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Industry Comment

Energy

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Oil & Gas Energy Services

Weekly Oilfield Bulletin; Discussing the WTI Trigger Points

As the Nymex WTI quote is flirting with the US\$80/bbl level for the second time in as many weeks, we once again find ourselves asking (and trying to answer) a vaguely familiar set of questions:

- ◆ At what oil price would drilling and completion work begin slowing down again?
- ◆ How long does it take for E&P companies to cut their budgets when oil and gas prices drop?

To begin with the first question, our analysis tells us that at WTI prices above approximately US\$90/bbl, drilling and completion activity grows at its maximum feasible limits. This maximum rate is constrained by both the capacity to construct new equipment and by the capacity to sufficiently train personnel to work it. But in the same way that nine women can't make a baby in one month, adding higher WTI pricing beyond this range isn't likely to result in even faster growth. What higher crude prices can do, however, is fuel a greater sense of urgency for producers, and hence, drive higher prices for many service lines.

Secondly, we think that most producers have predicated their budgets on US\$75 - US\$80 crude. Below this range, we'd expect formal curtailments in capital budgets for 2012 and that rig counts would decline from current levels.

This leaves a range between the high US\$70s and US\$90s in which we'd still expect growth, but at a more moderate rate than over the last few months. WTI has been testing the lower limit of this range over the last couple of weeks, so we expect a slower growth rate will develop before long.

This brings us to the second question, "How long?" We expect a longer response time than usual for producers to react to WTI pricing signals. Over the last several cycles we have observed a 4 - 5 month lag between major direction changes in WTI and the corresponding oil rig count. Holding fast to this rule then, we should start see a slowing in rig count growth any day now. However, for reasons outlined later in this Bulletin, we expect it could be a little longer this go-around.

Company	Ticker Primary	Ticker Secondary	Current Price	Target Price (6-12 months)	Dividend Yield	Total Return To Target	Rating
Completion Services							
Essential Energy Services Ltd.	ESN-TSX		C\$1.90	C\$3.10	0%	64%	Strong Buy 1
Pure Energy Services Ltd.	PSV-TSX		C\$7.70	C\$12.00	0%	62%	Strong Buy 1
Contract Drillers							
Ensign Energy Services Inc.	ESI-TSX		C\$17.42	C\$24.25	2%	34%	Outperform 2
Precision Drilling Corporation	PD-TSX	PDS-NYSE	C\$13.72	C\$18.25	0%	17%	Outperform 2
Savanna Energy Services	SVY-TSX		C\$9.00	C\$12.25	0%	42%	Outperform 2
Trinidad Drilling Ltd.	TDG-TSX		C\$8.78	C\$12.50	2%	48%	Strong Buy 1
Western Energy Services Corp.	WRG-TSXV		C\$8.95	C\$12.00	0%	37%	Outperform 2
Field Services							
Black Diamond Group Ltd.	BDI-TSX		C\$29.57	C\$35.00	4%	29%	Outperform 2
Mullen Group Ltd.	MTL-TSX		C\$20.21	C\$23.25	4%	8%	Market Perform 3
Secure Energy Services Inc.	SES-TSX		C\$8.86	C\$10.25	0%	29%	Outperform 2
Strad Energy Services Ltd.	SDY-TSX		C\$4.24	C\$6.75	0%	59%	Strong Buy 1
Pressure Pumps							
Calfrac Well Services	CFW-TSX		C\$36.44	C\$55.00	0%	62%	Strong Buy 1
Canyon Services Group Inc.	FRC-TSX		C\$12.87	C\$22.25	1%	84%	Strong Buy 1
GasFrac Energy Services Ltd.	GFS-TSX		C\$7.97	C\$12.50	0%	53%	Outperform 2
Trican Well Service	TCW-TSX		C\$23.64	C\$31.00	1%	44%	Strong Buy 1

Raymond James Ltd.

As we approached this analysis, we took into consideration that the oilpatch today is materially different from the oilpatch of, say, 2006 in at least a couple of key respects. One is that today we are hard pressed to find many active plays in Western Canada that are on the economic precipice. By contrast in 2006, there were many thousands of shallow gas wells drilled and completed whose viability was underpinned by a gas price that was perhaps just \$0.50 - \$1.00 above the economic threshold. So when we consider sensitivities to lower oil prices, we believe that what we are really talking about is the degree to which lower oil prices translates into lower cash flows for E&Ps, which in turn results in a slower spend rate and a commensurately slower pace of development within Western Canada's active fields. We don't envision any major fields in Western Canada suddenly becoming sub-economic within a reasonable range of the current oil price strip.

Another key difference is the logistical intensity in today's oilpatch. In the old days a producer wouldn't have thought twice about deferring a well construction project for whatever reason – just call up the service companies and tell them you don't need them anymore. Today, however, many plays are developed with horizontal wells, thus requiring specific rigs, drilling fluid, directions services, rental equipment, significantly more fracturing equipment, and flowback equipment. We think producers have come to understand that much of this equipment is relatively scarce and deferring a booked project might mean not getting access to the equipment later. Therefore, activity might be more "sticky" at oil prices above about US\$75.

Yet another consideration is the inherent cross-subsidies within producers, using cash flow generated by gas production to finance developments in liquids-rich and oil plays. We estimate that natural gas sales represent about 35% of US onshore producer gross sales and 39% in Canada. Gas prices are low, have been low, and will likely continue to be low for at least the next year...but at least it's consistent. We haven't seen significant gas price moves for more than a year now. As such, gas production is a relatively stable source of cash flow.

Lastly, as far as Canadian producers are concerned, the very high rate of drilling today is the product of pent-up demand through an extremely challenging spring and early summer. Plus, because their spring and early summer capital spending was curtailed, E&Ps' balance sheets are likely stronger than they would ordinarily be at this time of the year. And many E&Ps are justifiably concerned about getting their 2011 programs completed. As such, the true rig count growth numbers are probably lower than the raw count would suggest.

Our best guess is that the current pace of drilling in Western Canada is sustainably underpinned by a US\$90/bbl WTI oil price. This means that if the oil price were to remain in this range, we'd expect Canadian drilling rig utilization to average 47% over the next 12 months – similar to where it is now on a seasonally-adjusted basis – with the understanding that the August rig count is fairly high on an historic basis, as producers catch up from an especially slow spring.

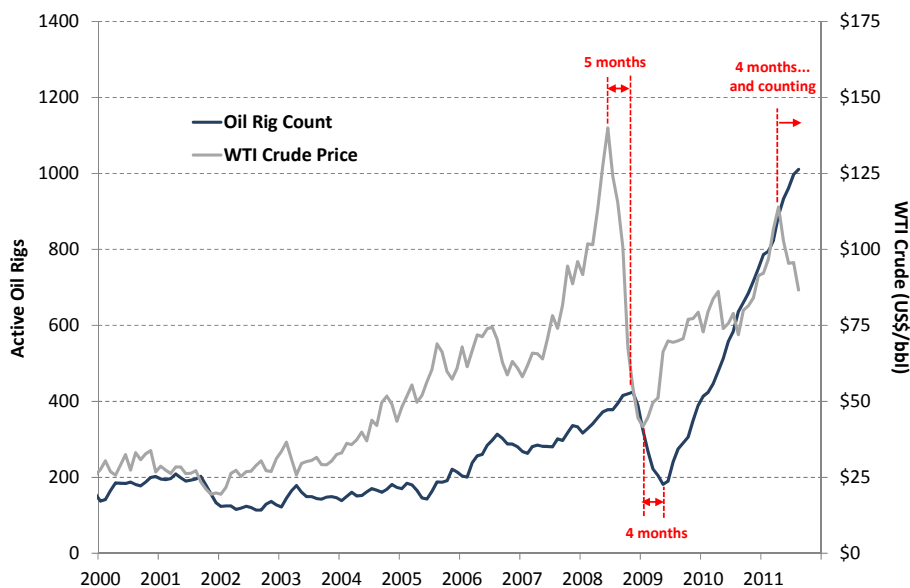
We say "ordinarily" because we come back to the idea that most plays with any concentration of activity are still generating highly attractive economic returns. In the olden days (6 or 7 years ago), we could hang our hats on the law of diminishing marginal returns to rig activity – that is, the best well in any given play was the first well, and each added rig and well tended to be less productive than the one before it.

By contrast, in these modern and complex tight sands and shales, E&Ps progress along a learning curve, applying different well designs and completion approaches, such that wells tend to get more productive and more economic as the play becomes busier. Or put another way, we tend to find *increasing* marginal returns to rig activity.

That's all good theory, but back in the real world what are we seeing? One observation is that the last time WTI was sub-US\$90, in Feb-2011, there were about 200 - 225 fewer rigs drilling for onshore oil in the US. That sounds bearish on the surface of it; but another way to look at the same data is that back in February, the US oil rig count was on a steep growth trajectory, adding 30 - 40 oil rigs per month. It's hard to say if improvements in completion approaches since February have kept pace with service cost inflation, but we can say that the old rules about diminishing marginal returns to rig activity probably aren't as applicable today. As such, it's not unreasonable to think that the oil rig count might still be growing even though WTI has dropped back.

Ok, now let's say that reduced WTI pricing means reduced producer cash flow, which, all else equal, should lead to reduced capacity to fund growth in all of these new wonderful and economically attractive plays. How long would it take for a material price decline to have a measurable impact on rig activity, even if it is just a flattening of growth, similar to what we saw in Canada in 2004? Over the last several cycles we've observed that E&Ps start responding to pricing signals within approximately 4 - 5 months (see Exhibit 1 for the link between the WTI crude price and the onshore oil rig count – the impact is much easier to observe in the US data due to the relative absence of seasonal and weather distortions).

Exhibit 1: Connecting the US Oil Rig Count to Oil Prices



Source: Baker Hughes, Bloomberg, Raymond James Ltd.

What makes the current cyclical upswing interesting is how completely unresponsive field activity has been to what amounts to a four-month WTI decline since the late April US\$114/bbl peak. In Exhibit 1, we show the WTI near-month average and the corresponding US oil rig count. On the one hand, we expect that the field economics in the plays where all these incremental rigs are going are supportive of growth at current energy prices. On the other hand, producers have less cash available today to fund that growth than they did, say, four months ago when WTI was above US\$110. We expect that we're going to see a modest flattening of the growth curve fairly shortly. We believe E&Ps will want to fund growth in plays such as the Viking, Bakken, Niobrara, and Cardium, though their capacity to do so has declined somewhat.

Oilfield Activity Summary & Industry Forecasts

Equity Indices & Energy Prices

	Price/ Level	Percent Change (%)		
		W/W	M/M	Y/Y
TSX 300 Comp	12,187	-0.1	-6.0	+7.0
TSX Oilfield index	1,517	-6.1	-14.0	+33.1
OSX	221	-4.2	-19.7	+25.3
WTI (US\$/bbl)	82.38	-3.9	-15.5	+10.7
C Par @ Edm. (\$/bbl)	89.35	+5.4	-6.0	+23.2
NYMEX (US\$/mcf)	3.89	-5.3	-14.1	-6.7
AECO-C (\$/GJ)	3.49	+0.3	-3.3	+15.6
USD/CAD	1.01	-0.6	-4.1	+5.0

Industry & Commodity Forecasts

	2009	2010	2011E	2012E
Active Drilling Rig Count	214	328	377	396
Drilling Rig Utilization	28%	41%	47%	49%
Wells Completed	9,394	13,575	16,000	16,700
Service Rig Utilization	39%	55%	59%	60%
WTI (US\$/bbl)	62.09	79.61	96.07	105.00
NYMEX (US\$/mcf)	4.16	4.38	4.26	4.25
AECO (\$/mcf)	3.99	4.18	3.59	3.58
USD/CAD	0.88	0.97	1.02	1.02

Canadian Active Rig Counts

	This Wk	Last Wk	Last Yr	13-Wk
				M.A
Active Drilling Rig Count	529	502	387	362
Total Fleet	812	810	811	811
Utilization	65%	62%	48%	45%
Active Service Rig Count	565	518	494	459
Total Fleet	926	904	896	895
Utilization	61%	57%	55%	51%

Canadian Wells & Licenses

	Year to Date		13-Wk Total	
	2011	2010	2011	2010
Total Completions	8,781	6,461	2,633	1,756
%Oil	55	46	58	61
%Horizontal + Directional	74	66	86	79
%Vertical	26	34	14	21
Well Licenses	9,824	8,083	3,988	3,419
Total Meters Drilled (000s)	14,260	10,567	4,193	3,533
%Development	82	78	83	79
Avg. Well Depths (meters)	2,567	2,284	711	746

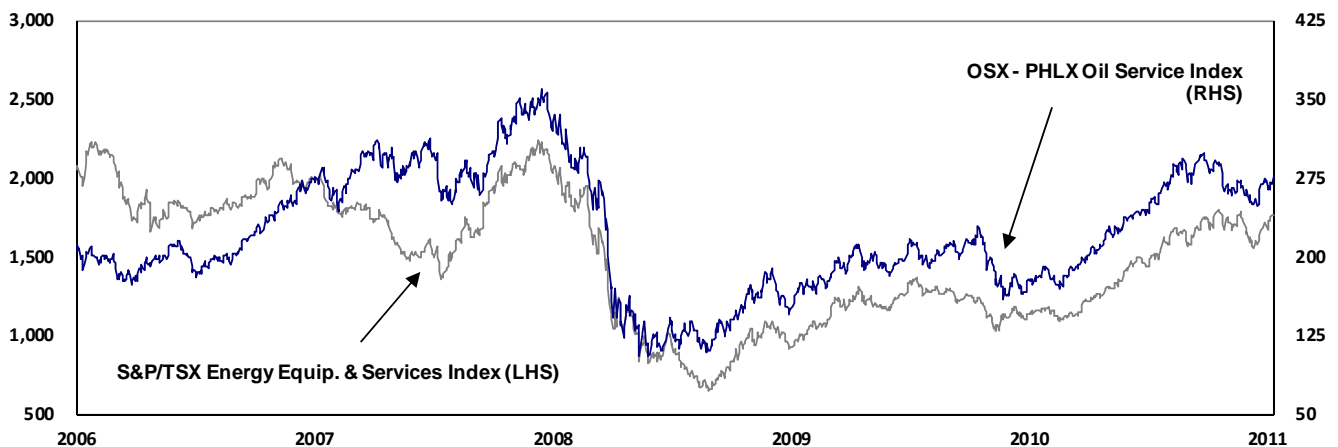
US Active Rig Count

	This Wk	Last Wk	Last Yr	13-Wk
				M.A
Total US Rig Count	1,959	1,920	1,640	1,885
%Oil	54	54	39	53
%Horizontal + Directional	70	70	68	70
%Vertical	30	30	33	30
Total Land	1,924	1,884	1,620	1,851
%Oil	54	54	40	53
Gulf of Mexico	35	36	20	34
%Oil	57	56	35	51

International Active Rig Count

	Jul-11	Jun-11	May-11	Apr-11
International Rig Count	1,150	1,158	1,151	1,129
%Oil / %Land	79 / 73	76 / 74	76 / 73	77 / 74
Australia	13	15	10	12
%Oil / %Land	54 / 54	60 / 53	30 / 30	33 / 42
South America	438	438	410	402
%Oil / %Land	89 / 79	87 / 80	87 / 80	88 / 81
Continental Europe	90	86	77	82
%Oil / %Land	50 / 67	47 / 69	47 / 66	52 / 68

S&P/TSX Energy Equipment & Services Index vs. OSX Phil. Oil Services Sector Index



All figures in C\$, unless otherwise noted.

Sources: Raymond James Ltd., Bloomberg, Nickle's Energy Group, Baker Hughes

Canadian Oilfield Activity Charts

a. Drilling Contractor Utilization – Weekly Observed and Actual Reported Rates

Drilling Contractor	Weekly Observed Utilization (%)				2009												2010		2011	
	This Week	Last Week	Last 13-Week Year	M.Avg.	2008	2009					2010					2011				
						Q1	Q2	Q3	Q4	Year	Q1	Q2	Q3	Q4	Year	Q1	Q2			
Akita Drilling	81	78	32	57	42	45	16	26	37	31	49	25	39	31	36	62	30			
Ensign Group	72	65	46	45	36	30	7	18	25	20	42	13	31	37	31	52	16			
Nabors Drilling	56	56	34	38	42	39	13	15	27	24	44	22	33	46	36	61	27			
Precision Drilling	61	55	46	41	38	33	11	20	28	23	50	19	37	47	38	61	21			
Savanna	60	64	54	47	42	31	5	19	31	22	54	18	40	47	40	64	22			
Trinidad Drilling	74	80	65	60	55	50	14	36	43	36	67	34	56	65	55	80	31			
Western (Horizon)	92	86	82	58	50	55	9	30	45	35	46	46	61	65	57	85	40			
INDUSTRY	65	62	48	45	42	36	11	21	32	25	53	20	41	49	41	67	23			

Historical utilization rates shown for Canadian drilling rig operations where available

Ensign Group includes: Big Sky Drilling, Ensign Drilling and Champion Drilling

Savanna includes: Lakota Drilling and Trailblazer Drilling

Prior to 1Q10, Western (Horizon) figures estimated using Nickle's utilization data

b. Drilling Contractor Utilization – Weekly Observed Rates by Depth Quartile

Depth Quartile		Rigs (% of fleet) Utilization	Ensign Group	Precision Drilling	Savanna	Trinidad Drilling	Western (Horizon)	INDUSTRY
Depth Range (m) / Average Depth (m)								
Q1	80 - 1,800m/ 1,371 m	Rigs (% of fleet)	40 (33%)	34 (17%)	30 (42%)	15 (28%)	1 (3%)	
		Utilization	38%	32%	30%	60%	0%	35%
Q2	1,800 - 3,000m/ 2,500 m	Rigs (% of fleet)	32 (26%)	69 (34%)	9 (13%)	7 (13%)	3 (8%)	
		Utilization	94%	55%	67%	100%	67%	69%
Q3	3,000 - 3,500m/ 3,266 m	Rigs (% of fleet)	36 (30%)	56 (27%)	12 (17%)	14 (26%)	20 (54%)	
		Utilization	92%	71%	92%	79%	95%	80%
Q4	3,500 - 7,000m/ 4,156 m	Rigs (% of fleet)	13 (11%)	45 (22%)	21 (29%)	18 (33%)	13 (35%)	
		Utilization	69%	78%	81%	72%	100%	77%
Total	80 - 6,700m/ 2,817 m	Rigs	121	204	72	54	37	812
		Utilization	72%	61%	60%	74%	92%	65%

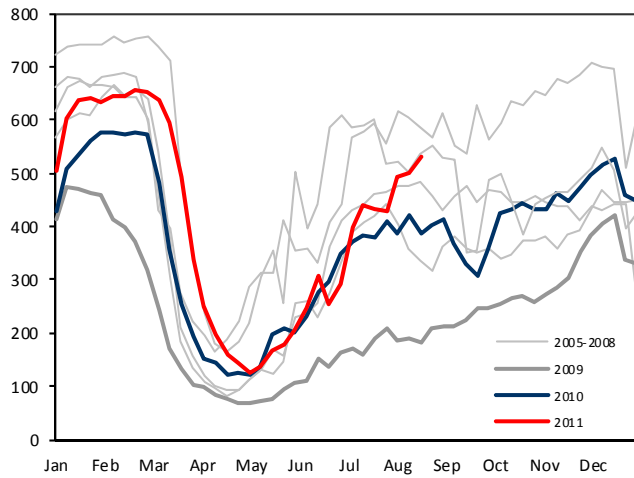
Ensign Group includes: Big Sky Drilling, Ensign Drilling and Champion Drilling

Savanna includes: Lakota Drilling and Trailblazer Drilling

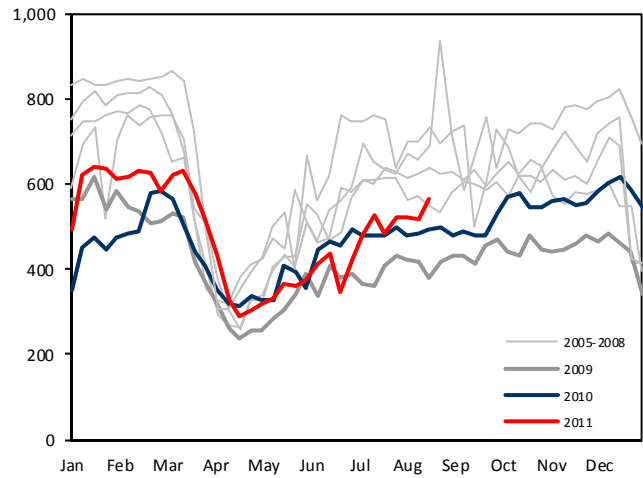
Sources: Nickle's Energy Group, Company reports, Raymond James Ltd.

Canadian Oilfield Activity Charts (continued)

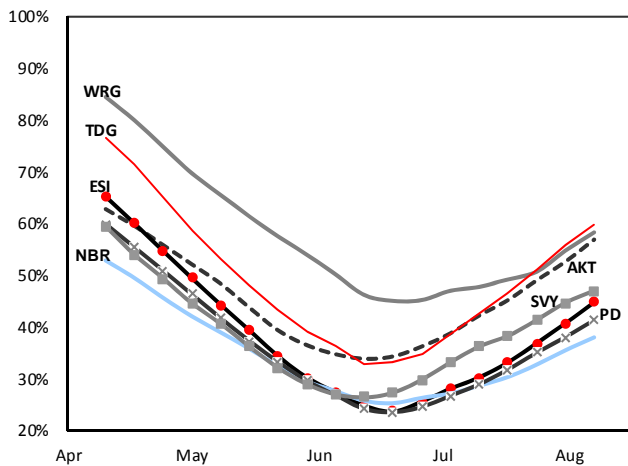
a. Weekly Rig Count



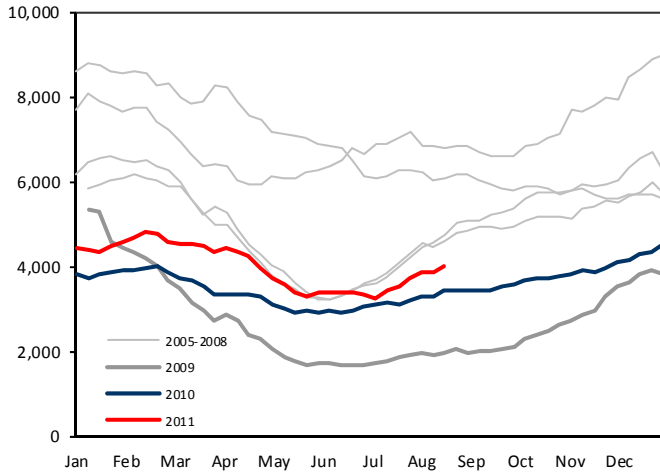
b. Weekly Service Rig Count



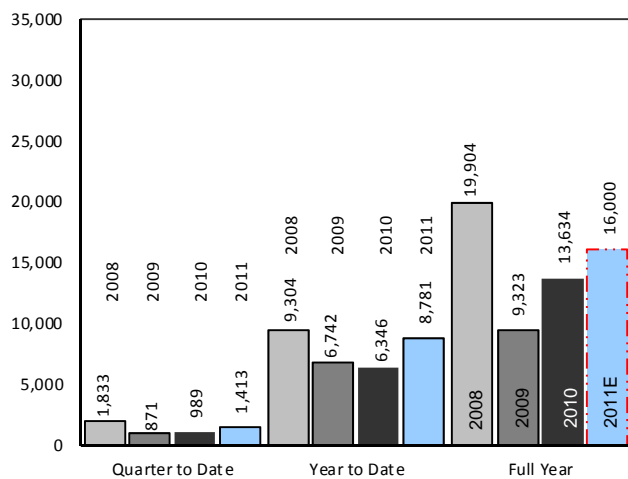
c. Contractor Utilization (13-Wk MA)



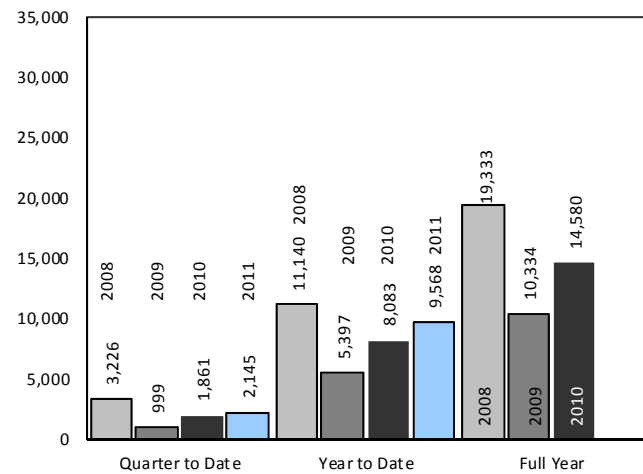
d. Well Licenses (13-Wk Total)



e. Well Completions



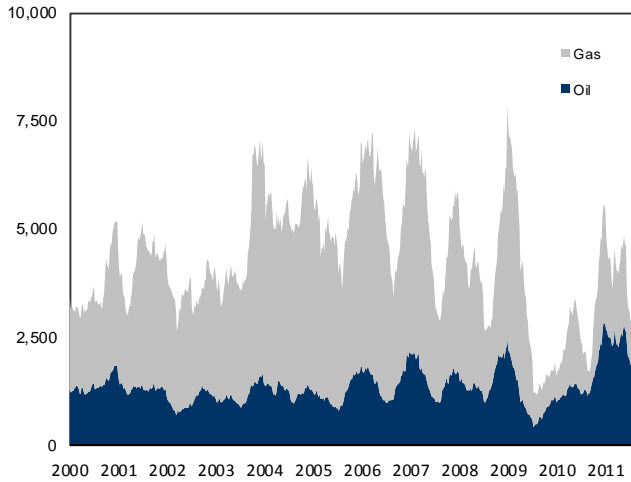
f. Well Licenses



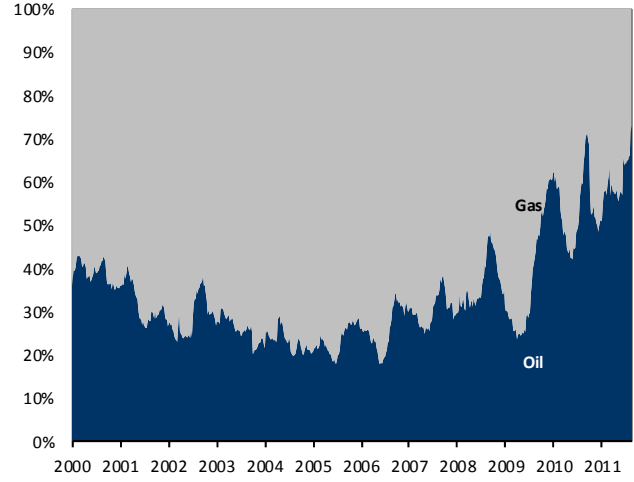
Sources: Nickle's Energy Group, CAODC, Raymond James Ltd.

Canadian & U.S. Oilfield Activity Charts

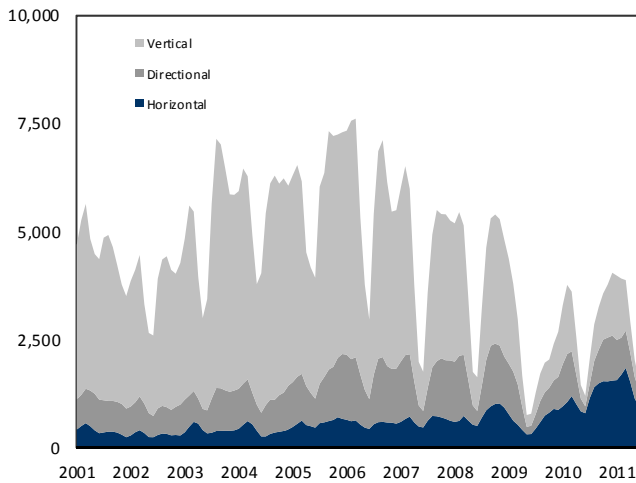
a. WCSB Well Completions (3-M RT)



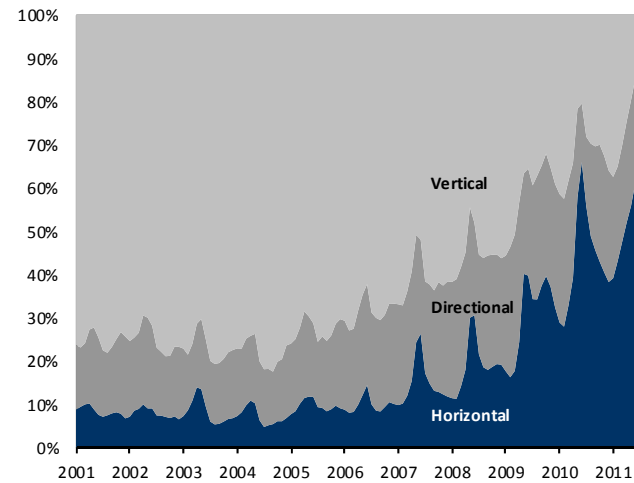
b. WCSB Well Completions (%)



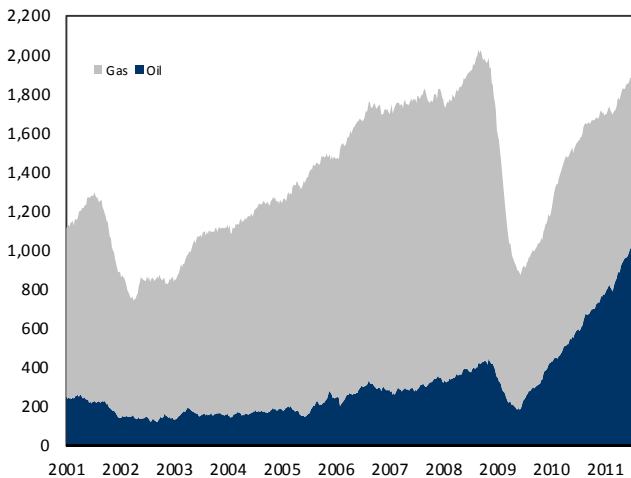
c. WCSB Well Completions by Type (3-M RT)



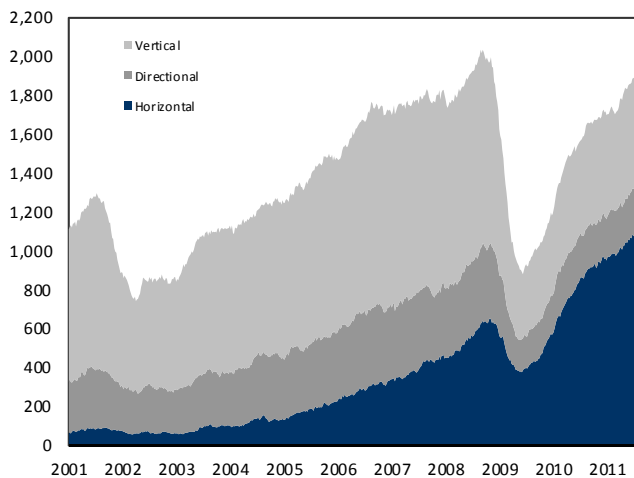
d. WCSB Well Completions by Type (%)



e. U.S. Active Rig Count



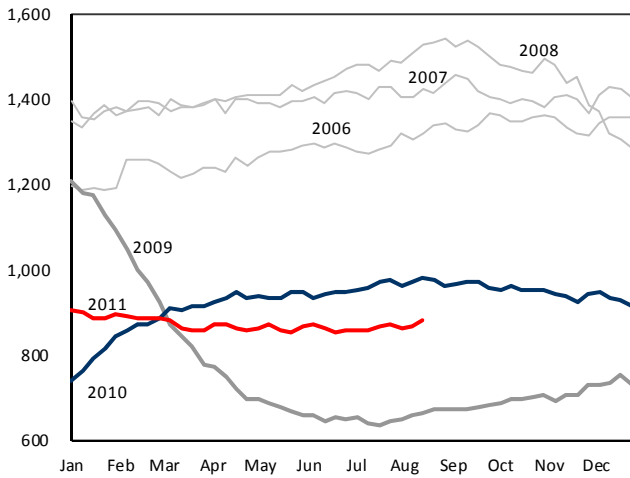
f. U.S. Active Rig Count by Well Type



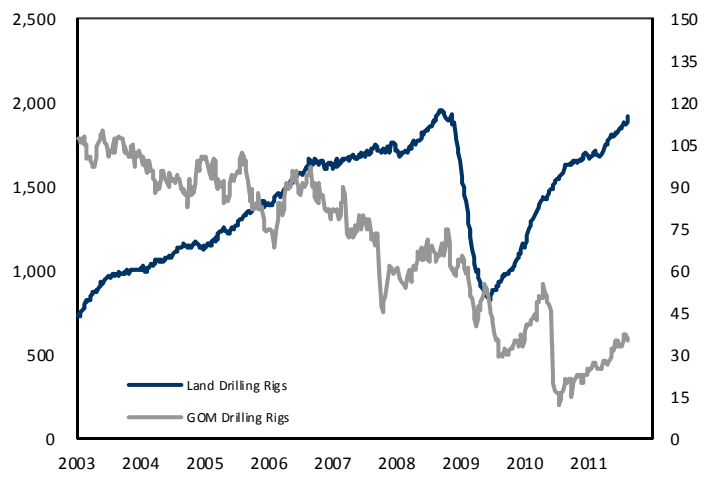
Sources: Nickle's Energy Group, Baker Hughes

U.S. & International Oilfield Activity Charts

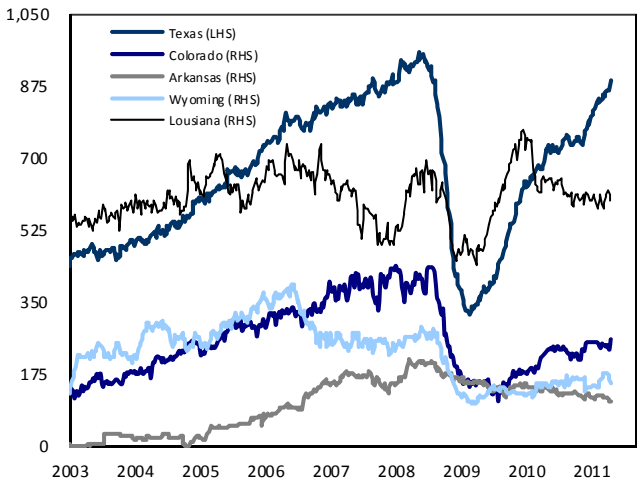
a. U.S. Active Land Rigs Targeting Gas



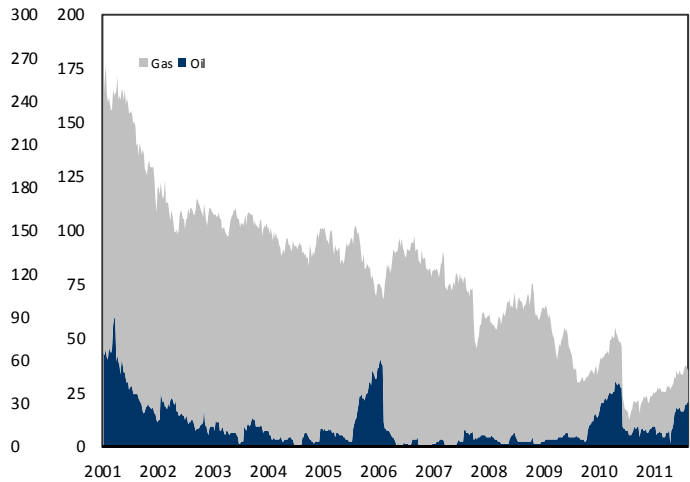
b. U.S. Active Land and GoM Rig Count



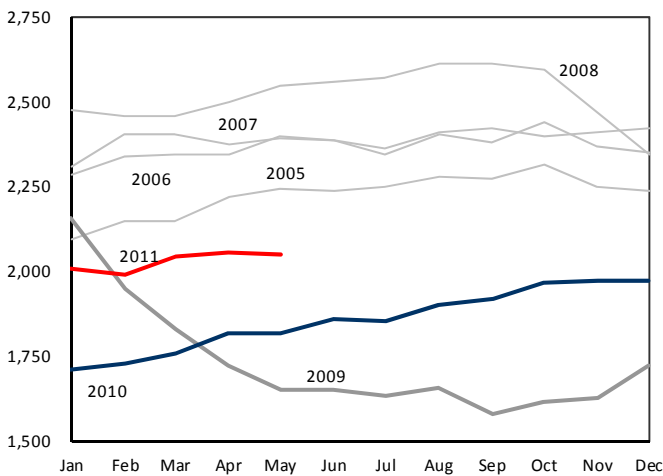
c. U.S. State Drilling Rig Counts



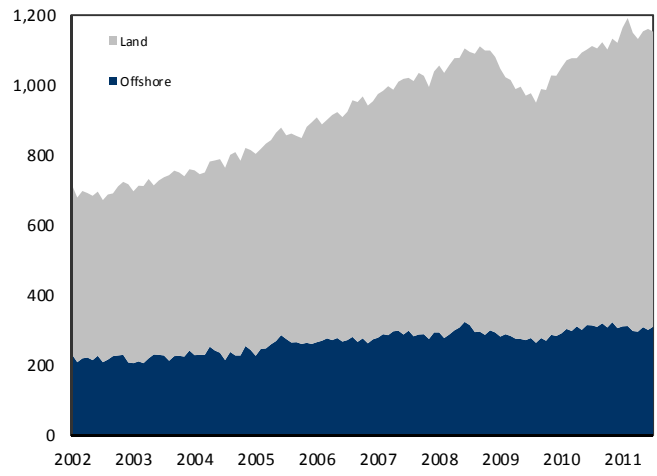
d. U.S. GoM Active Rig Count



e. U.S. Active Well Service Rig Count



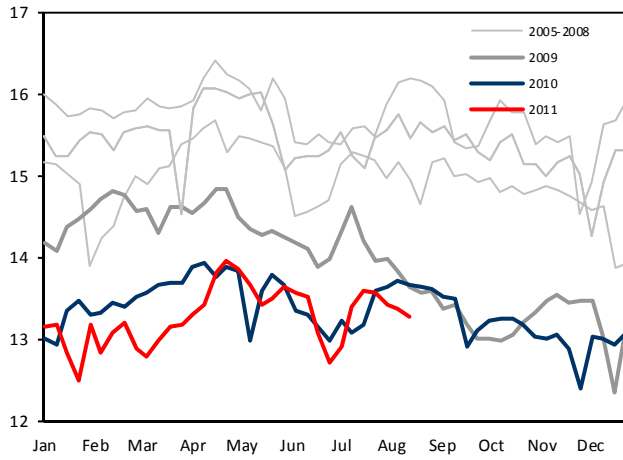
f. International Active Rig Count



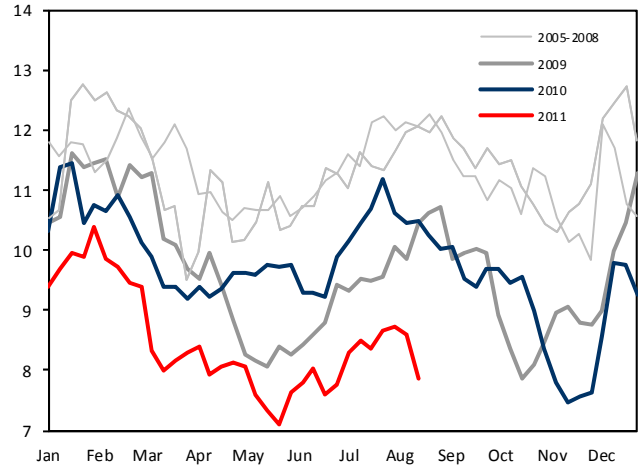
Sources: EIA, Baker Hughes, Raymond James Ltd.

Natural Gas Charts

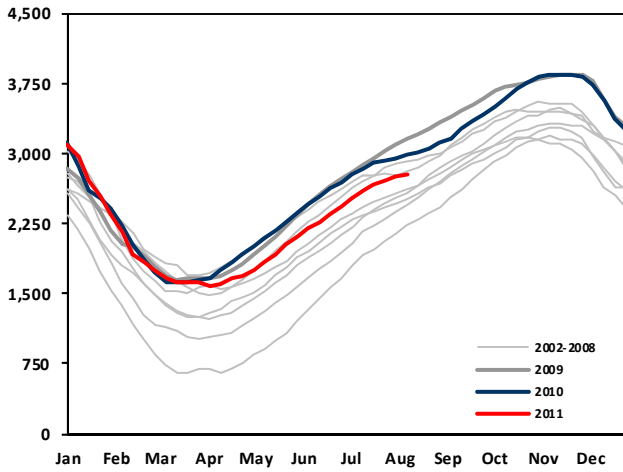
a. Cdn Natural Gas Production (Bcf/d)



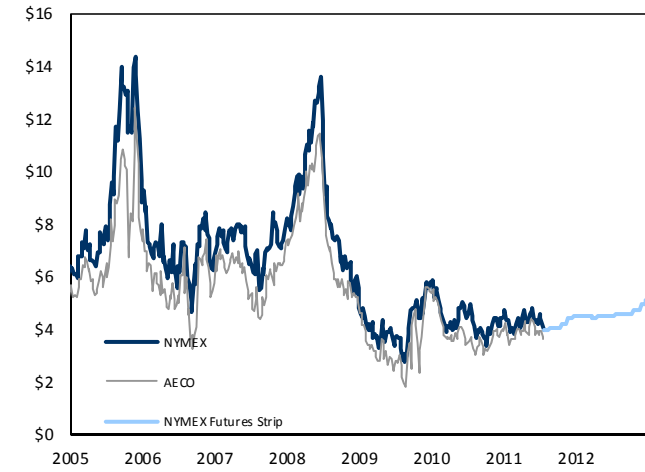
b. Cdn Natural Gas Exports to U.S. (Bcf/d)



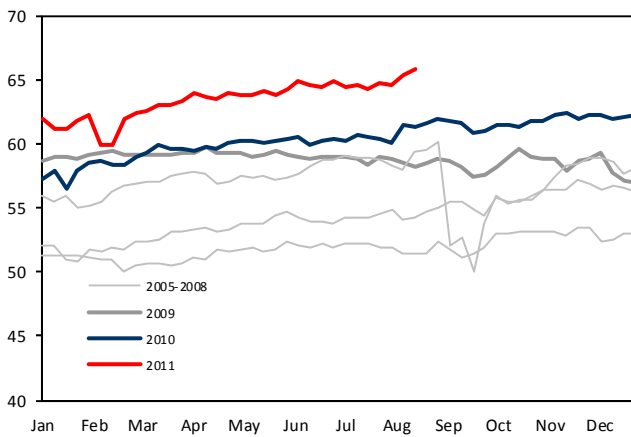
c. US Natural Gas Storage (Bcf)



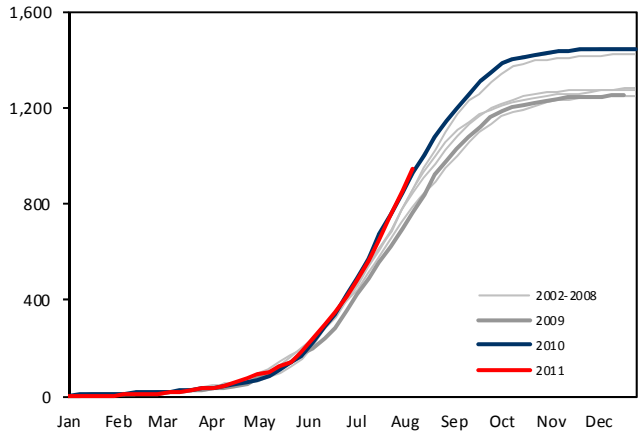
d. North American Gas Prices (US\$/mcf)



e. U.S. Natural Gas Production (Bcf/d)



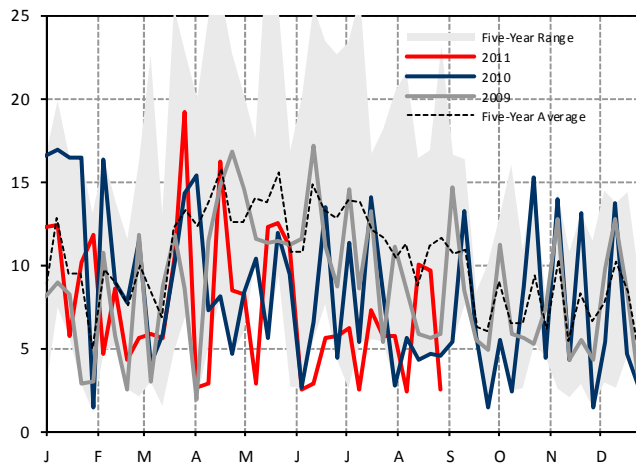
f. Cumulative Cooling Degree Days



Sources: Bloomberg, NOAA, Bentek Energy, Raymond James Ltd.

Natural Gas Charts (continued)

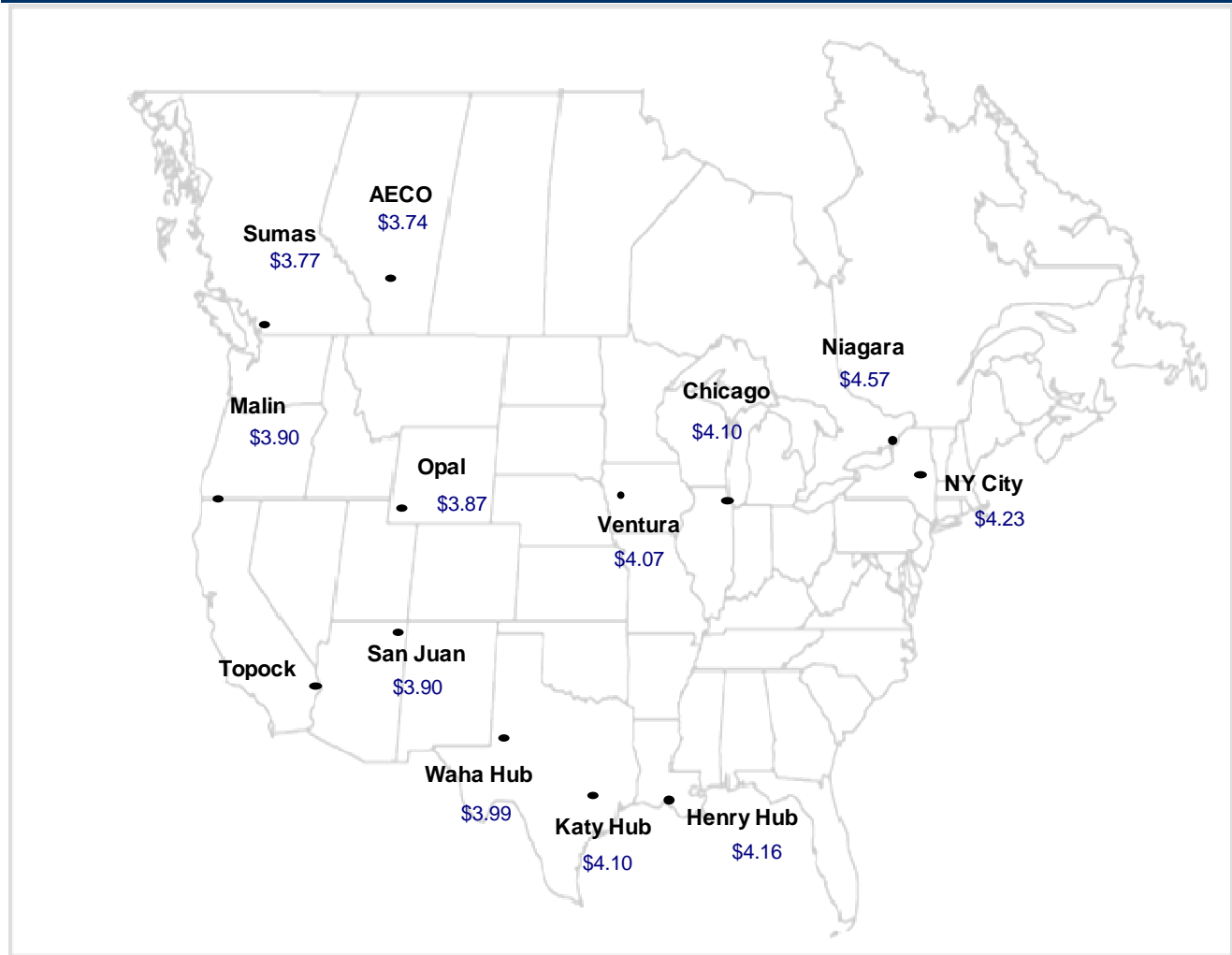
a. Weekly U.S. LNG Imports (Bcf)



b. LNG Netbacks - Landed (US\$/mcf)

Destination Port	Jun-11	Jul-11	Aug-11
Cove Point	\$4.40	\$4.39	\$4.11
Altamira	\$4.57	\$4.53	\$4.32
Lake Charles	\$3.93	\$3.89	\$3.70
Spain	\$9.15	\$9.18	\$8.63
Belgium	\$9.07	\$8.63	\$8.45
UK	\$8.99	\$8.39	\$7.94
India	\$12.00	\$13.73	\$13.04
Japan	\$13.10	\$14.47	\$15.17
Korea	\$13.10	\$14.38	\$15.77

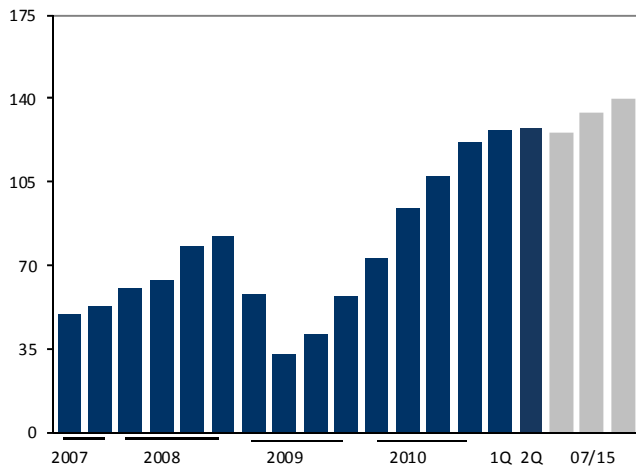
c. N.A. Gas Spot Prices (US\$/mcf)



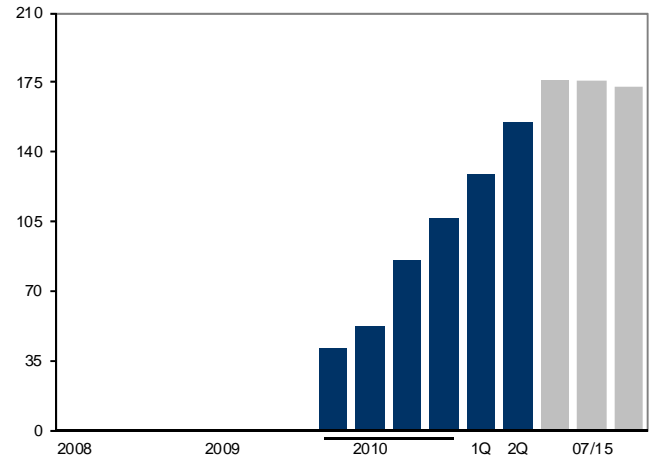
Sources: Bloomberg, Waterborne Energy, Raymond James Ltd.

U.S. Unconventional Rig Counts

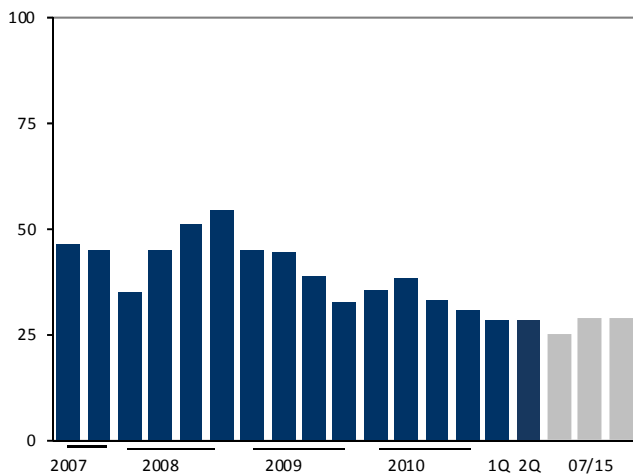
a. U.S. Bakken Shale Active Rigs



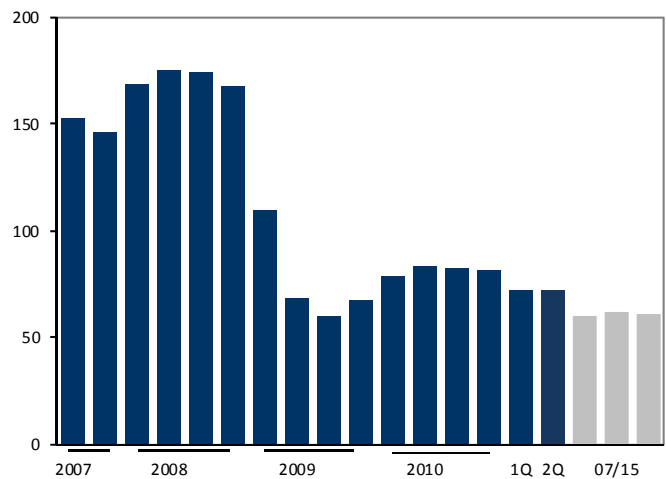
b. Eagle Ford Shale Active Rigs



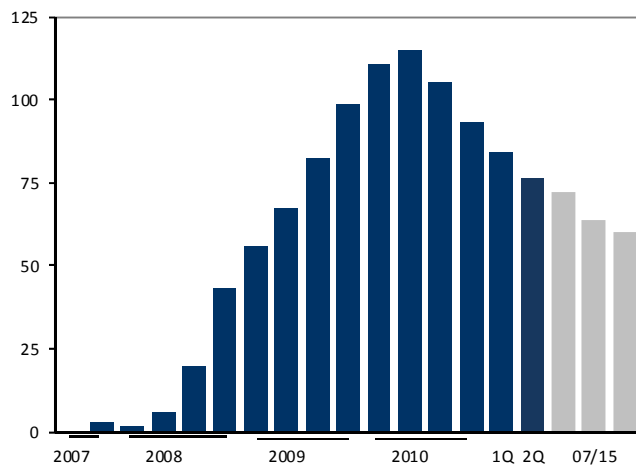
c. U.S. Fayetteville Shale Active Rigs



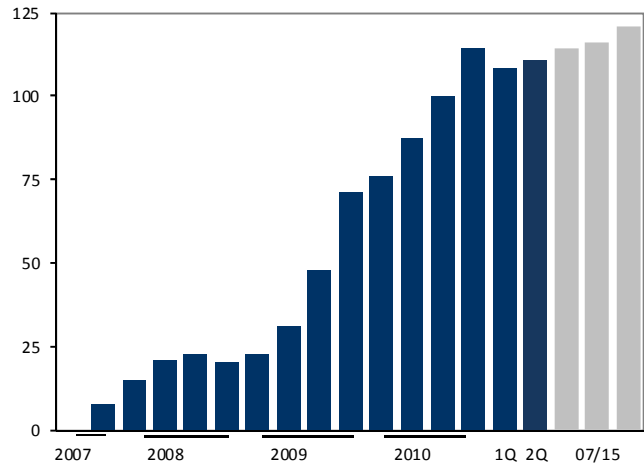
d. U.S. Barnett Shale Active Rigs



e. U.S. Haynesville (La.) Shale Active Rigs



f. U.S. Marcellus Shale Active Rigs



Sources: The Land Rig Newsletter

Energy Services

Company Name	Symbol	Closing Price	Target Price	Stock Rating	Target Return	Mkt Cap (\$mln)	Dividends		EPS (\$)		P/E (x)		EBITDA		EV/EBITDA		ROIC		Analyst
							S/sh	Yield	11E	12E	11E	12E	11E	12E	11E	12E	11E	12E	
Contract Drillers																			
Ensign	ESI	\$16.47	\$24.25	OP 2	49.5%	\$2,513	\$0.38	2.3%	\$1.46	\$2.01	11.3x	8.2x	\$496	\$636	5.7x	4.6x	12.4%	14.4%	AB
Precision	PD	\$12.41	\$18.25	OP 2	47.1%	\$3,424	\$0.00	0.0%	\$0.94	\$1.29	13.2x	9.6x	\$682	\$840	6.1x	5.1x	11.7%	13.5%	AB
Savanna	SVY	\$8.57	\$12.25	OP 2	42.9%	\$726	\$0.00	0.0%	\$0.54	\$0.88	16.0x	9.7x	\$133	\$180	6.4x	4.8x	6.0%	8.6%	AB
Trinidad	TDG	\$8.10	\$12.50	SB 1	56.8%	\$979	\$0.20	2.5%	\$0.58	\$0.83	13.9x	9.8x	\$253	\$300	6.0x	4.7x	7.8%	10.0%	AB
Western	WRG	\$8.50	\$12.00	OP 2	41.2%	\$498	\$0.00	0.0%	\$1.00	\$1.01	8.5x	8.4x	\$89	\$125	5.9x	4.8x	14.6%	12.3%	AB
Pressure Pumpers																			
CallFrac	CFW	\$33.27	\$55.00	SB 1	65.8%	\$1,457	\$0.15	0.5%	\$3.60	\$4.90	9.2x	6.8x	\$373	\$504	4.7x	3.5x	19.4%	21.2%	AB
Canyon	FRC	\$12.25	\$22.25	SB 1	82.4%	\$744	\$0.10	0.8%	\$1.39	\$2.09	8.8x	5.9x	\$149	\$229	4.9x	3.1x	35.1%	37.6%	AB
GasFrac	GFS	\$7.54	\$12.50	OP 2	65.8%	\$464	\$0.00	0.0%	\$0.05	\$1.05	nmf	7.2x	\$24	\$125	17.5x	3.7x	2.3%	22.4%	AB
Trican	TCW	\$21.69	\$31.00	SB 1	43.4%	\$3,159	\$0.10	0.5%	\$1.81	\$2.02	12.0x	10.7x	\$578	\$750	5.7x	4.8x	21.2%	18.6%	AB
Completion Services																			
Essential	ESN	\$1.79	\$3.10	SB 1	73.2%	\$220	\$0.00	0.0%	\$0.19	\$0.30	9.4x	5.9x	\$61	\$95	4.0x	3.2x	7.8%	10.7%	AB
Pure	PSV	\$7.46	\$12.00	SB 1	60.9%	\$181	\$0.00	0.0%	\$0.82	\$1.27	9.1x	5.9x	\$47	\$67	4.3x	2.8x	14.5%	20.2%	AB
Field Services																			
Black Diamond	BDI	\$29.00	\$35.00	OP 2	24.6%	\$538	\$1.14	3.9%	\$2.11	\$2.37	13.8x	12.3x	\$88	\$103	6.8x	5.9x	13.0%	13.7%	AB
Enerflex	EFX	\$9.68	\$13.25	OP 2	39.4%	\$747	\$0.24	2.5%	\$0.61	\$0.82	15.9x	11.9x	\$113	\$129	7.8x	6.1x	4.8%	6.2%	AB
Mullen	MTL	\$19.50	\$23.25	MP 3	24.4%	\$1,559	\$1.00	5.1%	\$1.20	\$1.18	16.3x	16.5x	\$265	\$279	7.5x	7.1x	11.0%	10.6%	AB
Secure	SES	\$8.39	\$10.25	OP 2	22.2%	\$748	\$0.00	0.0%	\$0.42	\$0.65	20.2x	13.0x	\$64	\$100	10.2x	7.2x	11.8%	15.5%	AB
Strad	SDY	\$4.10	\$6.75	SB 1	64.6%	\$153	\$0.00	0.0%	\$0.42	\$0.64	9.8x	6.4x	\$49	\$65	3.9x	3.0x	9.8%	12.5%	AB
Median					48.3%			0.2%	\$0.88	\$1.11	12.0x	9.0x			6.0x	4.7x	11.8%	13.6%	

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