BULLETIN # 51 – MARCH 23 2011

PORTFOLIO UPDATE (JUST ABOUT EVERYTHING...)

MARKET COMMENTS

The junior oil and gas stocks continue to have low volume, and correcting. Nothing has changed since my last update in that regard – the more "senior" junior stocks that are well funded, have production and reserves (North Sea, PetroFrontier, TAG etc.) are doing MUCH better than the start-ups (the speculative part of each section in the portfolio).

The Japanese earthquake has the global market thinking that LNG and gas will replace much of Japan's nuclear power until the reactors there are declared safe. I'm not sure how long that idea will last – but it has sure helped some senior producers' stocks.

As the US dollar continues to go lower – it is showing it is not a great safe haven right now – the market is going higher. People are protecting their wealth in the market. If QE2 really does end this summer in the USA, it will be interesting to see what happens to the equity market? Interest rates could rise quickly, which could suck money out of the equities into higher yields or it could make the market go higher as the dollar moves lower.

Technically, today was a GOOD day as the market went back above its short term moving averages. The markets are at an inflection point, in that regard. Tomorrow is important, short term.

There are many people smarter than me about macro-economics – I'll just stick with what I know best, talking about junior resource stocks.

NORTH SEA PLAYS

STERLING RESOURCES (SLG-TSX)	**see Dec 2009 original report**
ITHACA ENERGY (IAE-TSX)	**see Jul 2010 original report**
CANADIAN OVERSEAS (XOP-TSXV)	**no report yet**
IONA ENERGY (not listed yet)	**no report yet**

I recently made the North Sea oil plays of Sterling Resources and Ithaca Energy two of my top picks in the OGIB subscriber portfolio, because both companies are well funded, and strong growth in production and cash flow are already baked into these pies. There is no geological or financial risk and I said the only enemy was my own patience.

Well, a higher tax rate is also an enemy. Out of the blue yesterday, the UK government raised taxes on North Sea production from 50% to 62% based on higher oil prices. There was no consultation with industry, and the government said that if oil were to go below $75 then it would lower taxes. The Fair Fuel Tax they call it. Lovely.

The economic reality is that this new tax won't affect *the juniors* much for the coming 2-3 years as they have large tax pools that effectively shield them from paying any tax for that long. But the stock price reality is that investor sentiment towards these stocks will – and is today – taking a hit. Institutional investors in the junior energy space are now looking for excuses to sell stock and the UK government just gave them one.

I expect weakness in all these North Sea stocks in the near term until the institutional crowd sees such compelling value that they have to buy them. Of course, this bad news comes during the beginning time of seasonal weakness in junior energy stocks.

Individually, Sterling will be announcing Cladhan rates sometime in the next couple months and speculation around that well should help its share price.

Ithaca does not have any material news for several months, when its new production from the Athena field comes on stream. Production estimates for Q1 were lowered 20% recently as mechanical issues on a drill platform have interrupted production.

Canadian Overseas Petroleum CEO Arthur Milholland and I have been playing phone tag for a couple weeks. The market is waiting for management to outline the drilling timeline for its North Sea plays.

The company is chasing a very specific geologic target in each of its plays – "Paleocene oil accumulations trapped stratigraphically in Channel sands" which is very similar to what Sterling is drilling for at Cladhan right now. This is the former Oilexco team, which had very strong geologic success in that company (but not so good financial success, ahem – their banker went near bankrupt in the 2008 crash and management lost the company).

The PowerPoint that Canadian Overseas circulated last fall to raise its $130 million said it was going to drill two prospects in Q1 and Q2 2011 – Newt, Lower Toad and Bluebell – but the website now says that two other prospects will be drilled first. This confusion is not helping the stock, and it's a bit unusual for a company to have raised that much money and not have a

PowerPoint presentation on their website. This weekend I will be working on my reports for PetroFrontier and Canadian Overseas.

PETROFRONTIER (PFC-TSXV)   see March 2011 Purchase

PetroFrontier is chasing a Bakken look-alike shale oil play in Australia called Arthur Creek. Within days of my purchase (the bottom day of the stock ;0) two brokerage firms – Macquarie Capital and Cormark Securities – initiated coverage of PFC as well. So my timing was good (and I'll be telling you below about a couple my timing was not so good on) on this one.

They originally optioned this land from a small junior in Canada called Texalta (TEX.A-TSXv), and PFC had 64% of the play, which is some 13.6 million acres.

On Monday the 21st PFC announced they were buying Texalta for a combination of $10 million cash, and stock to bring the value of the deal to roughly $68 million. This transaction brings PFC's net working interest on this huge land play to 85.5%.

Texalta also has some small Bakken production in Saskatchewan, which I would expect PFC to either sell or create a new spin off company with – but only after drilling success in Australia.

The next catalyst for this stock should be mid-April when they are expected to announce the spudding of their first well in Australia. Now that Toreador drilling is delayed, this will be the first big international shale oil play to get drilled and the company has a lot of eyeballs on it.

LYNDEN ENERGY (LVL-TSXv)   see Jan 29 2011 original report

My "No-Brainer #1" has been the worst performing stock in the OGIB portfolio. **:0(**

Over one third of all OGIB stocks jump 50% or more in the first month after being included in the portfolio.   The reason for that is, IMHO, is because one of the things I think I bring to the table for subscribers is my nose for when a company is about to get discovered by the market.

I was obviously a little early in including Lynden. Fundamentally the development on the ground continues in its 43% owned Wolfberry play in the Permian Basin of Texas. Seven wells will be spud by the end of May, and in a perfect world we could see IP rates of close to 100 bopd each. 7 wells x 43 bopd = 301 bopd net new barrels of production to Lynden could be happening by the end of Q2.

Mitchell Ranch however is proceeding a bit more slowly than I expected. They have drilled two "technically successful" wells here, but neither produced anywhere close to expectations. On the MR-17 well very near the western boundary of the property they are planning to drill an uphole section that Lynden and CrownQuest, the operator, believes to be prospective. It's unclear if they will drill a new hole to do this or re-enter the existing hole. This well is very close to a great producing well on the other side of the Mitchell Ranch boundary, and as yet nobody is able to say exactly why these two wells that are so close have such different results.

The presentation on the website shows an outdated share structure and no production data. Lynden does have production. So that's a bit disappointing that's not being looked after.

The stock trades weakly – low volume, no bounce after last week's sector wide junior oil pullback. So management needs to do a better job sharing the potential that I see with others. In this market I don't think spudding a well will move a stock (2 months ago it would have), so I see no big catalyst for the stock until results from the first couple of the current seven Wolfberry wells are released.

ALBERTA BAKKEN

Bowood Energy (BWD-TSX) **see Dec 19 2010 original report**
DeeThree Expl. (DTX-TSX) **see Dec 19 2010 original report**
Primary Petroleum (PIE-TSXv) **see May 19 2011 original report**

After a great run up in late 2010, these stocks finally took a breather and the stock charts have consolidated, allowing the moving averages to catch up to the stocks.

Late last month it became known that Crescent Point's first three wells in the Alberta Bakken were not very good, and had found an unexpected source of water.

Both Primary and DeeThree are trading right at their recent financing prices, as the market digests all the free trading stock issued.

Bowood today announced that it and partner Legacy Oil and Gas are spudding their first well in the Alberta Bakken, and say theirs is 28th well licensed in the play on the Canadian side. So there should be a lot of news coming out over the coming months.

Subscribers should understand that the speculative run in this play is now over, and these stocks will now go up or down on actual results – not theoretical land values. The easy money is now made and the Truth Machines (drills) are turning. Should the next few well results be positive from players like Argosy, DeeThree or Crescent Point, that speculative premium could infect the whole play again, but remember this is now a much more cautious junior oil market than it was three months ago.

For Primary Petroleum in particular it could be a long spring/summer as they may not be drilling for awhile. They are currently looking for a partner in their play. The good news is that they have had increasing interest from larger players so the Joint Venture Dance is taking longer. But that's not necessarily a bad thing.

EQUAL ENERGY (EQU-TSX)   see Dec 6 2010 original report

The stock has been rising strongly after news that Equal and its bankrupt partner in the Hunton Oklahoma gas play, Petroflow, may reach a settlement in their ongoing legal dispute. Management didn't want to say anything until news is out, but somebody is pricing in a favourable resolution! (It would sure make sense for Equal to BUY Petroflow...)

They also announced their yearend results, which in terms of production and cash flow were in line with my expectations. 9100 bopd, good new management and the balance sheet has been fixed up with some new convertible debt.

So in this market where a lot more caution is present, investors are looking to larger junior companies, and cheap defensive valuations vs. the big growth stories. Equal is clearly benefitting from this trend. The stock has a low valuation, though it also has low profitability ($18/barrel, or $18 *netback)* and low to no growth this year. Given those last factors**, the stock has exceeded my expectations this quickly.** But I would add that I like management and the job they're doing.

I bought the stock last November anticipating that common sense would rule and their court action with Petroflow would be resolved in Equal's favour. For the most part that has happened, and now they can start drilling their liquid rich gas play at Hunton (the NGLs are butane and propane, NOT higher priced condensate) just as natural gas prices are on the rise, and the price of propane and other NGLs is also soaring. What's happening is that natural gas production in North America is getting continental pricing, but the NGLs are getting WORLD pricing. That makes it much more profitable for refineries to pump as much product through as possible.

Right now gas is having an emotional pop on the Japanese situation – though the gas stocks have been saying for a couple months now that gas prices aren't going as low as many analysts think this year. Time will tell how long this Japan factor lasts.

The stock also has very few shares outstanding – about 27.7 million, giving it a lot of leverage for investors.

Canadian Energy will pay a cash dividend of 12 cents per common share on April 15, 2011, to the shareholders of record at the close of business on March 31, 2011, representing an increased dividend of two cents per common share to the monthly dividend.

CANADIAN ENERGY SERVICES – (CEU-TSX) see April 28 2010 report

Canadian Energy Services is a drilling fluids company. It's easier to call it a MUD company though, because their core business is concocting and selling proprietary, high tech drilling mud.

Mud is put down the hole to ensure that pressure from the oil and gas doesn't blow back up through the well. The more down hole pressure there is the more dense the mud must be. It also sweeps the away the drill bit cuttings and several other useful functions.

They announced their yearend financials recently and all I can say is WOW. What the team at CEU has done in the last 18 months is nothing short of remarkable. They have acquired and successfully digested two US acquisitions – which gave them about 2% market share in the US at the time – and have already organically grown their presence to 7%, and a big chunk of it is in the Marcellus shale (I will explain why in a minute.)

Unfortunately, few subscribers bought the stock as it was thinly traded and $15 at the time, but it did pay a dividend. My premise for the investment was that the market was not appreciating what a cash cow this company is, and I expected them to increase their dividend of six cents a month.

They have now upped it 3x – once to eight cents, then to 10 cents, and now at 12 cents a share per month – so I am now getting paid roughly 9% dividend. (Many more subscribers bought Golar which is a dividend paying company I bought for the same reason.)

The quick numbers are annual revenue up 178% to $249.1 million, Q4 revenue up 246% to $94.5 million, EBITDA (Earnings Before Interest, Taxes, Depreciation and Amortization – a rough equivalent to cash flow) margin down slightly to 29% and annual EBITDA up 320% to $41.5 million. What do you do for an encore on that?

Growth should continue, though it's hard to say at what pace. What CEU muds do really well is make the well bore slippery, so the horizontal part of the drilling actually goes much faster. Gravity looks after the vertical part, but CEU muds have made drilling a well go from 28 days in the Marcellus down to 19 days in some cases. That saves the producer a LOT of money.

As horizontal drilling continues to increase market share, CEU revenues and profits should increase. Horizontal legs are getting longer, and where they are not getting longer they're getting put more closely together, so revenue per day is increasing – up 23% and 37% in the Canada and the US, respectively. Fluids are getting more complex and expensive.

I had a brief email exchange with CFO Craig Nieboer, and I asked him how they have been so successful in the Marcellus Shale and what that means to CEU. He wrote back:

“The Marcellus in PA (Pennsylvania) is running almost exclusively hydrocarbon based muds. We have the only DEP (Dept of Env.) permitted storage and blending facility in the state located in West Decatur, PA. We are looking to spot another one in the state.

“This facility allows us to "build" the mud at our facility and deliver it to a rig site which is a big advantage to us over our competitors. We also believe ABS40 and PureStar (a new salt free synthetic system) have operational and environmental advantages over competitive alternatives.”

So just like GasFrac, CEU has a competitive environmental edge in their business.

They also have a product that is being used in the oil sands – TarDrill, which is used in SAGD (Steam Assisted Gravity Drainage, where they heat two pipes in the oil sands and the oil melts into the bottom one – roughly speaking), and trust me, if you can get a technology/product accepted *there*, that will mean big money over the next three decades.

Average analyst targets for 2011 revenue are $430 million-ish, which is up 75% from $246 in 2011. Cash flow projections range from $73-$80 million, again a 75-90% increase. Price targets for the stock range from $35 - $40, but if those guesstimates on the financials come true I would expect much higher targets well before year end – especially as well licenses and drill rig utilizations still trending upward across North America.

More...

WAITING ON....

DRILL RESULTS FOR

- TAG Oil on their New Zealand Taranaki Basin play
- Torquay Oil Corp on their Lake Alma play
- Border Petroleum on their recompletion program at Red Earth in Alberta
- DeeThree Exploration on their first Alberta Bakken well (waiting for frack crew)
- Donnybrook Energy for first Resthaven well with Celtic
- 3P coalbed methane results in Ukraine

THESE SHOULD ALL BE HAPPENING IN THE NEXT 30 DAYS!

SPUD DATES FOR

- Bengal Energy on their Timor Sea play
- Lynden Ventures on Mitchell Ranch in Permian Basin in Texas
- Toreador Resources on Liassic Shale play in France (summer 2011)
- Canadian Overseas Petroleum in the North Sea

MISCELLANEOUS COMMENTS ON OGIB PORTFOLIO STOCKS

BENGAL ENERGY – is raising $20 million at $1.80 and if I wasn't fully invested I would buy 5000 or 10000 shares. The $1.20 financing was for the Timor Sea, this gives them lots of capital to go after Australia.

PEYTO – going up with natural gas prices – it's the lowest cost intermediate sized gas producer in Canada and therefore I use it as my personal ETF on gas prices in Canada. Time will tell if Japanese earthquake was a game changer in psychology on North American gas stocks – Encana and EOG, two gas majors have had big runs since the quake as the market expects increased natural gas shipments to Japan to stretch an already tight global LNG market – HOWEVER – shipping data shows that natural gas is not being diverted from anywhere to Japan in any great quantity. So this blip may not last. **:0(**

GOLAR LNG – while natural gas available to Japan is plentiful, the ability to ship it there is not, and GOLAR has been on a huge run up now that the focus of the market is on this niche industry. Chairman John Frederiksen has also said he wants to make GOLAR bigger and better, and his comments brought more volume into the stock. The stock is so much in the limelight

I’m tempted to sell some, but I only have 2000 shares so I will hold. You buy stocks in the dark and sell them in the light.

WIND RIVER – no news but it trades very well. I don’t expect any news on them acquiring land packages in the Niobrara formation in northern New Mexico for at least a month or three.

TOREADOR – well I missed that trade at $18, a double, though I did say if I had a bigger position I would selling some as soon as the French government announced its study on fracking. Small cap NASDAQ stocks are crazy volatile. I’m told that French President Sarkozy's god-son is on the board but have to confirm that. They can still drill strat wells – vertical wells to test the rock stratigraphy, i.e. how it’s laid down over the eons. At this point I expect the stock to go lower until the report is out in April – if it doesn’t get delayed, ahem.

DONNYBROOK – I saw that GMP Securities was the biggest buyer today. They did the ***bought deal*** financing at 75 cents, which means they guarantee the financing money to Donnybrook, as opposed to a best efforts basis. Anything the market is allowed to know, they know ***;0).*** The fact they are still buying at these levels gives me comfort. Hopefully their investment bankers are lining up the buyer for Donnybrook.

Talk again early next week! And welcome to all our new subscribers who got in under the wire before our price increase! All feedback welcome.