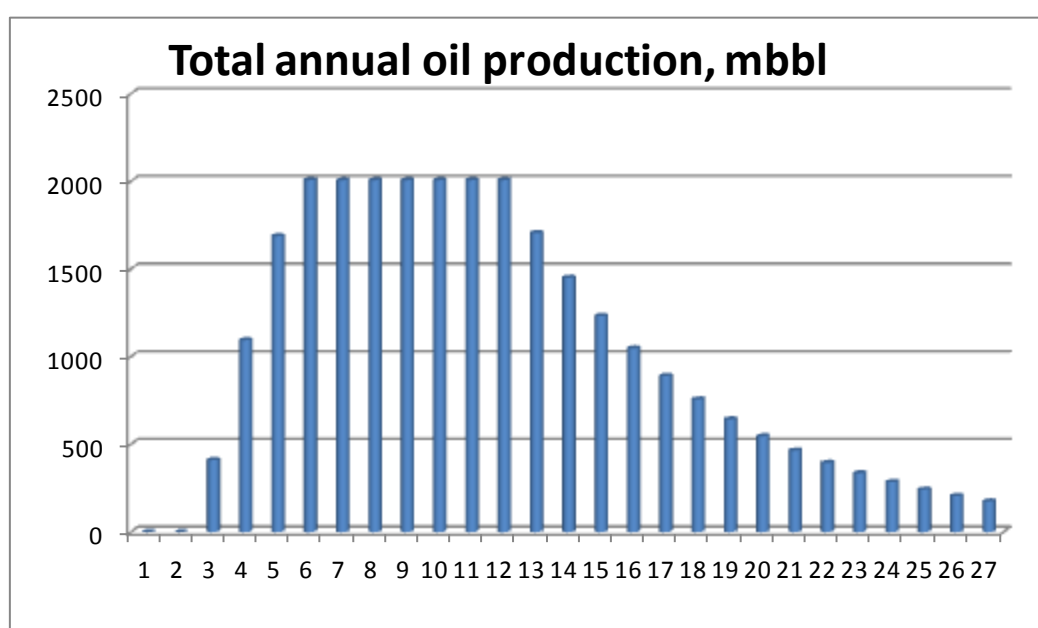
We used the following assumptions for the base case:

Initial daily production per well, bbl	250
Initial annual production per well, bbl	91,250
Initial production per well, mbbl	91.25
Total producible oil volume, mbbl	27,642
Total produced in the model, mbbl	27,628
USD/CAD exchange rate (per USD)	0.9948
Capex per producing well, C\$	2,800,000
Annual production decline after plateau	15%
Working interest	100%
Chance of success (CoS)	10%
Discount rate	10%
Income tax rate	32%
Opex per bbl, C\$	18.00
Oil price, US\$	86.65
Oil price annual growth	2%
Heavy oil price differential (relative to WTI), C\$/bbl	-\$20

Source: Mercom, analyst estimates.

We assumed that the acquisition and exploration costs will total \$7 million in year 1 and \$4 million in year 2, and that production will begin in year 3 (i.e. in 2015) with 9 wells, reaching 15 wells in year 4 and 22 wells in year 5. Wells are assumed to produce 50% of peak output in their first year and peak output after that and until production decline. Production decline is assumed to begin in year 13 (year 11 of production). At the end of production, capital costs associated with closing the site are assumed to be \$5 million.

The chart below illustrates annual production based on the assumptions above:



Source: analyst estimates.

The chance of success parameter reflects the probability that the project will yield expected results, used to provide “riskd NAV”. Without this parameter, valuation will yield “unriskd NAV”, which will reflect the value if the project is successful, but will disregard the high risk of failure. The chance of success also reflects the fact that Mercom still does not have any interest in Chard and that we are not certain that the company will successfully acquire the project.

Based on the above assumptions, our model suggests that Mercom’s unriskd value is \$245.2 million, and riskd value is \$20.1 million:

Years of production	25
Number of production wells	22
Total oil production, mbbl	27,628
Total revenue, C\$’000	2,399,986
Opex per bbl, C\$	18.00
Total opex, C\$’000	497,310
Total capex, C\$’000	77,600
Production royalties, C\$’000	684,582
Overriding royalty (2.5%), C\$’000	60,000
Profit before tax, C\$’000	1,080,495
Income tax rate	32%
Income tax, C\$’000	351,263
Income after tax, C\$’000	729,232
Working interest 100%, C\$’000	729,232
Chance of success	10%
Net riskd value, C\$’000	63,023
Discount rate 10%	10%
Cash on hand and proceeds from share issuance, C\$’000	4,813
Riskd NAV, C\$’000	20,145
Unriskd NAV, C\$’000	245,158

Source: analyst estimates.

The NAV values above include our assumption that Mercom has £2 million in cash left from its IPO (\$3.2 million) and that it will incur a 20% dilution to its 317 million shares (as reported by Reuters) with associated proceeds of approximately \$1.6 million³.

On per share basis, Mercom’s riskd value is \$0.05, or 3.3 pence, while the unriskd value is \$0.64, or 40.5 pence, compared to its current market price of 1.6 pence per share.

³ We assume that the dilution will be used as partial share-based payment to acquire Chard.

Sensitivity analysis

The table below shows how the estimated NPV would change in response to variations in our assumptions:

Scenario	Low	Base	High
Opex per bbl, C\$	20.00	18.00	16.00
Value - risked, C\$'000	19,212	20,145	21,079
Value - unrisked, C\$'000	235,820	245,158	254,496
Discount rate	12%	10%	8%
Value - risked, C\$'000	16,201	20,145	25,214
Value - unrisked, C\$'000	203,637	245,158	298,018

Source: analyst estimates.

The sensitivity to oil price growth assumptions is shown in the table below:

Annual WTI oil price growth rate	0%	1%	2%	3%	4%
Value – risked, C\$'000	14,564	17,331	20,145	23,298	27,016
Value – unrisked, C\$'000	189,341	217,011	245,158	276,688	313,864

Source: analyst estimates.

RELATIVE VALUATION

Relative valuation is not presently feasible because there are too few pure play oil sands companies in early development stage. In fact we have identified just two – US Oil Sands and Tamm Oil & Gas Corp. Therefore we have not factored relative valuation into the final value of Mercom.

It must be mentioned that any relative valuation would be very uncertain and subjective due to unique characteristics of each company. Peers differ in terms of size of their properties, volume of resources or reserves, stage of project development, financial strength, project location etc. All these factors make comparison less reliable. Moreover, since the companies (including Mercom) are not producing and thus have no revenues, operating cash flows or earnings, the usual multiples (P/S, P/E, P/EBITDA) are not applicable. The only usable indicator remains value per unit of resource, with some adjustments to account for the various factors identified above.

We have identified the following peer companies that have oil sands projects but which do to yet have commercial activities:

Name	EV, C\$ mn	Oil in place (OIP), mmbbl	EV/OIP
US Oil Sands	47	190	0.24
Tamm Oil & Gas Corp	8	2,713	0.003

Source: companies' reports and websites, analyst estimates.

The average of the two EV/OIP multiples, applied to 100% of Chard's oil in place of 240 million barrels and discounted by 20% (one of the peers has relatively large cash reserve, while the other has a large oil resource), would imply Mercom's equity value⁴ of \$23.8 million, or \$0.06 per share (diluted).

FINAL NOTES

We would like to point out the weaknesses of our valuation:

- Many inputs were either provided by Mercom or were assumed by us based on data from Mercom. We have no geological or oil industry background and thus our assumptions may be erroneous.
- We assumed a discount rate of 10% to account for Mercom's cost of capital, but its actual cost of capital may be different.
- The 10% chance of success is not based on any statistical data for similar projects and is a simple estimate. Actual success rates may differ significantly from our assumption.

PETROLEUM MARKET OVERVIEW

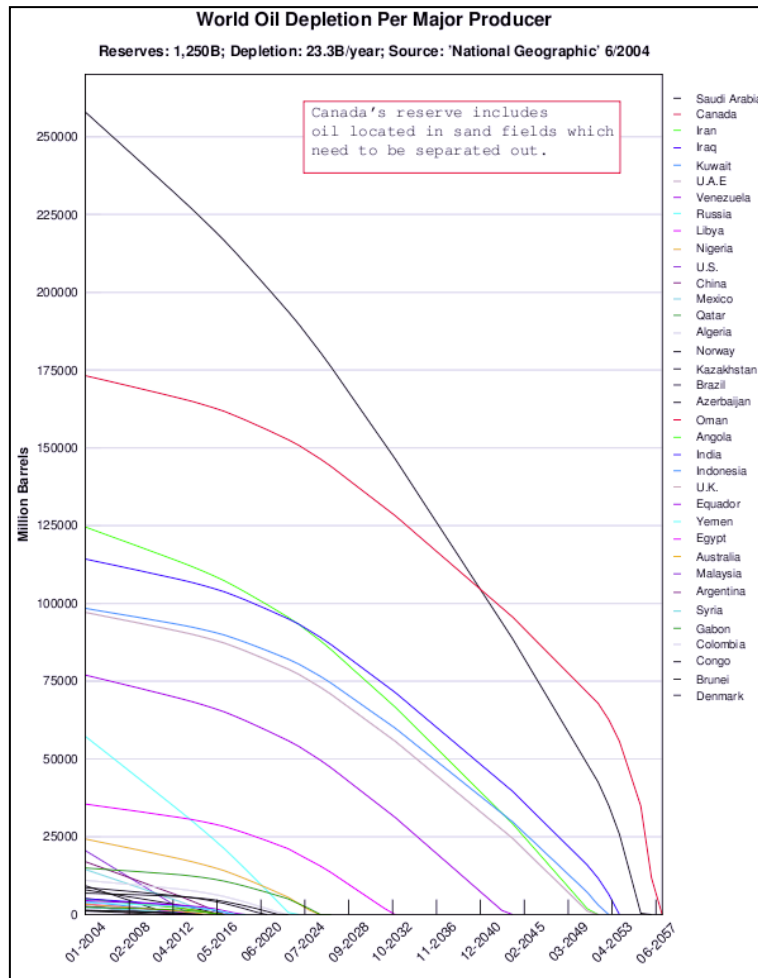
Petroleum (oil) is one of the most important natural resources and its price is one of the primary global economic indicators. Obviously, the outlook of the oil market is primarily a function of demand and supply, with additional volatility conditioned by political uncertainty in major producing countries and economic instability in global markets.

SUPPLY

Oil is a fossil fuel and as such its supply is determined by finite underground (or underwater) resources and the rate at which it is extracted. While the exact volume of oil remaining on earth is difficult to estimate (especially the exact amount that can be extracted), there is little doubt that it will eventually be depleted.

The chart below illustrates the predicted oil output of main producing countries in the next decades, according to one model:

⁴ We assume that whatever cash the company has will be spent to acquire the Chard project and thus enterprise value equals equity value.

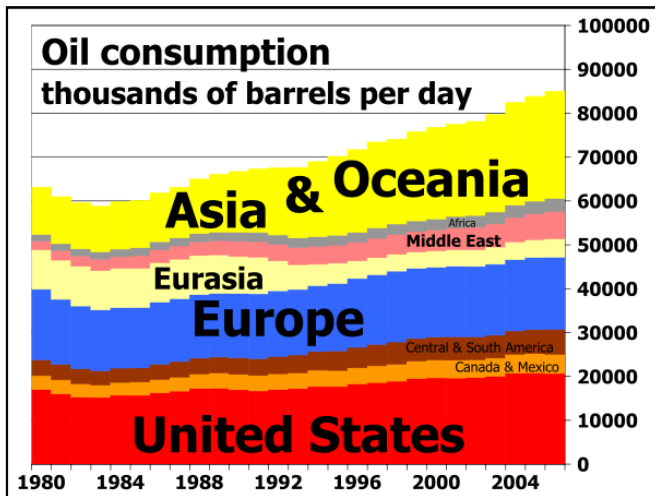


Source: http://en.wikipedia.org/wiki/Oil_depletion.

As conventional sources of oil are drying up, exploration is moving to increasingly difficult and technically challenging locations: oil sands, deep waters, etc. However, even those resources will eventually run out.

DEMAND

The demand for oil correlates with global economic growth, and is in large part driven by the growth in emerging markets, that are catching up with developed countries in terms of per capita consumption. At the same time, global population keeps rising, also driving the demand for oil. The chart below illustrates the trend of growing importance of emerging markets as oil consumers:



Source: http://en.wikipedia.org/wiki/Peak_oil.

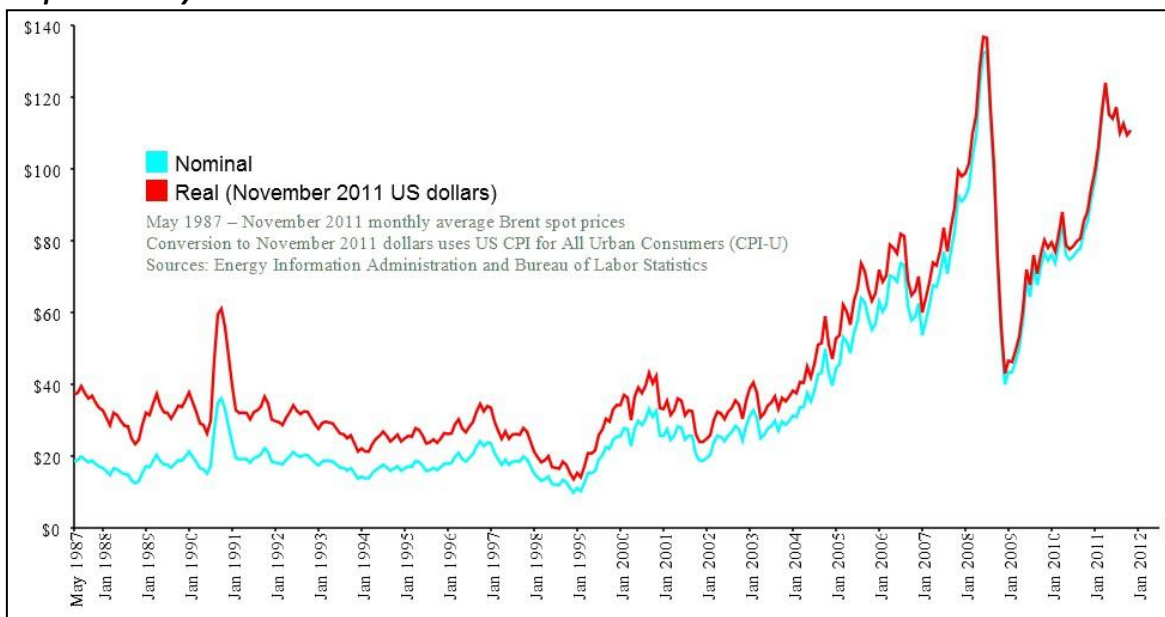
OTHER FACTORS

Price volatility

In addition to supply and demand trends, the price of oil is significantly affected by other factors. One of them is the instability in the Middle East, a primary supplier of oil. Tensions between the West and Iran, civil unrest and terrorist threats in a number of producing countries etc. all add to the price volatility as each unfavorable event fuels speculation that global oil supply may suffer. Generally, all such events tend to raise the price of oil, benefitting producers.

The health of global economy is another factor. Economic declines reduce demand for oil, significantly affecting prices, as shown in the chart below.

Oil price history:



Source: http://en.wikipedia.org/wiki/Price_of_petroleum

Environmental impact

Another factor is the huge impact that petroleum industry is making on the environment. Oil spills are notoriously difficult to clean up and cause irreparable damage to wildlife. As exploration is moving into increasingly difficult locations, environmental risks are growing, with incidents beating previous records (such as the Deepwater Horizon explosion in 2010). These concerns prompt authorities to tighten environmental regulations, increasing costs to companies.

It is worth noting that the European Union is considering labeling Canadian oil from oil sands as the most polluting oil in the world⁵, which may have unfavorable impact on demand.

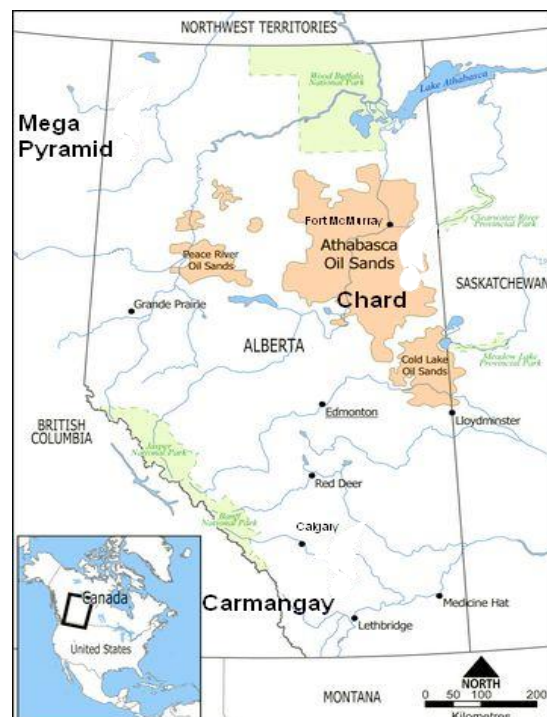
Fiscal regime

Oil is both difficult to replace and environmentally damaging. The combination of these properties has prompted authorities to profit by imposing additional taxes (royalties and duties) on producers and consumers. As such, in Alberta, a Crown royalty regime was introduced in 2009, which escalates the royalty share proportionately with the oil price (the higher the price of oil, the higher the percentage of revenue or operating income must be paid). Fiscal burden limits producers' profit potential, but at the same time it is our belief that authorities will not try to stifle the industry too much due to its importance for local and national budgets, especially when fiscal health is on the agenda of most countries.

ATHABASCA OIL SANDS

The oil deposited in Northern Alberta sands⁶ can be found in three locations: Athabasca, Peace River and Cold Lake. The Athabasca deposit is the largest one and has the most concentrated oil sands development. Alberta's oil sands geologic formations span across over 140,000 km² of pristine boreal wilderness containing about 1.7 trillion barrels of bitumen in-place with nearly 10% of these deposits, or approximately 170 billion barrels considered economically recoverable, making Canada's proven reserves of oil second in size to Saudi Arabia⁷.

Canadian crude oil production has increased by 1.3 million barrels/day over the past 30 years



⁵ Source: <http://www.bbc.co.uk/news/science-environment-17102027>.

⁶ Source: <http://www.infomine.com/minesite/minesite.asp?site=athabascaoilands>

⁷ Source: http://en.wikipedia.org/wiki/Athabasca_oil_sands

thanks to oil sands production. In 2010, Canada produced 1.5 million barrels/day, which accounted for less than 2% of global supply⁸ and is expected to produce about 3.7 million barrels/day by 2025.

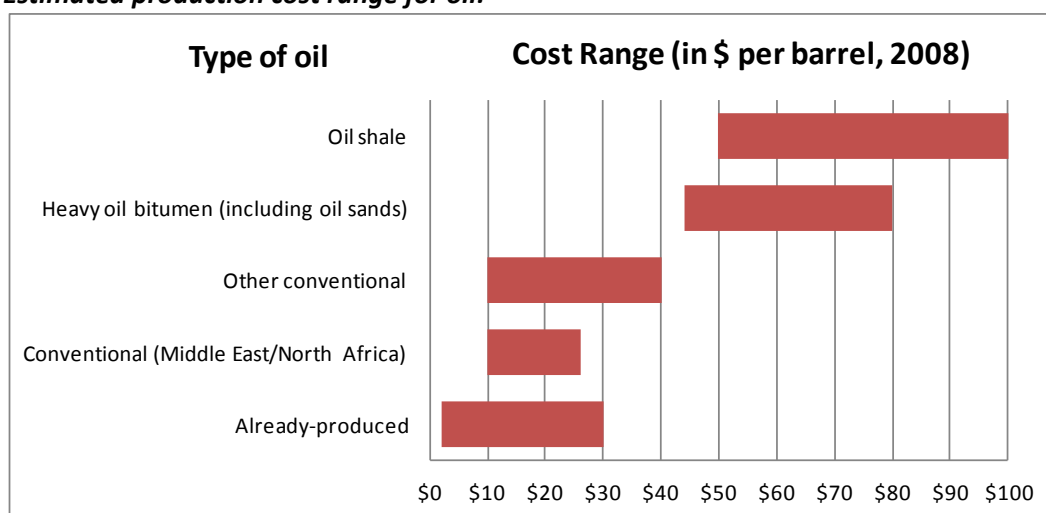
Canadian oil production:

Year, in million barrels/day	1980	2010	2025
Crude oil (including oil sands)	1.5	2.8	4.7
Oil sands	0.1	1.5	3.7

Source: CAPP 2011

The factors that aid to development of oil extraction from oil sands are the increasing demand for oil and the falling cost of production. For a long time the cost of extracting the oil from bituminous sands made production unprofitable, however new technologies and methods of extraction and crude oil price increase on international markets have positively impacted the economics of oil extraction from oil sands. According to the Economist⁹, “The cost of production has fallen: a few years ago most firms thought the break-even price was \$75 per barrel, but now companies such as Shell say new developments are economical at \$50.” However, the BBC reports that the cost of extracting oil from oil sands can reach more than \$60 a barrel whereas Saudi oil often costs less than \$10 a barrel to extract¹⁰. The National Energy Board estimated that the minimum price needed for new oil sands extracting projects to be commercially viable is at \$85 to \$95 a barrel¹¹.

Estimated production cost range for oil:



Source: <http://www.theglobeandmail.com/globe-investor/economics-biggest-threat-to-embattled-oil-sands/article2307229/#>

⁸ Source: <http://www.economist.com/node/17959688>

⁹ Source: <http://www.economist.com/node/17959688>

¹⁰ Source: <http://www.bbc.co.uk/news/business-15889665>

¹¹ Source: <http://www.theglobeandmail.com/globe-investor/economics-biggest-threat-to-embattled-oil-sands/article2307229/#>

In 2010, Canada exported approximately two million barrels/day on average¹². At the beginning of 2012 president Barack Obama put on hold the plans on constructing a new pipeline from Alberta to Texas, the Keystone XL, due to environmental concerns¹³. Nevertheless, the main export market remains the United States due to “its strong demand, geographic proximity and established pipeline infrastructure.”

In addition to the large bitumen deposits, Canada is very attractive as a supplier of petroleum given the lack of stability in the Middle East.

SWOT	
Strengths <ul style="list-style-type: none"> • Development plan in place • Chard has good infrastructure access • Contingent resource estimated • Canada is a stable economy 	Weaknesses <ul style="list-style-type: none"> • No specialist staff or equipment • No projects owned • Funding • Focus on just one project
Opportunities <ul style="list-style-type: none"> • Significant upside in case of success 	Threats <ul style="list-style-type: none"> • Obtaining Chard working interest is uncertain • Actual reserves may prove to be uneconomical • Oil price volatility • Environmental risks

DISCLAIMER

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¹² Source: <http://www.capp.ca/getdoc.aspx?DocId=191939&DT=NTV>

¹³ Source: <http://www.bbc.co.uk/news/business-15889665>