

BULLETIN 49 – MARCH 2 2011 - PORTFOLIO UPDATES

GASFRAC

VALEURA ENERGY

TORQUAY

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ALBERTA BAKKEN (IMPORTANT) WAVEFRONT TECHNOLOGY

GOLAR LNG

Here's a quick mini-update on a few OIGB stocks (in order of importance), as I won't be doing a weekly wrap this weekend. You readers get a weekend off while I'm chauffeuring two ballerinas between performances.

GASFRAC – GFS-TSX

This is always my favourite company and favourite stock. Its proprietary Liquid Propane Gas fracking method creates a compelling win-win for GasFrac and its customers – if you haven't read the original report yet please do so ASAP.

It continued its remarkable run this week – up 40% in three weeks – and I discovered why this morning. BMO Nesbitt Burns, Canada's second largest brokerage firm, upgraded the stock to \$17 in a research note – here is the relevant part:

“BMO hosted a series of meetings with GasFrac management in Europe during the week of February 21. We came away even more convinced that GasFrac's shares represent a unique opportunity to gain exposure to the secular trend towards increased frac-intensity at a very compelling valuation to its North American pressure pumping peers. Further, the company is expected to deliver explosive earnings growth at minimal risk because they are simply expanding capacity to meet already-established demand for the proprietary LPG fracturing process.”

BMO said that GFS shares trade at 4.6x 2012 cash flow, and their \$17 target is 6.4x multiple which is (I checked) in between Calfrac and Trican valuation.

So that is why the stock was trading up so aggressively – those meetings were bringing in buying. It came off hard today as Calfrac and Trican each did this week after they reported their quarterly numbers. As far as I can tell it was just a sympathy trade, though I have said the market will start pricing in a more balanced oil services market at some point this year. The

fracking companies (and the drillers and everybody else in the sector) is building capacity as fast as cash and credit lines will allow, and that insatiable demand from producers for equipment will get sated.

A couple subscribers have asked about GasFrac's patents, and how exclusive their relationship with Chevron is – they license some technology from Chevron. GasFrac CEO Reid MacDonald replied to my query:

“Chevron and Halliburton hold a patent on a particular method of gelling propane. Chevron assigned their Canadian patent rights to us and has licensed us to their rights in the USA. We have patent pending ourselves on several alternative methods and of course the IP on the pumping and application issues.

As Chevron has publicly stated they are our technology partner I would find it unlikely they would license anyone else in the USA. They cannot license anyone in Canada as the patent rights are assigned to us.

Our Patent Lawyers have not given us any reason to believe that we will not be successful in our patent applications. As they are granted we will probably announce them. Patents are typically a 4-5 year process.”

BMO has done quite a flip flop on GasFrac, as during the industrial accident in January BMO was quick to downgrade the stock to \$8 and say it could permanently damage the company's reputation and valuation.

But I can't criticize them for that, for when the facts change I must as well.

And that brings me to **Torquay Oil Corp – TOC.A-TSX** – also one of my favourites. The full report is at the top of the Members Centre right now.

Since my bullish write up on the company this last weekend *I have discovered that they missed on two of their four Lake Alma Bakken wells*, which means there is more importance on this latest well that is using a bigger frack job (20 tonnes per frack vs 8 before).

It does take time and money to figure out the right completion method (read: how to frack a new formation properly) in a new area.

So what this means is that when the company's operations update comes out in 2-3 weeks, this next well - which they are fracking now – is the only one that could be positive news for the

company. So I hope management has learned a lot from their previous four tries. Two of those four ARE producing, which means there IS a play here. I just don't know how big or how regular it will be.

I increased Torquay to my highest ranking this weekend – a “1”, but I confess in light of this new information I'm not comfortable with that and I'm moving it to a “2”. *I appreciate that may not sit well with some but my job is to be as real and immediate with the information I have at the time.*

Torquay has a strong completions team, their partners (Chinook) are very competent as well, and they have a huge land package with an entirely new play – the Ratcliffe – they will be exploring.

There's just a little more riding on this well - in terms of what the stock price will do - than I realized last weekend.

THE ALBERTA BAKKEN PLAYS

Bowood (BWD-TSX) – original write up Dec 19 2010

DeeThree (DTX-TSX) - original write up Dec 19 2010

Primary Petroleum (PIE-TSXv)

This play could start to get interesting very quickly. One of the junior players on the Canadian side of this play (it straddles the Alberta/Montana border) is Argosy Energy Inc. (GSY-TSX), run by Peter Salamon and Ray Dobek. They previously built and sold Olympia Energy and are well respected in Calgary. I was a shareholder in Olympia and talked many times with them back then. They are a competent Tier 1 team.

Argosy will probably be the first company to release results from an Alberta Bakken well, and it is possible that will be soon. They have 33.5 net sections just northwest of Bowood's lands with the Blood Tribe – and they have seismic over that area. About 20 net sections are estimated to be prospective for the Bakken on Argosy lands.

They drilled for gas on their lands, and deepened it to test the Bakken. There have been no results other than comments that it was encouraging. In late January they spud a horizontal well for the Bakken, and that is the well that I expect to be announced shortly.

Argosy is giving informal guidance of 1400 boe/d production by year end, weighted 50-50 oil and gas. Right now they are producing 800 boe/d of almost all gas, and their Alberta Bakken

lands are where they are drilling right now (two wells this quarter) so therefore their production growth will come from...where...????? What am I supposed to get from that? It's got to be here in the Alberta Bakken.

I am not buying Argosy because it is too thinly traded; there are only 19 million shares out. Where this is going to benefit ME is in my newly increased position in DeeThree. DeeThree and Bowood could/should have immediate small jumps in price on this news – or the news of any success in the Alberta Bakken. DeeThree is trading very well after its big dip on the financing news of a couple weeks ago.

If I get really lucky, both Argosy and DeeThree come up with positive results within the next six weeks. With the leverage that DeeThree has to 180,000 acres (more than 9x what Argosy has) of the Alberta Bakken, the market should pay a lot more attention to it.

Primary should also benefit but not as much as it is farther away, down in the Montana part of the Alberta Bakken.

I am a buyer of DeeThree on a bad day.

GOLAR LNG - GLNG-NASD (original write up Bulletin 39, Jan 6 2011)

Golar released its preliminary (unaudited) Q4 financials on Monday. This company has two main businesses – transporting Liquid Natural Gas (LNG) around the world in the big LNG tankers, and building/operating FSRUs – Floating Storage and Regasification Units; ships which put the LNG back into regular usable natural gas.

Golar is the world leader in FSRUs. They cost \$250 million all-in vs. an LNG import terminal at \$2 billion, have a small footprint and sit offshore just out of sight. And they're twice as profitable as LNG tankers.

The lower the price of natural gas, the better business is for the LNG shippers like Golar. And as the shale gas revolution spreads round the globe, gas prices will go lower – for awhile, like a decade or more. That's one reason why I bought this stock.

The highlight for me was that operating income for the year was almost double last year at \$60.2 million, and that allowed management to declare the regular 25 cent quarterly dividend AND an extraordinary 5 cent dividend.

That's the second reason why I bought this stock. It's a yield play, and Chairman John Fredricksen – who owns 46% of the stock - has an incredible track record of increasing dividends in his other shipping companies like Frontline (FRO-NYSE). He's old school – puts his money where his mouth is and grows the business and collects dividends.

The global LNG trade has increased dramatically this year, and day rates for shipping doubled between Q2 and Q4 2010, which was the main reason operating income was up.

However, that was a double edged sword for Golar, as they thought (and think) they can leverage their intimate knowledge of the business into becoming an LNG trader, buying and selling cargoes. But the tight shipping market basically meant they couldn't find a boat to fulfill any contracts! They are looking at increasing capacity, either organically (building) or otherwise (buying). Literally, every single LNG tanker in the world (366) is being used.

Net income was down over last year, but the stock now trades on the potential of yield growth via new FSRU contracts. The Indonesian FSRU that will be operational late this year will add 30 cents in dividends in 2012. The market was willing to look past so-so financials and see a ship utilization rate of 95%, rapidly increasing day rates for LNG tankers, a dividend increase in 10 months and price in the future, not the past.

And they started a commodity trading business, which uses derivatives and other such wonderful esoteric money making things. They lost \$2.6 million on that division.

Golar is a difficult company to monitor financially because they own a consolidating interest (greater than 50%) of Golar Energy Ltd., a Norwegian listed company that basically acts as a feeder for long term contracts for Golar LNG. The corporate presentations and language in their press releases are often almost identical and it makes me hope there are much smarter people than me watching these companies.

Golar says (and I concur) that FSRUs are being considered in many places around the globe right now, and interest in them is increasing. They reported that all the planning and construction to implement their new FSRU in Indonesia is on track.

I am a buyer on a bad day. I think they will win enough FSRU contracts to take the dividend to \$3 in five years.

VALEURA ENERGY (VLE-TSXV)

Valeura is managed by Jim McFarland, who built and sold Verenex Energy in Libya to the Libyan government (who actually stole it but that's another story). The stock caught fire today – up to 49 cents - as National Bank Financial, a Canadian brokerage firm, came out with an aggressive 95 cent target.

The company just raised \$86 million at 32 cents with a half warrant at 55 cents to pay for part of a Turkish joint venture that includes 440,000 acres. Valeura is paying 60% for 40% WI (working interest).

However now there is 636 million shares out, and the company added 10 million cubic feet per day of gas production (that's \$8 gas with \$6 netback) and reserves of 10 bcf (billion cubic feet). That's not very much. Shallow wells have 0.5 bcf targets, and deep targets have IP targets of 3-4 mmcf/d – again, not big.

There will be 18 net wells drilled this year on this package for Valeura. And there could literally be hundreds of wells on a land package this size, but that will take time and capital. There are a lot of targets, but nothing big and special in this package – that could fill the value vacuum the share structure has created.

However, the market is clearly more enamoured with this transaction than I am so I will be calling Jim to get a better understanding of the plan around these assets.

In my view, the stock will continue to trade on the theory that management past successes' will keep the deal flow high, and other acquisitions will be made, and move production and reserves higher faster.

I'm not a buyer, I'm not a seller.

CGX ENERGY OYL-TSX – (see write up ISSUE 43 Jan 30 2011)

Bad weather has delayed the offshore drill rig that CGX will be using for its big drill punt off the coast of Guyana/Suriname on the northeast coast of South America. This is a huge target – potentially 300 million barrels net to CGX. The ultimate drill punt. I think this is actually good news, as more speculative premium can work its way into the stock. Investors are still expecting to see results from another couple wells that will be drilled in the Guyana Basin before the CGX drill turns.

It will also give CGX management more time to find a partner for their working interest in the well, which now sits at 25%. They would happily go to 12.5% carried. They also have a 100% interest in another well in which they are searching for a partner – but won't realistically get one until somebody hits in the Guyana Basin.

I already have my position and I'm not a buyer, I'm not a seller. I am looking to sell my cost out before drilling results come out.

BORDER PETROLEUM (original write up Bulletin 39 Jan 6 2011)

I bought this stock as I was looking for another junior that was active in the very hot Slave Point play in north central Alberta that Pinecrest Energy (PRY-TSX) had made newly famous. That stock went from \$1.30 to \$2.80 very quickly late last year.

Border CEO Kelly Kimbley (a real gentleman) has spent the last two months putting his own management and board of directors in place. His CFO used to work with Bountiful Resources, a 3000 barrel a day private co that was active in Slave Point, and new board member Hal Jamieson also has experience in that area.

Getting the right people in place is the most important first step in a young start up company like Border. I think they're doing a great job in recruiting the right people with the right resumes. I expect an operational update in about two weeks.

BENGAL ENERGY - BNG-TSX

My report on the company is complete and posted to the Members Centre. Bengal is well financed, and has two for sure and potentially three large targets to drill this year, and several smaller targets. I don't expect the stock to trade higher until they announce drilling at the KingTree prospect in the Timor Sea in April or May.

But I would draw your attention to their latest release – and I'm not picking on them here as everybody does this – they announced “prospective oil and gas resources”. I'm actually going to do a story on this in the public blog next week. How do they come up with these numbers? Because sometimes these prospective resource numbers – like the ones for TAG Oil's Waitangi Shale in eastern New Zealand – are in the tens of billions of barrels of oil on properties that have had either no work or little work.

Again I'm not picking on TAG (they actually subscribe!) but the point is there is a bit of a game here that public companies play to be able to throw out some big numbers to impress investors. All I really want to say about this is, investors should not necessarily pay any real attention to what the actual prospective resource is – just know that it's a big target and nobody really knows what amount of economic oil or gas is underground on a property until its drilled.

This “prospective” term, and the resources it defines, is...what family word could I use here? Recyclable?

To me, each sentence in this Bengal release is remarkable in its effort to convince you that the author has a sense of what is real. To be fair, 3D seismic and nearby fields that are analogous

can help improve a guesstimate of resources, but this language should give every investor a reason question what this could really mean (which is basically nothing):

The resource estimates in this report are classified as undiscovered petroleum initially in place (undiscovered PIIP) and prospective resources. How can they tell me what's undiscovered?

COGEH defines undiscovered PIIP as that quantity of petroleum that is estimated, on a given date, to be contained in accumulations yet to be discovered. It took millions of years to cook the oil and they want a date?

COGEH defines prospective resources as those quantities of petroleum estimated, as of a given date, to be potentially recoverable from undiscovered accumulations by application of future development projects. Read that last clause and try not to blink.

Prospective resources have both an associated chance of discovery and a chance of development. That would be a given.

The undiscovered hydrocarbon resource volumes and prospective resource volumes presented in a table are unrisks. The term unrisks means that no geologic risk (chance of discovery) and no commercial risk (chance of development) have been incorporated in the hydrocarbon volume estimates.

Here's a SIMPLE guide to reserve and resources sent by a friend of mine in the oilpatch:

Reserves Are Like Fish

Proved Developed:

- The fish is in your boat.
- You have weighed it, you can smell it, and you will eat it.

Proved Undeveloped:

- The fish is on your hook, in the water, by your boat, and you are ready to net it.
- You can see how big it is (they always look bigger in the water).

Probable:

- There are fish in the lake and you may have caught some yesterday.
- You might be able to see them, but you have not caught any today.

Possible:

- There is a lake,
- Someone may have told you there are fish in it,
- You have your boat on the trailer, but may go golfing instead.

Prospective Resources:

- Someone told you there is a lake.

WAVEFRONT TECHNOLOGY WEE-TSXV

Without new orders, the stock will continue to drift. If it cracks 90 cents it will likely hit 70 cents, which is where it started that beautiful run to \$3 last year.