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Good Alaska location goes bad for Agrium

Nikiski fertilizer plant location's advantages are overshadowed by iffy Cook Inlet gas supply, company says

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In many ways, Alaska's Kenai Peninsula is a wonderful place for Agrium Inc. to have a nitrogen fertilizer plant, except for one glaring and perhaps fatal weakness — there doesn't seem to be enough natural gas around to feed the thing.

The plant is scheduled to close in November for lack of gas. The Kenai area stands to lose 230 high-paying jobs, millions of dollars in local spending and a huge chunk of property tax revenues if the plant closes.

On other points, the Kenai plant scores high. It is located in the United States, a

How much gas is left in Cook Inlet?

The following articles published in Petroleum News in the last year are just a few of those that offer different views on Cook Inlet's remaining gas potential and the successes and challenges involved in chasing those reserves.

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bastion of political stability. The Kenai Peninsula is a beautiful, sparsely populated area, full of outdoor recreational opportunities for employees and families. The plant is located at tidewater, and is advantageously positioned to deliver nitrogen fertilizer to its largest customer, Korea.

The Kenai plant is the only one Agrium has on the Pacific Ocean, and the Pacific is a great place for a nitrogen fertilizer plant these days.

“The Pacific Rim is a growth area, with a rising standard of living,” said Christine Gillespie, Agrium investor relations manager. “People are wanting higher food quality, and it takes more fertilizer to make beef than rice.”

It’s not just the economy; population growth is driving the market for fertilizer upward as farmers strive to produce more food from the land, Gillespie said.

“People want food to eat,” she said.

Despite the glowing attributes of a Kenai location, an apparent Cook Inlet natural gas shortage casts a pall on hopes that the plant can stay open.

“The reality is to prepare for the worst,” Gillespie said.

Gas always #1

Agrium faces two major issues that threaten the viability of its Nikiski plant, Gillespie told Petroleum News.

“The first issue is, can we get gas, period?” she said. “Profitability is secondary at this point — is it even physically possible to get gas?”

The second part of the equation concerns

from the perspective of a small independent working in Alaska

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profitability.

“If there is gas, can you get it at a level that allows a return; can we break even on a variable cost basis?” Gillespie said.

“Over the long term, we need to be able to meet fixed costs.”

The primary product of Agrium’s Kenai plant is anhydrous ammonia. Air, natural gas and steam are the raw ingredients for production of ammonia. Natural gas is the highest cost component in the process, adding 80 percent to 90 percent of the cost of manufacture.

Anhydrous ammonia is the feedstock used to make urea. Agrium sells Kenai-produced anhydrous ammonia and urea primarily to Korea and Mexico, and also makes deliveries to Thailand, the United States, Australia and New Zealand. All of the plant’s output travels to market by ship, except for the amount sold locally for fertilizer and snow melting compound.

A one-dollar increase in the cost of gas adds \$35 per ton to the cost of manufacturing ammonia at Agrium’s Kenai plant, Gillespie said.

A \$35 per ton increase doesn’t seem like much today, with ammonia prices at an all-time high, but the increase would hurt a lot if ammonia prices plunge again, as they often do in the cyclical commodity market, Gillespie told Petroleum News.

“The Black Sea price today is \$180 per ton, but when the market goes south, you get prices half that,” she said, adding that the per-ton price of ammonia went to \$53 in 1999, \$85 in 2001, and to \$70 in 2002. Without the use of variable cost analysis, a plant might appear to be making a profit, while it actually is losing money on a long-term basis.

“We can’t pay \$5 gas and compete on the international market,” she said.

Cook Inlet situation ‘dire’

The situation in Cook Inlet is dire, Gillespie said.

“Once upon a time there were huge gas fields, but now we’re at the bottom of the reserves; there’s almost nothing left,” she said.

Once a court-ordered supply contract with Unocal ends Oct 31, Agrium will have to look elsewhere for gas.

“We’ve realized we’re not going to be able to get gas from Unocal by litigation or negotiation,” Gillespie said.

Conservation measures won’t do the trick either, she said.

“There’s talk of re-firing coal plants to save gas now used to generate electricity, but it only saves 3 bcf per year,” Gillespie said. “At full operation the Kenai plant uses 46 bcf per year — at the bare minimum the plant uses 23 bcf when it’s running at its minimum 50 percent capacity.”

Other users around Cook Inlet are drawing hard enough on the gas supply that the system can no longer provide for Agrium’s needs. Worldwide, Agrium builds where gas is trapped, Gillespie said. By following that strategy, the company takes some of the uncertainty out of the natural-gas-supply side of its equation.

The company does seek safety from wild gas prices, but it is also willing to share temporary windfalls with its gas suppliers. Gillespie said at other locations, the company has supply contracts for gas with a base price of \$1 per thousand cubic feet,

but the supplier participates in gains, based on nitrogen prices.

Labor not issue

Labor costs at Kenai are high relative to other plants worldwide, but labor costs are not the issue in the company's decision to shut down the operation, Gillespie said

"Labor is not a deal killer if there is ample gas that is competitive," she said. "A commodity company must be vigilant about costs, but I can't imagine Agrium abandoning Kenai because of labor costs."

The greatest danger for an operator is to lose its work force, Gillespie said.

"If you close the plant, does your workforce stick around?" she said.

The plant can be restarted, but keeping it in working order after closing it takes continued maintenance, an expense the company doesn't want to make if a future supply of gas is unlikely.

"Do we mothball the plant and keep a skeleton staff and if in a few years gas becomes available — hopefully — restart it?" Gillespie said.

The uncertainty makes it difficult for the company to determine what level of continued maintenance it will institute at the plant after shut down.

"Hopefully it's not over," Gillespie said. "We still have a full-time team of people looking for gas in Kenai."

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