# BULLETIN # 46 – WEEKLY WRAP--FEBRUARY 20 2011

# PARTIAL PORTFOLIO SALE (WINSTAR – WIX-TSX)

# PORTFOLIO UPDATE

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| **3P Int'l Energy** | **Ridgeline Environmental** |
| **Canadian Energy Services** | **Second Wave Petroleum** |
| **Golar LNG** | **Sterling Resources** |
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## WINSTAR RESOURCES - WIX-TSX – sold half on Friday at the close-$5.49

*(see updates Dec 23 2010, Jan 6 2011 and Jan 29 2011)*

Up until December 2010, Winstar was a very cheap international oil producer, producing about 2000 bopd from its Tunisian properties in North Africa, trading about 3-4x cash flow at $3.50/share. Then the investment world got wind that this highly leveraged small cap stock with only 35 million shares out had a really good shot at a 5000-6000 bopd oil well in Tunisia.

If successful, this well would prove up an extension of a prolific oil field 25 km east where the success rate was 80% and other wells produced at that high rate. Shortly after I bought the stock, Pioneer (PXD-NYSE) sold some Tunisian production for $94,000 per flowing barrel, and I outlined how a valuation like that with Winstar drilling success could make the stock worth $18.

So me and a few hundred other investors piled into the stock. Then came the Tunisia revolt. Then came a little institutional note in late January that I passed on to subscribers where management downgraded their expectations on the well, saying the well will be mostly gas, not oil, with 1000 bopd of oil being a good well and 2000 bopd of oil would be a great well.

When I buy these high risk drill punt stocks I count on selling into a speculative premium as other investors pile in (The Greater Fool Theory). With results now due early next week, I sold half – and really should have sold 80% to get all my cost out – as there will be no greater speculative premium than there is now.

I did get hold of management after market Friday, and they did confirm the institutional note that said this well would be mostly gas. They really (and appropriately) didn't want to say anything as results are imminent. They could have been trying to lower expectations so a 2000 bopd oil well would be considered good news, not bad.

Everyone please understand I have no idea what this well will produce. My gut says it will come in slightly below to below expectations, but even if I thought the well result was to be positive I would still be selling some as a hedge.

I bought 5000 shares at $4.20, so 2500 shares sold at $5.49 is a gain of 30.7% in two months. But I should have sold 80% of it and got my entire cost out.

## 3P Energy – DOH-TSXv *(original write-up IB#58, Dec 19 2010)*

3P is developing shallow gas assets in Ukraine, where prices are $8/mmcf and management says netbacks (profit per barrel equivalent of gas) are over $6/mmcf. I bought this play because it should be able to develop its assets quickly and cheaply compared to other European gas plays that are much deeper and much more expensive and take much longer to get to production. I think this is a better way to play European gas than the shale plays. (And I'm not convinced European gas will as profitable 5 years from now when all that shale gas comes online. Have we not seen that movie before?)

Their original asset is a 512 km2 coal bed methane gas play in the eastern part of the country – the drilling of which has been delayed due to cold weather.

This week they announced a second suite of properties; four conventional shallow gas properties in the west side of the country, totalling 337 km2. The purchase price of $17 million just happened to be exactly how much cash 3P had in the bank at the time ***;0)***, thanks to the early exercise of 70 cent warrants from the 25 cent financing by key shareholders. Management said $17 million bought over 42 bcf of 1P reserves.

I spoke with CEO David Kahn to get some key points on the assets. The properties are:

1. the Rusko-Komarivske,
2. Stanivske
3. Korolivske gas fields
4. Uzhogorod exploration block

1. Rusko-Komarivske – Kahn says there is 1P resverves of 33.9 Bcf at Rusko, which come from five different sands ranging in depth from 750-1300 m. Production is now from

two old wells that were drilled in the 1990s and produce from just one zone, and production has not declined after 14-15 years, and he says the pressure in the well is still good. 3P intends to drill five new wells by the end of Q3 this year and complete all five zones. Kahn said a good well would be 2 mmcf/d but drop in half after 90 days, and then the decline curve would flatten out over 20 years (the industry calls this the *long tail)*, but most of the 33.9 bcf would be produced over 10 years

He said a 2006 US engineering company estimated $750,000 to drill and complete these wells, and there is infrastructure there. It's an opportunity to get cash flow quickly and he thinks 5-7 wells could drain the field. These wells in total could produce 5000 mmcf/d by the end of the year with $6/mmcf netback.

2. Stanivski has had 10 wells drilled on it, and Kahn said all wells showed good gas rates, and three of them showed more than 1 mmcf/d. There are 1P reserves 9 bcf and 3P reserves of 69 bcf. Kahn estimates they can put the three larger historical wells back online total for a total of $1 million.

3. Korolivske is 40 km2, and in the 1990s a single well was drilled that Kahn said produced 4 mmcf/d, but it was not pipeline spec gas. To get it to spec now will cost $2 million. There is a 1P reserve of 4 bcf and has 65 bcf possible reserves. After the $2 million capex (capital expenditure) is complete, 3P will drill 2-3 more wells here.

4. Uzhgorod is pure exploration which has three structures which Kahn says has the potential to be the same size as the other assets.

Overall, Kahn is targeting production to be 5 mmcf/d by year end, and 12 months from now be producing 12 mmcf/d, by YE 2012 producing 15 mmcf/d off these new assets.

Back to the CBM lands, he said they are re-entering old wells, and have recompleted four of them. He would not say what production was like but did indicate nothing has surprised them and they had given earlier guidance of about 300 mcf/d per well. They are acquiring additional lands. These low cost wells have the potential to be VERY profitable for 3P at $8 gas, and plunking down these shallow holes should turn this property into a "resource play" – a large number of low risk wells. Kahn said they have over 1000 drilling locations if this play works, with a potential 3.5 Tcf (trillion cubic feet) of potential reserves.

Kahn said he wanted to let the wells run for at least a month before announcing flow rates, so don't expect to see any news until April. **I am a buyer on weakness.**

## CANADIAN ENERGY SERVICES – CEU-TSX *(see Bulletin #20 April 20 2010)*

If the rumours are true, I'm going to miss this stock. The stock jumped from $27 to $31 this week with above average volume. This high tech drilling mud supplier – and HUGE cash cow - is evidently on the radar screen of some global service companies. Rats. They've raised the dividend twice since I bought the stock a year ago and I'm now getting paid 9%. Hopefully management says no – they own enough stock they can – and my dividend will just keep going up.

Believe it or not, this was one of my biggest mistakes. After I bought the stock at $15 they announced a financing at $15.50 and I thought about buying more and I should have backed up the truck, filled my boots, whatever expression you want to use. It was a "no-brainer" and I let myself get distracted. There are so few shares out – and management owns over 20% of them - that this stock has HUGE leverage to earnings increases. I know, I know – cry me a river.

## GOLAR LNG – GLNG NASD *(original write-up Bulletin #45, February 9 2011)*

Golar's stock had another great week as a Bloomberg story on February 16 told the world what our subscriber community at OGIB already knew – record demand for Liquid Natural Gas (LNG) was doubling freight rates and increasing profits for LNG shipping companies like Golar.

The stock hit $19.47 this week, but I have to say I don't see it going a lot higher, based on fundamentals. If day rates go from the current $70,000 a day to $100,000 or higher near term, then yes of course. (They were $47,000 in the fall of 2010 and $30,000 a year before that.)

I see Golar as a yield play, and my guess is that once the yield gets close to 6% based on next year's expected dividend of $1.30 (it is now $1/yr), the stock will peak – that would be $21.67, which isn't far from here. I am looking to add to my Golar position but not here, not now.

http://www.bloomberg.com/news/2011-02-16/lng-tanker-rates-seen-doubling-as-ship-glut-disappears-freight-markets.html

Golar does not intend to increase the number of LNG tankers it owns. They have a rough gross profit of $50,000 per day right now. They are focused on securing more FSRU contracts (Floating Storage and Regasification Units, which turn the compressed LNG back into regular natural gas) which have gross profit per day of $100,000.

I would also urge you to read this story on why Sri Lanka now intends to use LNG to supply a huge chunk of its energy needs - http://www.asiantribune.com/news/2011/02/20/sri-lanka-provide-one-third-energy-demand-lng-2020

## GASFRAC – GFS-TSX *(original write-up Aug 25 2010)*

When the stock popped this week I went to find out why. It's a wonder management can run the business with every brokerage firm in Canada getting them to present at their investment conferences, talk to their nationwide institutional desk. GasFrac is in demand by the market. Feedback was that a lot of the buying was word-of-mouth coming from industry people who have seen the product work and were impressed. That's the best kind of buying.

## IONA ENERGY

This is a new North Sea play that will start trading in about 6-8 weeks, and is headed up by the original team of Ithaca Energy (IAE-TSX) – which has done very well.

The 60 cent financing did close, and it was for more than $60 million but I'm not sure how much – it hasn't been announced formally yet. I will be doing a full report on Iona before the stock comes free trading.

## Ridgeline Environmental RLE-TSXv *(original write-up IB # 58 Dec 19 2010)*

I put this company into the OGIB portfolio because I believe water is the next big thing in oil and gas. This very early stage company has a license to use a proprietary method of cleaning water used in fracking. They can either clean it to re-use or get it to potable standard.

The technology is now used to clean hotel waste waters, but is not used in the energy sector. However, the company does have an agreement to install a commercial scale facility with a large independent producer that is now getting underway. Even to get THAT is good news for a start up.

Ridgeline does have an $8 million annual environmental service side that is profitable, and many of their clients in the mainstream business are oil and gas companies. So they have a track record and credibility with their target client base on this new water initiative.

They will be setting up pilot plants for potential customers and testing their product for them during the next several months. Water treatment is a big cost for oil companies, particularly the heavy oil producers. If this technology works and shows good economics, a ready – almost desperate – market is waiting for them.

There is a lot of work to be done here however. More capital will need to be raised, though Ridgeline says they are having success in getting clients to pay for trials—this is rare for any startup, but speaks to the need in the industry for a solution to their water issues. The next financing could be a good entry point on the stock; then you know something is moving ahead.

In a perfect world, this next trial goes well and they are able to land 3-4 more trials over the spring/summer. Each trial must be customized to the water from that particular oil field. The capital costs will be covered by Ridgeline, but the clients have indicated they will cover all operating expenses. The company has about $2 million cash. So they will need to finance again, and that will be a good entry point for subscribers.

The oil and gas industry has entire 3 day conferences dedicated to just water management solutions. This will be a BIG niche for a HUGE global industry.

Chairman Doug Johnson has had success in the water industry – he had a run-of-power river project stock go to $8. And this stock is now very well held; it's almost too tight for the size of our subscriber community right now. But it's a sleeper stock which if all goes well will have milestones that will impact the stock price this summer.

## SECOND WAVE PETROLEUM SCS-TSX *(original write-up Bulletin # 21 May 10 2010, and the last good update was Interim Bulletin #46 – October 28th 2010)*

Second Wave is developing the Pekisko formation at its Judy Creek property northwest of Edmonton. It's a mid-grade oil, and has a high gas content – 35% of production. So it is not high netback (profitable) production. But it is a very porous formation, and it has a carbonate host which means it responds well to acid fracking. When I say carbonate, think limestone, think basic on the ph scale and mild acid solution dissolves it. The acid fracking took IP rates from under 100 bopd to just under 200 bopd, and took the stock to well over $2.50.

This is a BIG field with dozens of drilling locations and can be pad drilled – one pad, many horizontal drills going out from each one. That helps keep costs low.

I bought the stock at $1.21 well over a year ago – a key Fibonacci level at the time – and watched it to go to $3 as the rest of the market understood the story, and the stock acquired a big valuation for its profitability.  They are aiming for a $35 netback at Pekisko this year.

The run from $2.50 to $3.25 was on the anticipation of a successful well in a different formation, the Beaverhill Lake (BHL) about 1000 metres below the Pekisko.  Second Wave has about 50,000 acres of prospective BHL ground – which could support hundreds of wells.  Arcan Resources (ARN-TSX) went from $1 - $6 on developing this formation in 2010.  It's light oil with high IP rates for the Western Canadian Sedimentary Basin (WCSB) of 600 bopd.

Second Wave CEO Colin Witwer did his best to downplay this potential, as he understood the BHL under his ground was slightly different than Arcan's geology.  This was to his credit, as their first well was successful, but in the Gilwood formation just below BHL.

Despite it being a good well (590 boe/d), the stock sold off – which was because management said they weren't going to drill any more BHL wells for 4-6 months, not because the well was bad.  All the hot money in the stock wanted a new light oil resource play and saw the stock going to $5 in a hurry – on a successful BHL well.  When it was clear there would be no momentum on this new play, the hot money left and the stock has been treading water at $2.50 for four months.

This is a better price level than I expected, which is a sign of how much the Street likes the team here – Witwer and VP Exploration Doug Hibbs.  It's also smart to remember that Bamfield Asset Management (BAM-TSX) has a huge interest in this company – the Montreal Bronfman dynasty. They continue to participate in financings keeping their pro rata interest.

Given all that, I knew SCS would be back at BHL sometime this spring, so I chatted briefly with Colin this week.

They also had the misfortune of a fire in one of their gas plants at Judy Creek in January, which cost them about $4 million.

Surprisingly, Witwer said he expects to meet or be very close to meeting his old Q1 production target of 3100 boe/d – that's truly very good news, considering the downtime they had.

That Gilwood well has now been online for a week-10 days and while he didn't say what production he did say it was what he expected.

He added that a private company called Coral Hill has a successful BHL well only 2.5 km (1.5 miles) north of their property.  So as he said when the BHL was discovered, he would wait until everyone figured out the best way to complete (frack) this formation and then just copy them while he continued to develop his no-risk, cookie-cutter Pekisko drill plan.

So that time has now come and expect Second Wave to give a bigger focus on BHL this year, which should be good news for shareholders. The economics for the light oil at BHL could be VERY strong for SCS as there is a good possibility they can drill from the same pads as what they're using for the Pekisko drilling.

BHL is also 40 API plus – very light oil, which they could mix with their mid-grade Pekisko oil to get a better netback out of that.

Before everybody runs out to buy the stock, consider two things:

1. Witwer added that Arcan hasn't been able to increase production much out of the BHL on their lands as high declines have put them on a production treadmill where new wells just replace declining production (think Petrobakken).
2. Witwer says the BHL has streaky porosity, so it's NOT a pervasive play; it has definite sweet spots. They will be drilling using their 3D seismic data and if a well hits off that a couple times then Witwer can say he has tapped into the formula. But that learning curve could take several expensive wells ($4.5 million each) and several months to figure out.

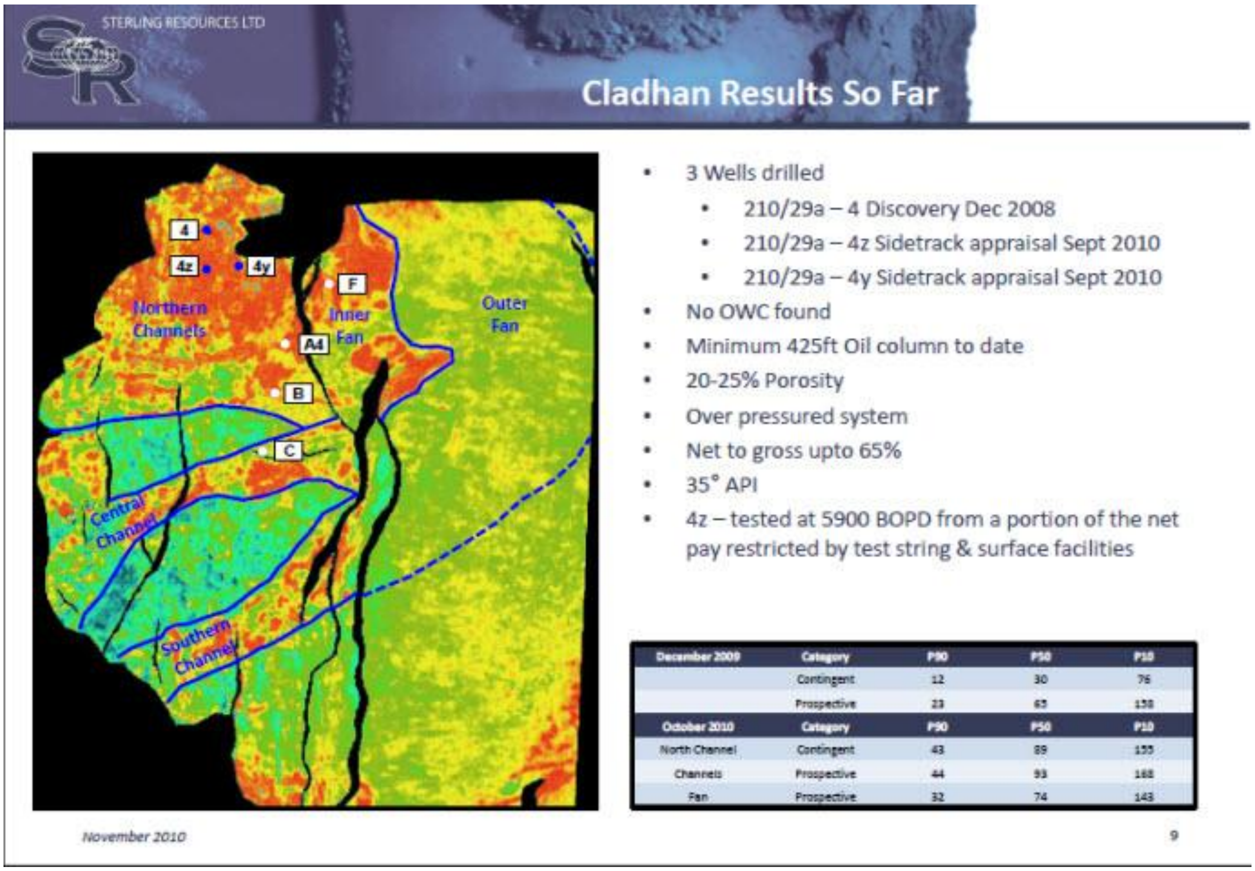
If it was truly that easy we'd all be rich, right?

## STERLING RESOURCES – SLG – TSX *(original write-up Bulletin 11, Dec 29 2009)*

The analyst reports have been fast and furious on this North Sea exploration/development play – they spud their next Cladhan wells this week. Sterling is the operator and owns 39.9% of this OIL play in the North Sea, which has already been proven commercial. This well will also have two sidetrack wells with success. Sidetracks are drilled out of the main well; they don't have their own new well (I call them mother and daughter wells). Cladhan has already been given credit for a P50 resource (independent reservoir engineers say there is a 50% chance of that many barrels being recoverable) of 256 million barrels. Analysts predict that could get bumped to 600 million barrels with success on these three wells.

The good news is that so many analysts follow the company, and so many institutions love the story, that success will be met with immediate buying and a stock price increase. The bad news is that expectations for this program are quite high after the success at Cladhan last year, so I'm unsure of how the market will take a so-so result.

These wells are being drilled to test how deep the oil column goes, which is now at 425 feet with a 60% gross to net (60% of that 425 feet will be productive). They are now targeting sub-sea river channels that fan out from their original discovery, as you see in this slide.




This Cladhan asset is one of the few oil arrows in Sterling's quiver. Like I said with 3P, I am **not** a believer in the current $8/mmcf natural gas prices in Europe long term, so to me, this asset is very important for the company.

Sterling has MANY assets, and they're all big. Their Breagh gas deposit, also in the North Sea, is now being developed (and should be onstream to enjoy current European gas prices). There is a lot of oil and gas infrastructure in the North Sea, which despite its heyday being 20-30 years ago is still an important producing area globally. That means that getting production out of Sterling's assets will be relatively easy (if you call working offshore in some of the stormiest seas on the planet easy.)

Sterling will also be drilling the Grian gas prospect in the North Sea, which could host 50 bcf or better of recoverable gas. Sterling has a 57% interest in this asset. 2011 is a very active year for this company so there will be lots of news flow throughout the year.

This is a great management team, proven in every respect – finding oil and gas, doing corporate deals to bring in partners and in getting the market (investors) to notice them. I fought hard to get as much stock as I could on the last $3 financing, **and I may be buyer on weakness from here.**

## Torquay Oil Corp. – TOC.A – TSXv *(Original write-up Bulletin 27, July 27 2010)*

Management continues to keep a low profile but drilling is continuing on both properties. This company acquired an 81 CONTIGUOUS sections (1 section=1 square mile=640 acres) for ZERO dollars (i.e. just drilling costs) of land along the Saskatchewan/North Dakota border. They call it Alma Lake. Torquay then joint ventured it **:0(** and now have 57 net sections. This is prime Bakken potential territory, and it's a big land package on a company with only 35 million shares out. There is lots of leverage here.

One analyst update this week (GMP Securities) pointed to recent drilling success down by the North Dakota border by Painted Pony and Crescent Point, which I have mentioned before.

Wells from offsetting properties in the area are starting to get bigger, as the average peak IP rate has gone from 165 bopd to 200, with some wells over 350 bopd over the first 30 days. This is a good sign, but it's not on their property yet.

Torquay also has one section in the middle of the main Viewfield area of the Canadian Bakken, which is about 65 km northeast of their Alma Lake property and the market could see drill results from their drilling here within the next 2-3 weeks. The company has said they could drill as many as 10 wells on this one section they own 100%. (I hope so--they paid $10 million for that one section.)

Assuming Torquay can produce 110,000 barrels lifetime out of a well at Alma Lake, GMP had a low-case price target of $3.44 on less than one well per net section. The high price target of $8.60 assumes 146,000 barrels recoverable on less than two wells per net section. I would expect four wells per section ***if this play works***. So even the high case number is quite conservative, though obviously more dilutive capital would need to be raised with success.

Torquay is so cheap that as soon as Alma Lake is proven someone will buy it. But management has been slow to get this play moving and the stock needs that to move up. I'm holding, and **I'm definitely a buyer on a bad day**, (maybe even a good day) simply because I believe the likelihood of that property NOT economically producing oil to be remote.

But there is a hedge fund out of New York, Elliot International Capital Advisors who own enough stock they have to file insider reports, and are regularly buying the stock. So it may never have a bad day.

Bottom line is that there is some BIG upside here if/when management gets a couple successful wells at Alma Lake.

Stocks that I may buy at current price levels include Torquay, GasFrac.

Stocks I may buy on weakness include 3P, Golar, Second Wave, Sterling.