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A New North American Shale Oil Champion

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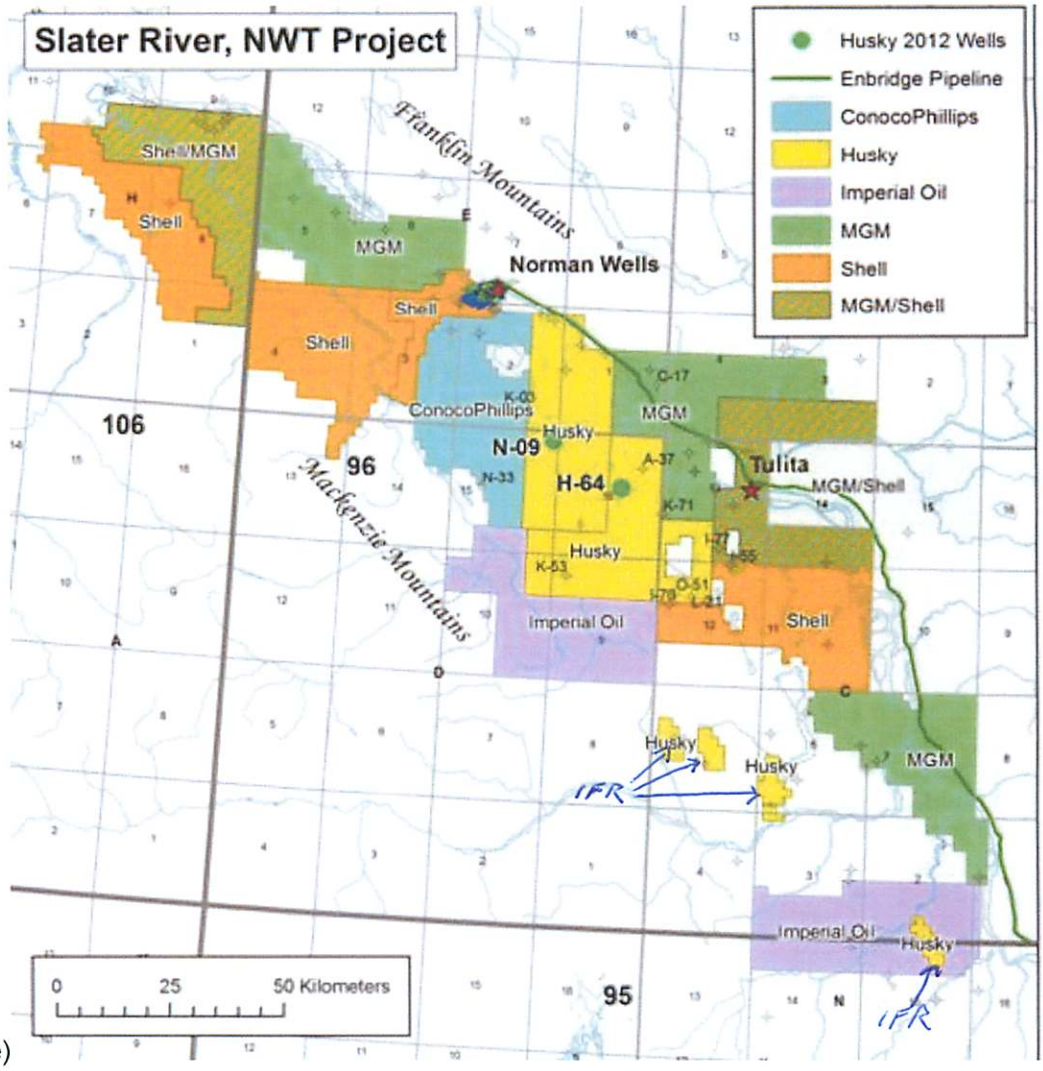
| about: MGMCF.PK

Disclosure: I am long MGMCF.PK. **(More...)**

The emerging Canol oil shale is poised to challenge the Bakken and Eagle Ford plays as one of North America's largest oil shale deposits when the super majors unveil their significant positions this winter. The Canol is a high quality shale reservoir which covers a larger area than the Eagle Ford and has better reservoir parameters than either of its southern rivals. This oil play in Canada's North West Territories (NWT) offers risk tolerant investors the possibility of a high impact investment opportunity which has not shown up on investor's radar screens because the majors who control the play are not as prone to self promotion as junior and mid-sized companies. As a result, the potential value of the play may not be reflected in their stock prices.

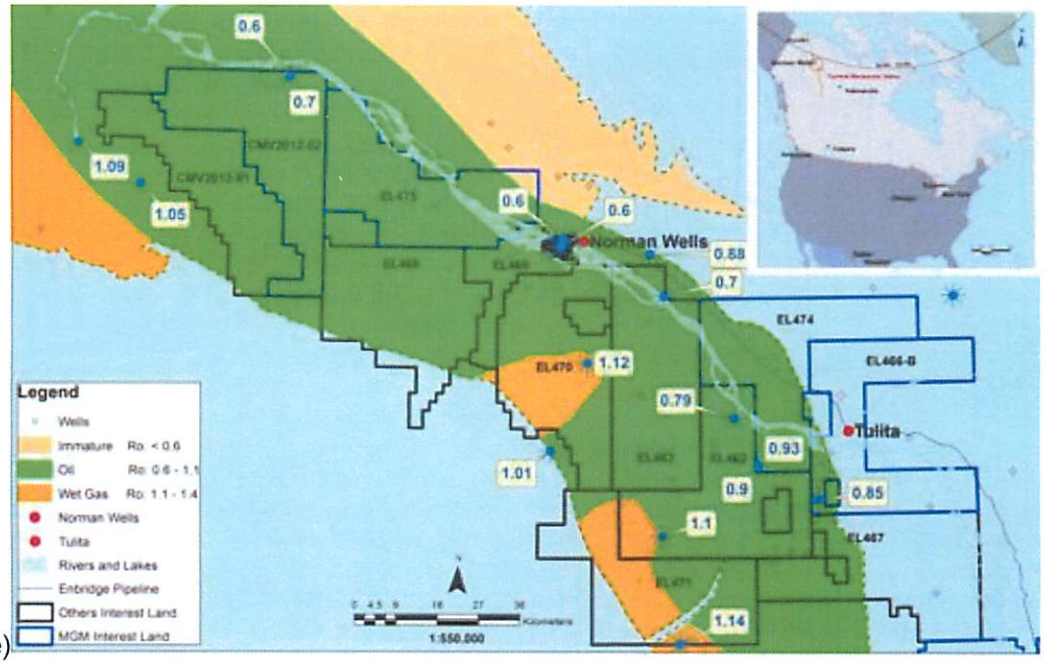
The 2011 and 2012 Canadian Government land sales were a confirmation of the magnitude of the resource. In this sale Conoco Phillips (COP), Shell (RDS.A), Imperial Oil (IMO), Exxon (XOM) and Husky (HUSKF.PK) committed to spending over $630 million to acquire over 1.5 million acres. These companies are seeking reserves that can move the needle on their stock price and the Canol has the potential to be material to even the largest companies. MGM Energy (MGMCF.PK) is the sole small company involved in the play. At a share price of $0.25 it has a market capitalization of about $100 million. MGM was formed in 2007 to look for gas reserves to deliver to the now dormant Mackenzie Valley Pipeline project. As a result of luck and good management, MGM found itself with over 330,000 net acres in the play.



(click to enlarge)

Source: Husky Energy Nov. 2012

The Canol shale is the source rock for the giant conventional oil field at Norman Wells. The play has two pay zones with a combined average thickness of 300 feet. There are oil, wet gas and dry gas widows which cover an area of about 3,500 square miles. The oil window is roughly 2,200 square miles which is 20% bigger than the Eagle Ford oil window which is about 1,800 square miles. The Canol has average porosity of 12% while the Eagle ford has 10%. Since the Canol is thicker and has higher porosity than its two competitors it has oil resources per well which are approximately 4 times the Bakken and 2 times the Eagle Ford. Furthermore, unlike most frontier oil deposits there is an under-used pipeline from Norman Wells to Alberta capable of carrying 50,000 barrel of oil per day (bopd). The parties have signaled that this pipeline is inadequate for the expected production by entered into Confidentiality Agreements and discussions with Enbridge Pipelines (ENB) to twin the pipeline.



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Source: MGM Energy Dec. 2012 Presentation

In June of 2012, Shell became the largest land owner in the play when they signed a farmout agreement and bought into all of the MGM acreage. By teaming up with MGM they have potentially acquired one of the "sweet spots" for oil. Further, Shell has made the unusual step of agreeing to allow MGM to operate. This is a tremendous vote of confidence for MGM and Canada's legendary oil man, Clay Riddell, who is CEO and principal investor.

The winter drilling season is just beginning and by the end of March, Husky will have tested two wells that were drilled and cored last year, Conoco will have drilled three wells and MGM will have completed and tested a well paid 100% by Shell. This well has a high probability of finding the Canol as there are two old wells that are a few miles away. Similar to other shale deposits, the major risk for all of these companies is not whether there is hydrocarbons, but whether it can be produced in economic quantities.

The size of the oil resources in place is reasonably well known as there is lots of well and seismic data because oil exploration has been conducted in the area since the 1920s. Resource estimates for the oil window vary considerably, but the most likely figure (50% probability) is 270 billion barrels in place with associate gas of 270 Trillion cubic feet (Tcf) and Natural Gas Liquids (NGL) of 38 billion barrels. In addition to the oil window, the wet gas and dry gas windows cover an area of about 1,300 square miles, but all eyes are focused on the light, sweet crude portion of the play.

How much of this immense bounty is recoverable is still speculative as well testing is scheduled for early 2013. However, early indications are favourable. The first discovery well in the area was drilled in 1920 and was a Canol shale oil well which blew out and sent oil 50 feet in the air. This is very unusual for tight shales and indicates that the shale is highly naturally fractured. This was confirmed when Husky drilled and cored two wells last year. They stated that one well will not require hydraulic fracturing before being tested as it is naturally fractured. Husky has shown a great deal of confidence in the results so far as it has applied to build a 40 km all weather road, permanent air strip and camp which will accommodate about 200 people. This is estimated to cost $60 to $100 million.

Early studies indicate that the Canol field will be economic at recovery factors as low as 3%. Recovery factors reported for other significant shale oil deposits vary from a low of 6% to a high of 24%. At the lowest recovery factor of 3% this field would have expected oil reserves of 8.1 billion barrels, 8 Tcf and 1.1 billion barrels of NGLs making it one of the largest oil finds in North America. Higher recovery factors similar to the Eagle Ford and Bakken are indicated by the higher quality of the reservoir which contains an average total organic content (TOC) of 8% and clay content of less than 5% (Eagle Ford has an average TOC of 4% and clay content of 20%). The lack of clay and very high silica content make the rock very brittle and an ideal candidate for massive fracturing.

While operating and capital costs are high in the NWT, the fiscal regime is extremely favourable. Royalties are 1% in the first 18 months escalating to a maximum of 5% in 6 years. In comparison royalty rates in Alaska, Texas and Alberta are

around 20%. While the Alaskan fiscal regime assesses a "profit taxes" of approximately 35%, there are no other wellhead assessments in the NWT. Corporate taxation in the NWT is competitive with the USA.

The Canol is an emerging shale oil play with large rewards and commensurate risks. While most of the companies mentioned in this article are well capitalized, MGM Energy is a thinly traded micro-cap affected by systematic and unsystematic risk factors. It tends to experience volatile price movements and is high risk and speculative in nature. MGM Energy has little institutional coverage and hence information can be difficult to find. While every effort has been made as to the accuracy of the information presented, readers are advised to do their own due diligence. This article is written for educational purposes only and is not in any way to be construed as investment advice.