

Update on Drilling Activity

Summary

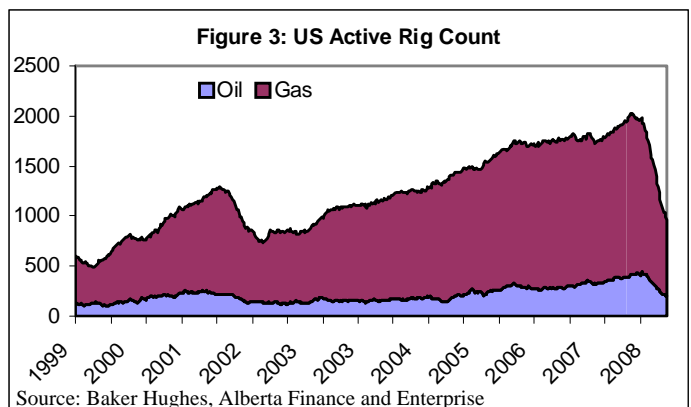
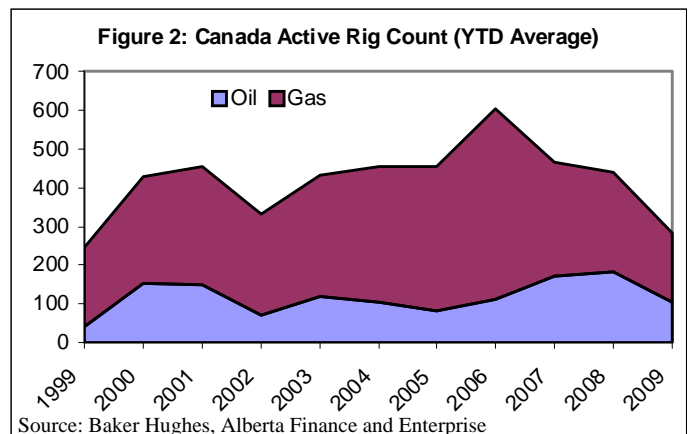
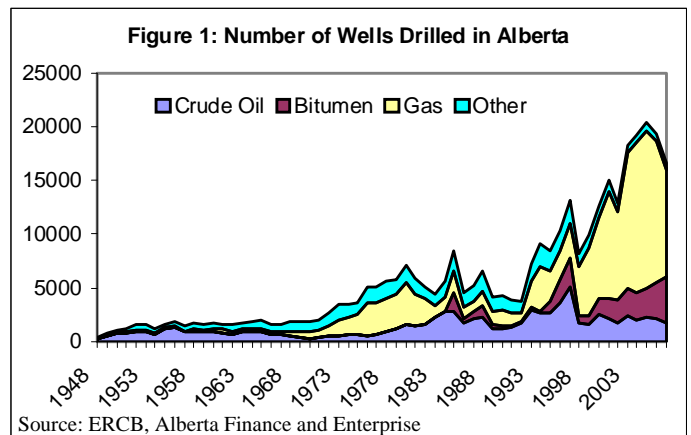
Alberta is experiencing a precipitous decline in drilling activity, led by a sharp pullback in the natural gas sector. However, current percentage rig count declines are comparable to previous cyclical troughs. The contraction is not unique to Alberta, either. Most North American jurisdictions are experiencing similarly reduced activity.

Drilling Activity

Drilling rigs serve two main client industries: natural gas and oil. Up until the 1970s, most Alberta rigs were searching for oil. As conventional oil reserves began to mature, however, natural gas drilling took on a more prominent position. Today, the vast majority of rigs are in the hunt for gas.

Since oil drilling levels have remained fairly stable over the years, cyclicity in rig counts can largely be attributed to fluctuations in the natural gas industry. Although subject to considerable variation, since 1999 an average of 69% of Canadian drilling activity targeted natural gas. In the US, on the other hand, the average proportion has been a more consistent 82%.

Rig counts have varied dramatically over the last decade. The recent growth in US active rig counts has been spectacular: increasing fourfold over the last decade, until an extremely sharp decline beginning in October 2008 that has affected both oil and gas drilling proportionally. For the Canadian industry the trend has been similar, although for that analysis it is preferable to aggregate data into year-to-date averages in order to smooth strong seasonality. The northern spring thaw dampens drilling activity by greatly restricting the movement of heavy rigs through primitive access roads.



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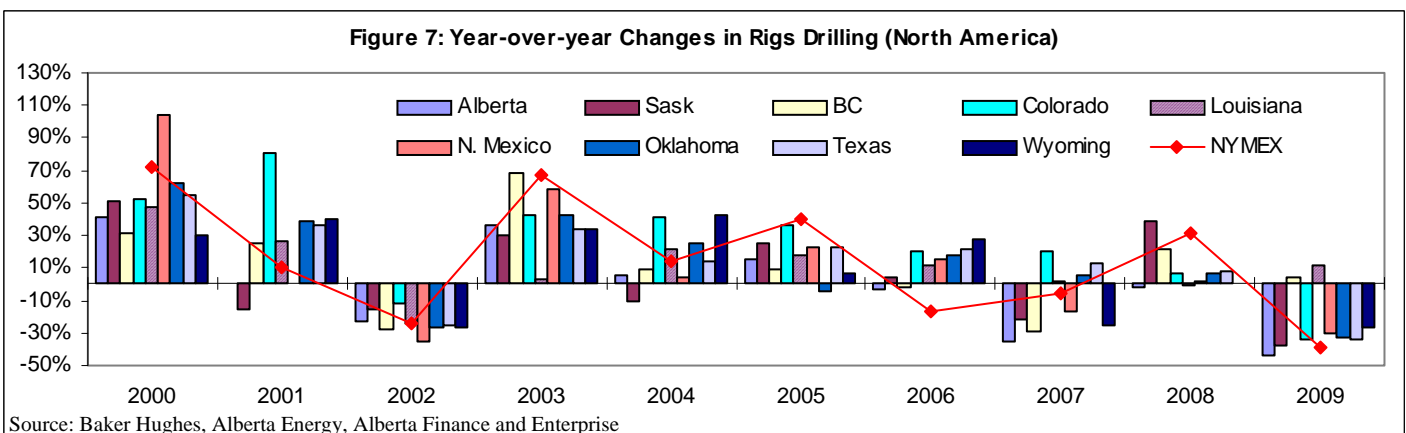
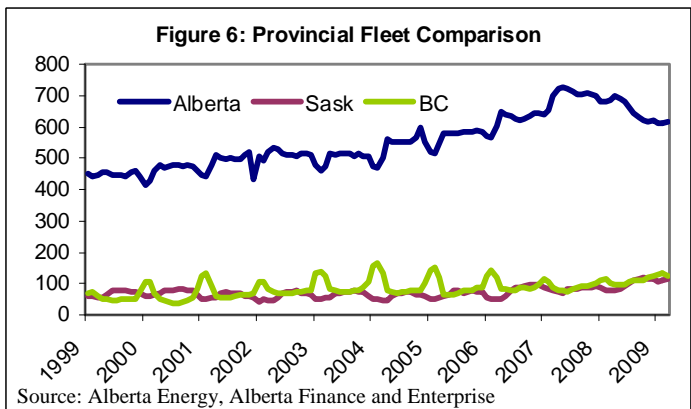
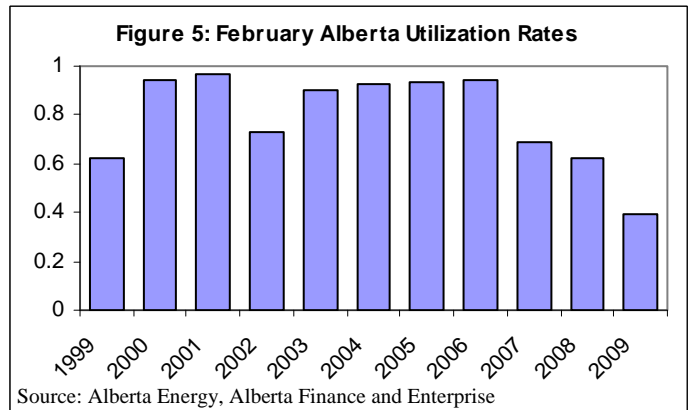
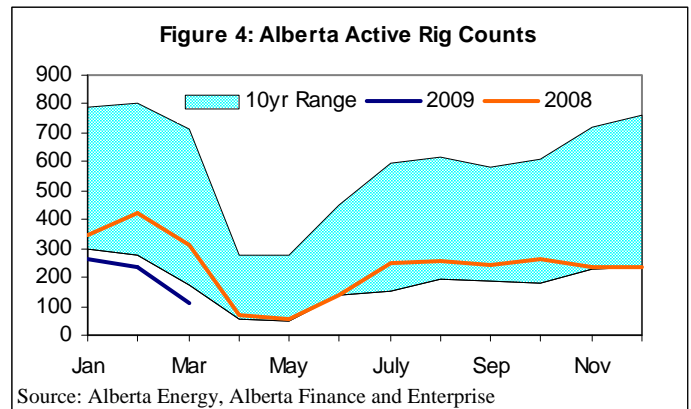
Alberta rig counts have fallen substantially recently, with January, February and March counts lower in 2009 than in any year for at least the last decade. While there has been an annual pattern of slowing activity underway since the 2006 peak, this year marks the first in at least a decade without a spike in winter activity. Usually February is the busiest month, but this year drilling actually slowed from January and was down 44% from the previous year. Although year-over-year declines of this magnitude have been seen before, they have always occurred during the marginal months right

before or after the prime drilling period, when weather plays an important role. In effect, this year has seen the loss of an entire winter drilling season.

The drop in utilization rates (the proportion of available rigs actively drilling) has been even more severe. In Alberta, February 2009 utilization was 39%, well below the preceding 10-year February average of 83%. However, beyond weak economic conditions and low prices, a primary cause of the plummeting utilization has been a dramatic expansion of the drilling fleet that began around 2004. Between 2003 and 2007, the average number of available rigs in Alberta expanded from 502 to 700. In comparison, between 1999 and 2003, the average fleet size increased by only 53.

Regional Comparison

Drilling slowed down substantially across most jurisdictions in late 2008. So far in 2009, the average year-to-date decline across the continent's major producers has been 25%, although that number has been held up by increases in Louisiana and non-



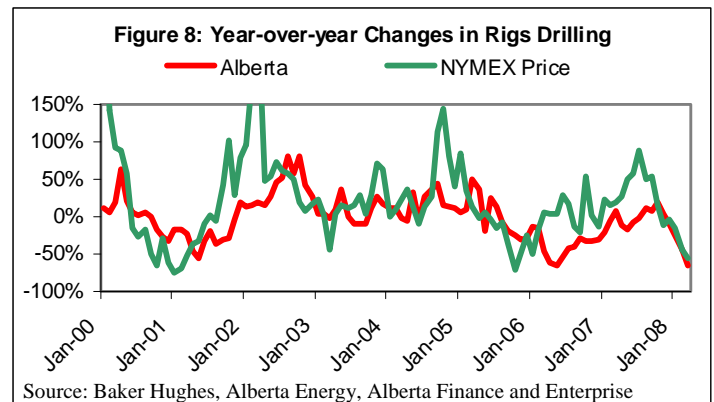
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conventional discoveries in BC. Excluding those regions, drilling has declined 34%. The 44% pullback in Alberta has been the largest among major producers, with expensive labour costs and a preponderance of high-cost non-conventional natural gas deposits potentially making Alberta especially vulnerable to a general market slowdown. In particular, the geological characteristics of the BC Montney shale play are generally seen as more attractive than the Alberta portion of the formation, which has led to some shifting of investment across the provincial border.

Among major producers in North America, the convergence in annual drilling trends has been remarkable. Although the scale of changes in drilling activity has been very different, the directions have generally been similar. 2007 represented an exception to the rule of thumb, as Colorado, Louisiana, Oklahoma and Texas posted increases while the western Canadian provinces, New Mexico and Wyoming saw drilling activity decrease. However, that year also marked the beginning of the commodity surge and the resulting rapid appreciation of the Canadian dollar. In the face of such drastic volatility, it is not surprising that synchronizing trends were temporarily broken up.

One of the strongest explanatory variables for rig counts across North America has been the natural gas price trend. As can be seen in Figures 7 and 8, fluctuations in the NYMEX natural gas price tracks rig count variations quite closely. Between 2001 and 2009, prices alone can explain 40% of the year-over-year variation in Alberta rig counts. Recently, the credit crisis has become another important factor. Firms with limited access to financing are restricting capital outlays in order to stretch weakening cash flows, leading to reduced drilling activity. Even those firms with financing available seem to be following

suit, preferring instead to use their resources to purchase the cheap assets of struggling competitors. While Alberta has certainly been hurt by a slowdown in drilling activity, it is hardly unique in that respect. Rather, the pain has been shared quite evenly across the various resource-dependent districts in North America.



Prepared by Economics and Statistics.

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