Paul van Eeden

July 13, 2007

Altius Minerals Corp. (ALS.T, C$21.59)
In the June 22nd newsletter I described what I believe to be the best investment thesis I have come across thus far in my career: oil refineries. On June 25th Bloomberg ran an article that started off with the sentence: “Li Ka-shing and Thomas Barrack have found a way to make more money from record gasoline prices than Marathon Oil and Royal Dutch Shell.” It’s worth noting that Thomas Barrack ranked #374 on the Forbes list of America’s richest people with a net worth of approximately $1 billion and Li Ka-shing is Asia’s richest man with a net worth of about $23 billion. They are buying up oil refineries and making a killing.

Bloomberg quotes Lynn Westfall, chief economist of Tesoro (the largest refiner in the western US) as saying that America needs to add the equivalent of 2 1/2 new refineries each year to keep up with rising gasoline demand. The US hasn’t built a new refinery in 30 years.

While the gist of the Bloomberg article is that buying existing refineries is less expensive than building new ones I think the journalist missed the point entirely. It is true that refining margins have been increasing because refining capacity has not increased in step with rising gasoline demand, but the real problem in the refining industry is the lack of light sweet crude oil to meet demand and the resulting necessity to blend heavy sour crude with light sweet crude for feedstock. Refineries that were designed to process light sweet crude do not cope well with blended feedstocks and most refineries in operation today were built three decades ago specifically to process light sweet crude. So while there is merit in buying existing refineries and capturing the rising operating margins I think the best opportunity lies in building modern refineries capable of processing heavy sour crude oil, which is what Altius’ subsidiary, Newfounland & Labrador Refining Corp. (NLRC) is busy doing, as described in the June 22nd letter.

Rising engineering costs and rising raw materials prices have scuttled numerous recent refining projects and Lynn Westfall told Bloomberg that, with respect to building new refineries, “For five to six years, you’re pouring billions of dollars into a project and getting nothing in return.” She went on to say that “Even at today’s margins, it’s going to take 10 to 15 years to repay that investment.”

I suspect Ms. Westfall is comparing today’s capital costs with historical operating margins as is typical at large, bureaucratic companies. While many in the oil industry are reluctant to invest the money to build a new refinery, entrepreneurs such as Li Ka-shing and Brian Dalton (President of Altius Minerals) are not. And not all project economics are as dire as Ms. Westfall is making them out to be: Marathon is currently spending $3.2 billion to add an additional 180,000 barrels of refining capacity. Assuming 350 days of operation and a $20 per barrel operating margin, the expansion should pay off in roughly 2 1/2 years.

Existing refineries are currently generating record profits of $17 to $24 per barrel and are changing hands in private transaction for about $12,000 per barrel of capacity. It may sound like a good deal to buy a refinery for less than two times profit but in many cases these refineries are being bought in order to upgrade them to conversion refineries capable of breaking down heavy sour crude oil. If you add the cost of upgrading to the purchase price of the old refineries you will find that in most cases it is actually less expensive to build new. Unfortunately it is extremely tough to get a new refinery permitted, since while everyone would like to pay less for gasoline nobody wants a refinery in their back yard. A new refinery also has the benefit of being based on the latest technology as opposed to an upgraded refinery comprised of a 30-year old core with a modern expansion module tacked onto it.

When you add the cost of upgrading these old refineries to their purchase price the cost per barrel often increases above $20,000. For comparison, NLRC's projected capital cost is just over $15,000 per barrel and for that they get a state-of-the-art refinery.

If NLRC's refinery were up and running today it could have had an operating margin in the order of $30 per barrel. NLRC's operating costs are expected to be lower than the industry average because of its design, resulting in above average operating margins. Once built, it would be one of the most advanced refineries in the world. At today's margins NLRC would be generating roughly $3.15 billion a year in cash flow and could pay back the $4.6 billion in capital costs in less than 18 months.

If Altius retains a 15% equity interest (currently 37% pre-financing) then their share of NLRC's cash flow would amount to $473 million per year, and if Altius manages to hold on to their 62.5% interest in the sliding scale royalty on NLRC's production, it would add another $177 million a year. Together, that would amount to $650 million per year in attributable cash flow to Altius, or about equal to the company's current market capitalization. Publicly listed refiners such as Tesoro are currently trading at about ten times earnings, which would put a value of $200 per share on Altius.

Now, I am not suggesting Altius is worth $200 per share; the refinery is not built yet. But if you read the June 22nd letter you'll see that I do think it could be worth a much more conservative $30 a share based on $8.75 per barrel in refining margins, which is the floor margin being built into the financing structure. We can look at the valuation in yet another way. If NLRC generates $3.15 billion a year in cash flow it would imply a private transaction value of at least $6.3 billion, and if it were bought Altius would receive $945 million assuming they had a 15% equity interest. But they would still have the $177 million a year in royalty revenue that should be worth at least ten times that much and an additional $300 million in other assets. Adding this up comes to just over $3 billion, or $100 per share. If all goes well, the refinery could be built in 3 ½ years and at current operating margins the capital could potentially be paid back 1 ½ years later. My hope is therefore that sometime between now and then the stock will be between $100 and $200 per share.

What I am trying to convey is that even though this is a twenty-dollar stock, it still has the same kind of upside potential as a junior penny stock but with much less risk.

If the entire refinery project fails Altius still has a hard $10 per share in net assets of which almost $9 per share is cash or cash equivalents.

Altius currently comprises roughly 17% of my portfolio and is my single largest position. I was not planning on buying any more shares but after looking at current operating margins I might just succumb to the temptation.

Metals and markets
Victor Adair interviewed me for HoweStreet.com in Vancouver last month. We discussed metals and markets and if you did not read Frank Veneroso's World Bank Presentation that I sent out as a commentary on July 3rd you can catch the essence of it in the interview. It is also a good overview of where my head is at with respect to metals and

markets: www.howestreet.com.

Conferences
I have agreed to present at the Las Vegas conference to be held on September 10th and 11th. Please visit the conference list on my website for more details.

Paul van Eeden

www.paulvaneeden.com

Disclaimer
This letter/article is not intended to meet your specific individual investment needs and it is not tailored to your personal financial situation. Nothing contained herein constitutes, is intended, or deemed to be -- either implied or otherwise -- investment advice. This letter/article reflects the personal views and opinions of Paul van Eeden and that is all it purports to be. While the information herein is believed to be accurate and reliable it is not guaranteed or implied to be so. The information herein may not be complete or correct; it is provided in good faith but without any legal responsibility or obligation to provide future updates. Neither Paul van Eeden, nor anyone else, accepts any responsibility, or assumes any liability, whatsoever, for any direct, indirect or consequential loss arising from the use of the information in this letter/article. The information contained herein is subject to change without notice, may become outdated and will not be updated. Paul van Eeden, entities that he controls, family, friends, employees, associates, and others may have positions in securities mentioned, or discussed, in this letter/article. While every attempt is made to avoid conflicts of interest, such conflicts do arise from time to time. Whenever a conflict of interest arises, every attempt is made to resolve such conflict in the best possible interest of all parties, but you should not assume that your interest would be placed ahead of anyone else's interest in the event of a conflict of interest.