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Midstream Start-Up Sees Unconventional Gas Opportunities

By Elsie Ross

While Canadian oil and natural gas producers have typically preferred to own and control their own infrastructure, a Canadian start-up midstream company believes that attitude may be changing with the development of unconventional resources.

"We think there is a movement afoot to move from a basin where we have 30 to 40 per cent ownership of gas gathering and processing facilities by midstreamers to something more like the U.S., which is over 80 per cent, **Kevin Cumming**, president and chief executive officer of privately held **KANATA Energy Group**, said this week in a panel session at an unconventional resources conference.

"Producers are seeking alternate sources of capital," he said at the Hart Energy and CSUR's **DUG Canada** conference and tradeshow. "We see that in some of the larger E&P companies selling their midstream assets."

KANATA, which is backed by **ARC Financial Corp.**, **Energy Spectrum Capital** and **Teachers' Private Capital**, will focus only on field gas gathering and processing and field enhanced natural gas liquids extraction. Its platform for growth will consist of the construction of new infrastructure, facility expansions and enhancements and acquisitions.

"We still have the strong, strong belief that midstreamers can enhance shareholder value," said Cumming, who previously was president of **ATCO Midstream Ltd.** "We are an entrepreneurial company and we will be extremely aggressive and we will take on risk and we will align ourselves with producers out there."

There has been a fundamental step change in upstream capital costs, which nearly doubled to about \$40 billion a year in 2011 from \$20 billion annually in 2004-2005, he said. Typically, midstream costs account for 20 per cent to 30 per cent.

As new unconventional plays are developed, existing infrastructure may not be suitable or in the right location, according to Cumming. "This is different gas; it is not heavy sour so a heavy sour plant may not be appropriate; it [the new play] may be high in NGLs therefore you have to have a solution to extract the NGLs."

The capital required for new facilities is huge and producers are seeking financial solutions, he said. Under current market conditions, producers do not have easy access to conventional sources of capital and low gas prices are reducing their cash flow. "Capital is drying up and it's going to be important to fill that gap with different sources of capital," said Cumming.

KANATA, he said, believes producers now are reluctant to shift that capital from upstream to midstream. "Upstream returns are higher than midstream returns and that should really be driving the movement to outsource your midstream assets."

Cumming acknowledged that it's extremely difficult for a midstreamer to come up with a lower operating cost than an E&P company but said there are things it can do to mitigate the cost of capital on a midstream asset.

A midstreamer can acquire a producer's midstream asset for cash, which can then be redeployed for other upstream purposes, he said. "They get a far better bang for their buck than investing in midstream assets."

According to Cumming, a midstream company can really add value through capital efficiency. At present, the average gas plant in Alberta has a 30 per cent to 40 per cent utilization rate. "The midstreamer's goal is to see every plant at 100 per cent utilization." A higher utilization rate drives down per unit costs and that could help to offset the higher costs compared to those if the producer owns the plant.

More importantly, a producer contracts with a midstreamer only for required capacity, he said. "We have

seen it time and time again where producers have gone and built plants to what they thought would be their ultimate production levels and sometimes they achieve that or sometimes they are not able to keep those plants full." A reluctance to allow third parties in the plant often keeps the plants from being as full as they should be, he said.

In addition to economies of scale that go to the overall capital cost, a midstreamer could potentially combine gas from a couple of different plays and introduce enhanced NGL extraction, said Cumming. With higher aggregated volumes comes better access to markets and better pricing for the product.

An alignment between producers and a midstreamer can be achieved through proper commercial arrangements and a properly-written contract, he said.

The conference also heard from **Brad Lock**, senior vice-president, liquids business unit, at **Keyera Corp.**, who said his company has seen significant growth over the past few years due to unconventional gas development in Western Canada.

"Unconventional rich gas is changing the landscape of the midstream NGL business in Canada," he said. "Facility constraints are becoming more evident with every producer, and midstream facility suppliers are working hard to try to address these gaps," he said. "Through co-operation between producers and midstreamers these gaps will be efficiently filled."

As NGL production grows in Western Canada, utilization of fractionation, storage and transportation to the Edmonton-Fort Saskatchewan hub has been increasing, he said. "As a result, industry's ability to provide these services is limited and producers are looking to industry to grow capacity in this area."

In response, Keyera is proceeding with the development of new storage caverns at Fort Saskatchewan, expanding its condensate transportation network, including rail and truck terminal business and expanding its liquids infrastructure at Edmonton-Fort Saskatchewan.

Producers have been actively growing unconventional production as they can achieve significant returns from liquids-rich unconventional plays such as the Duvernay and C2+ and C3+ volumes have been increasing in recent years, according to Lock. Propanes plus (C3+) production had been relatively flat in Alberta until 2011 when unconventional gas showed up, but production rates have grown steadily since then, he said.

Although C2+ production rates appear to be flat to steadily declining over the same period, this is somewhat misleading as there are several C2+ facilities in the Deep Basin that are either recently commissioned or under construction, which will have a dramatic effect on these rates, said Lock.

At Fort Saskatchewan, Keyera is adding a de-ethanizer that will enable its existing fractionator to handle up to 30,000 bbls per day of ethane plus liquids in addition to C3+. The project is supported by new volumes from the Deep Basin but some capacity remains uncontracted.

"We see this as an opportunity to address the ethane shortfall being seen by the existing petrochemical business and support our producers who have already committed to C2+ extraction in the field," he said. Keyera expects the plant to come online in 2014 and to be fully subscribed at start-up.

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