THE INVESTOR'S DIGEST INTERVIEW

When sizing up the oilpatch, this fund manager really knows the drill

For five years, Alex Ruus trekked through the Alberta bush — first as a rig supervisor and, then, as a production engineer. As a result, he knows the oilpatch from the ground up — something, he says, is important when it comes time to determine if an energy outfit really has the goods it says it has

If Alex Ruus can still tell you what a degasser is, it's because he knows of what he speaks.

From 1986 to 1987, Mr. Ruus bossed Chevron drill crews in Northern Alberta during which time he managed to become thoroughly familiar with degassers, dampeners, as well as the gazillions of other components normally found in an oil drilling rig.

It was an experience that's stood him in good stead — especially when figuring out if an energy firm actually has what it takes to go out and drill for oil.

"Much of the drilling is a very technical business," says Mr. Ruus, who runs the Conservative Growth Fund for Toronto's Northern Rivers Capital Management.

"And someone who's never worked in the oilpatch has a very tough time realizing who has a technological advantage and who does not."

Born and brought up in Calgary, Mr. Ruus, 42, earned a B.Sc. in engineering from the University of Calgary in 1986.

OK, so you'll never mistake a dampener for a degasser. But what else do you bring to the table from your years trekking through the bush?

Contacts, for starters. If an oil company exec brings out a map and says a certain property is a great play, I can phone people I know in Calgary and ask them if the claim is true. Still, you can never underestimate the value of technical knowledge. In oilfield servicing, for example, I'm able to pick out those companies whose technology is truly innovative. And that's important because an oilfield firm that builds a better mousetrap will not only grow rapidly, but make money as well. True, oil drilling is often pictured as an all-brawn, no-brains activity. But it isn't. The energy sector is home to some of the most technologically savvy people in the world. Indeed, the oilpatch is probably one of the biggest buyers of information technology anywhere. Remember, finding oil today isn't like it was 60 years ago. Then, guys would just go out and pound a hole in the ground. Today, because the easiest-to-find reserves have all long since been tracked down, a company that wants to find oil pretty much has to use every trick in the book.

You went into the oil and gas business fresh out of college. But in doing so, you were only following a family tradition.

True. My dad was manager of heavy oil operations at Norcen Energy, now part of giant Anardarko Petroleum. And my uncle was senior engineer at Pembina Resources, a privately held energy play. My brother, meanwhile, holds down a similar position at Baytex Energy Trust.
I myself did a stint in this area, becoming a production engineer at Chevron after my one year as a rig supervisor.

So, with all your oilpatch experience, why did you later go into the fund business?

Because I began to find investing interesting. After about two or three years at Chevron, I started buying stocks — primarily in the energy sector because this was the field I knew the best. And as I became more and more interested in the market, I decided I needed to know more about it. So, in 1990, I returned to school, earning an MBA from the University of Western Ontario in 1992. After that, I headed to Bay Street.
I joined Northern Rivers in 2005.

And you obviously haven't regretted the switch.

Not at all. I feel lucky to be working in fund management. If I weren't doing it for Northern Rivers, I'd be doing it at home for my family and relatives because I love what I do. It's like being paid to go to MBA school.

Tell us a little about the Conservative Growth Fund.

Set up in November 2005, the fund is designed to double an investor's money every five years. As such, it's modeled on my own RRSP. With my portfolio, I've averaged a 15 per cent return over the past decade and a half. True, such a return is relatively aggressive. But we diversify extensively to reduce risk. So while our objective is high, our style is risk-averse. We're also value investors — especially for the long term. So, even though the companies we buy may look pricey, they'll probably look a lot cheaper a few years down the road. And although we can theoretically invest anywhere we want, our fund is now 85 per cent Canadian simply because we tend to invest in companies and sectors we know well.

The oilpatch is obviously one such sector. What's another?

Financial services — particularly investment management firms. After all, I've worked in this sector for 15 years. So, whenever I see a firm with strong portfolio management, as well as a top-notch sales force, I look at it as a possible buy. In investment management, both are key ingredients for success.

Yet, your fund's biggest weighting is in industry and transportation — two sectors which you don't know that well.

But because we're stock-, and not sector-specific, and because we just happened to find good value plays in industrials and financial services, we've ended up with this big weighting. Of course, because we don't want too much exposure to any one area, it's unlikely we'd ever allow either sector to account for more than 35 per cent of our holdings. Typically, we'll try to apportion the fund among small, medium and large caps at 25 per cent each. We'll then use the remaining 25 per cent to take advantage of other opportunities that happen to come by — opportunities we've now found in small caps.

You say you'll never invest in a lousy sector. An example?

Forest products. There are just tons of companies here that have gone down the tubes. True, there are exceptions, like TimberWest Forest Corp., a timber land management firm based in Vancouver. But TimberWest is primarily a real estate play. Generally speaking, many forest products firms have very low margins. They're also highly susceptible to all sorts of external shocks, the prime one now being the rising Canadian dollar. Then, too, the sector is still reeling from America's soft housing market. In addition, pulp and paper firms are taking a shellacking from falling newsprint demand. Indeed, with more and more people now getting their information online, it's unlikely newsprint consumption is going to rebound any time soon.

ZCL is Canada's lowest-cost producer of fibreglass tanks.

It's also top dog, having sewn up 90 per cent of the Canadian market. If a new gas station is going up, chances are its underground storage tanks will have been made by ZCL. And given the ever-growing need to replace steel tanks with ones made of fibreglass, ZCL is likely to be busy for years to come. Steel tanks just rust out over time. ZCL should also benefit from any wholesale switch from gas to ethanol. That's because when ethanol is poured into fibreglass tanks that were installed before 1985, a chemical reaction is set off that corrodes the lining. Meanwhile, ZCL has entered the American market, having bought Xerxes, a U.S. maker of fibreglass products, earlier this year. And with the American market for fibreglass tanks 10 times that of Canada's ZCL's move was obviously smart. Indeed, we see ZCL eventually becoming a dominant player south of the border.

STOCKS ALEX RUUS LIKES

ZCL Composites Inc.
(ZCL-TSX; $10.80)
Phone: 800-661-8265

Bank of America Corp.
(BAC-NYSE; $49.80)
Phone: 704-386-5681

WestJet Airlines Ltd.
(WJA-TSX; $15.61)
Phone: 877-493-7853

Pacific Energy Resources Ltd.
(PFE-TSX; $2.92)
(562-436-6566)

Burlington Northern Santa Fe Corp.
(BNI-NYSE; $86.84)
Phone: 800-795-2673

You say U.S. banking is moving toward an oligopoly.

Putting Bank of America in the cat bird's seat. As the biggest domestic bank in the U.S., BAC is most likely to profit from any trend toward consolidation. Moreover, BAC has already racked up a strong record of making good acquisitions and then integrating them successfully. What's more, with a network of branches and ATMs across the U.S., Bank of America benefits from the demand for transaction portability. People just appreciate being able to find their bank's ATMs when they travel or go on vacation. They also appreciate not having to pay transaction fees to another financial institution. Meanwhile, because it now trades at less than 10 times 2008 earnings, BAC remains the cheapest large-cap bank in North America.

You say that in general, you dislike airline stocks. Yet, WestJet, a discount carrier, is one of your five top picks.

Because WJA is the lowest cost airline in North America. And over time, such carriers will steadily grab market share. In the meantime, WestJet remains by far the cheapest good quality airline that you'll find anywhere. And given that it now trades at just 12 times 2008 earnings, WestJet is indisputably cheap. Another plus? A work force that's non-unionized.

Pacific Energy Resources is a small-cap energy play.

But one that could become much larger if any of its three major assets — in California (Long Beach), Wyoming (Green River) and Alaska (Cook Inlet) — proves to be a success. Indeed, the market value of any of these three plays if brought to full production would top the market capitalization of Pacific Energy itself.

When it comes to hauling containers, Burlington Northern does one of the biggest businesses of any railway in North America.

And in its Chicago-Los Angeles main line, BN boasts one of the best transportation backbones between the midwest and the Pacific. Of course, BN, like all major rail carriers, benefits from the inherent cheapness of rail transport. After all, rail haulage is so much more energy efficient than truck transportation. So, as gas prices continue to rise, rail freight becomes that much more attractive to shippers. Indeed, you might call railways an indirect energy play. Then, too, the railways are just much more competitive, having done wonders with their on-time performance. And having pared back excess trackage, they're leaner and meaner. With over 50,000 kilometres of track, BN is one of North America's biggest railways, stretching west to the Pacific, as well as south to Texas and the Gulf Coast. In effect, it blankets almost all of America west of the Mississippi.