

INTERIM BULLETIN #80 – MAY 18 2011
PORTFOLIO SELLS - XCITE ENERGY,
STERLING RESOURCES
UPDATE - ITHACA ENERGY

There are some harsh winds blowing in the North Sea oil stocks today, humbling your editor.

Sterling Resources (SLG-TSX)

Sterling today announced their third well in their offshore Cladhan oil play in the North Sea encountered sand with good porosities, but a lot of water, not oil. Their previous well hit low porosity sands that were too tight to produce from. So that is now 2 out of 3 misses, with the final well being drilled quickly.

The stock is off 50 cents to \$2, which is down a full 50% in the last three weeks. (Thankfully I sold some before this collapse!) I am selling 5000 shares today at \$2.05, which is a \$1 share or 33% loss on this trade. I bought this stock on the \$3 financing last year.

There is an argument that the stock is a buy today, being as Cladhan is already proven commercial. It will go into production. That has already been proven. But I think I would rather pay a few pennies more after I know the results of this fourth well before deciding to repurchase. I am also seeing fairly light volume to the downside today – I would be much more concerned if by now, 1 hour into trading (often the low of the day) the stock was down on millions of shares instead of just over half a million.

On the negative side, this stock was/is very well institutionally held, and there is 184 million shares outstanding. If the Sterling story falls out of favour with the institutional crowd, that's a lot of stock to turn over into new hands...the stock would take weeks if not months to re-base and move up. All of Sterling's other meaningful assets are gas, which is not as sexy as oil.

Remember that France has recently said they want to ban fracking, which puts their high quality but low impact Paris Basin play in limbo. Their Romanian assets are in limbo as they squabble with the Romanian government. So this Cladhan play is really flying the flag for Sterling. I continue to now hold a very minor position. I may buy or sell depending on the results of the fourth Cladhan well.

XCITE ENERGY (XEL-TSXv) –

Xcite is developing a large homogeneous heavy oil field in the Central North

Sea. The stock climbed from 62 cents to \$6 as the company proved that this field did indeed have as much OOIP (Original Oil In Place) as expected, and that they could make this gooey 12 API oil flow.

Last week while I was away Xcite issued a reserve report that came out with a number much lower than The Street was expecting – 22 million barrels of 2P reserves vs. The Street's expectations of something more in the range of 200 million. 2P, which is sometimes also called P50, means that the independent reservoir engineer is giving a 50% chance of that number actually being there – it's an educated guess based on all the drilling & seismic etc. On a reserves basis, the stock is trading at roughly 50% of its 2P reserves if you value them at \$20/boe.

From what I can tell, the difference here is not so much geological (which would be bad) as legal/practical. Xcite management only had the independent reservoir engineer do reserves in the area in which they are going to produce FIRST. They are not going to run a huge horizontal pipe the length of the Bentley field and produce it all right away.

The independent engineers gave a secondary area of production a contingent resource of 87 million barrels. Most of the Bentley field is still outside these two areas.

I sold my remaining 2000 shares this morning at \$3.15 for a gain of 408%. I will watch the development of the Bentley field from the sidelines for now, but will continue to monitor this. As their new rig is developed and delivered this fall, I may revisit this story.

ITHACA ENERGY – IAE-TSX

Ithaca announced this morning that they have stopped drilling the J03 well in their Jacky field, because they hit a smaller oil column than they expected in the Beatrice A reservoir. They may use it as an injector well, where they pump water downhole into the formation and that keeps up the pressure in the formation to help the oil flow to the other oil wells.

Being as the market is looking for any excuse to sell junior oil stocks, the stock is off 10% to \$2.

The company produces about 6600 boe/d of oil and gas right now, after recently purchasing 2200 boe/d from Hess – at a very cheap metric of \$10.87 a boe (2P). Management says that that average production from Cook for 2011 will be about 1,900 boe per day net to Ithaca.

The problem here is that the company didn't give any context for what this will mean to overall production. How can you trade into a black hole of information?

Very frustrating - poor disclosure. As soon as I get a handle on that issue I may be a buyer, as this company will quadruple production in the next two years – the oil and gas have already been discovered, and the money is raised. (This means you may get another email from me later today even). I expect continued weakness in the juniors through the next few weeks and possibly months. Depending on this outcome, I will increase my position over several purchases this summer.

In market news, I don't like the looks of the technical chart on oil – it is trading at the bottom of its new range (despite today) and I think there is a good chance it will go lower before it goes higher.

The global demand picture for oil is still robust, supply growth is still limited, but inventories are high and oil could easily spike down in the 80s for a short time. For investors, the issue is simply an issue of market timing and valuations – even at \$80 oil most companies are still making great profits. I don't see oil trading like natural gas – below its cost of production. The other factor in my favour is that the US government wants their dollar to go as low possible as fast as possible without causing any economic disruption a la 2008. That's positive for the oil price and more so oil stocks.

ALSO, please take note of some OGIB stocks that are outperforming the overall junior oil market – they are, in alphabetical order:

Border Petroleum—hoping to learn more on the development program for Slave Point play

Coastal Energy – top pick at many smaller firms now

DeeThree – in a good market that stock would be up 50 cents on that first Alberta Bakken well

Golar LNG – waiting for transparency on Golar Energy buyout and dividend policy

Wavefront – steady as a rock, there are buyers under \$1

I bring these to your attention because the stocks getting support in this market are telling us something...the charts speak to us investors, we just have to figure out what they're really saying...

Lastly, you will soon see an article in my public blog on the new type of energy trusts that are being created right now – the income game is back in the energy sector. The management teams have found a way around the Canadian government tax issue – they use foreign assets. This is huge news for investors and I am on THE NEXT ONE – like GasFrac I expect to have my report out on the company before its IPO, and I will let you know who is in the selling group so you can call your broker to get some if you can. I think this sector could come back with a vengeance – especially for Americans who will get yield in Canadian dollars – unlike their own MLPs (Master Limited Partnerships).

I'm very excited about this one, but it's not likely coming to trade until August – only 3 months away.

Thank you for all your feedback and if you see any way I can improve my service please send me an email!