

Harvest Energy Pays C\$1.6B for Vitol's North Atlantic Refining

By Michael Tutton
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HALIFAX (CP) -- In an unusual move for an energy royalty trust, Calgary-based Harvest Energy Trust [TSX:[HTE.UN](#); NYSE:[HTE](#)] is buying an oil refinery in Come by Chance, N.L., with the intention of spending millions to modernize the facility.

To date, energy royalty trusts have tended to concentrate on purchasing shares in western Canadian oil wells to create steady cash flows for investors and none have yet added a refinery to their assets.

Nonetheless, Harvest announced its intention Wednesday to spend C\$1.6 billion to buy North Atlantic Refining Ltd.'s facility, along with a network of gas stations and heating fuel suppliers in Newfoundland and Labrador.

The deal is expected to close by the end of October.

In a conference call from St. John's, chief executive John Zahary praised the refinery, saying it would mean improved distributions to unitholders thanks to strong profit margins and its ability to process high-sulphur-content oil from anywhere in the world.

"Underinvestment in refining capacity has contributed to a supply shortfall, resulting in very robust refining margins, a situation expected to continue, at least over the medium term," he said.

The refinery on the north shore of Placentia Bay has struggled in the past.

Constructed in the mid-1970s, it quickly closed with the loss of tens of millions of dollars of taxpayer money in a C\$500-million bankruptcy.

It reopened in the mid-1980s and has been owned by Geneva-based Vitol Inc. since 1994, employing 700 people and processing up to 105,000 barrels of oil a day from supertankers.

When Vitol put the operation up for sale last December, executives from the Swiss firm said they weren't willing to spend up to C\$800 million to upgrade the plant.

Questioned by analysts about whether Harvest would make that investment, Zahary responded "that is something that over time, the owner of this refinery ... should do to capture maximum value. We hope to do that under the Harvest ownership."

However, investors reacted cautiously and unit prices fell 36 cents to close at C\$33.60, a decline of 1.1%, in trading on the Toronto Stock Exchange.

The refinery purchase led Standard & Poor's Ratings Service to put Harvest Energy on its CreditWatch list.

"The negative CreditWatch placement reflects our concerns regarding the scale of the transaction, the increase in debt levels, and the acquisition being a departure from the company's business experience both in terms of geography and operations," said analyst Jamie Koutsoukis.

"Debt levels will increase upon closing of the acquisition as it is expected to be funded 75% through debt," Koutsoukis said, noting that the refinery industry "historically has been volatile."

Ian Doig, editor of Doig's Digest, a Calgary oilpatch newsletter, said investors are likely adjusting to the idea of owning the Come by Chance complex, which will require Harvest Energy to seek fresh equity.

"I would doubt very much yesterday night, when the unitholders went to bed, that they were expecting to wake up owning a refinery this morning," he said.

Still, he said the purchase of the refinery extends the lifespan of the royalty trust, as it is expected to continue operating for 30 years.

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It also diversifies the trust's holdings.

"They seem to be broadening their envelope looking for new revenue sources. Their historical revenue sources, being oil and gas production in the western Canadian basin, has been getting pretty costly," said Doig.

The firm is expanding its line of credit to C\$2.2 billion, underwritten by CIBC World Markets and TD Securities, and plans to seek equity over the next two years.

North Atlantic's main asset is a medium-gravity, sour-crude hydrocracking refinery.

The acquisition also includes a marketing division in Newfoundland and Labrador with 69 gasoline stations, a home heating business that serves 20,000 residential and commercial customers, the supply of refined products to commercial and wholesale customers and the bunkering of refined petroleum products.

In the first half of this year, North Atlantic and the related businesses reported operating cash flow of C\$214 million.

St. John's-based Altius Minerals Corp. [TSXV:[ALS](#)] is looking at adding a second refinery in southeastern Newfoundland, with a feasibility study expected by the end of November this year.

Brian Dalton, president of the firm, said his company's plans aren't affected by the announcement.

"The early part of the feasibility study was that our production wouldn't be displacing anybody. There's enough of a market to accommodate any new production we'd bring on."

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