BULLETIN #65 – JULY 25 2011
IONA ENERGY INA-TSXv – COMPANY ANALYSIS

Iona Energy right now is a very simple story, which is why you will see this report is smaller than most. It just came public at 60 cents, and is cashed up with $67 million – which should be enough to last them until the end of 2012. With successful exploration, one analyst (the only one so far) expects 2012 cash flow of $0.64 – which on a 5x multiple could give a $3 stock price in 18 months. That's a six bagger from here at 50 cents.

So that's the prize; the reason I bought the stock (and the fact management has built up an international junior before).

I bring two things for subscribers to consider, one positive and one negative. Positive – the market does not appreciate how low risk these wells are. Geologically, they are basically zero risk as they are being drilled into known productive reservoirs – one twinning a hole in 1998 that hit 2850 bopd vertical well, and one just updip from existing producer.

Negative – market wouldn't care right now if they did know that. Subscribers should keep in mind that right now, summer 2011, this type of international junior oil play is not investors' favourite – in fact this has been the hardest hit sector of the energy stocks I cover. And what that could (likely) mean is that the stock might not perform until exploration success – despite production and cash. Think of Ithaca losing 30% in four months, when it has production and all the money it needs to get its next two assets into production.

I'll briefly explain their first two plays, and mention a couple things that could cause them to raise money sooner than expected.

Trading Symbols:	INA-TSXv
Share Price:	50 cents
Current Production:	450 boe/d (going to 650 once compressor is fixed)
Basic Shares Outstanding:	144.2 million
Market Cap:	$72.1 million
Net CASH:	$58 million
Enterprise Value (EV)	$14.1 million
EV per flowing boe	$31,333

http://www.ionaenergy.com

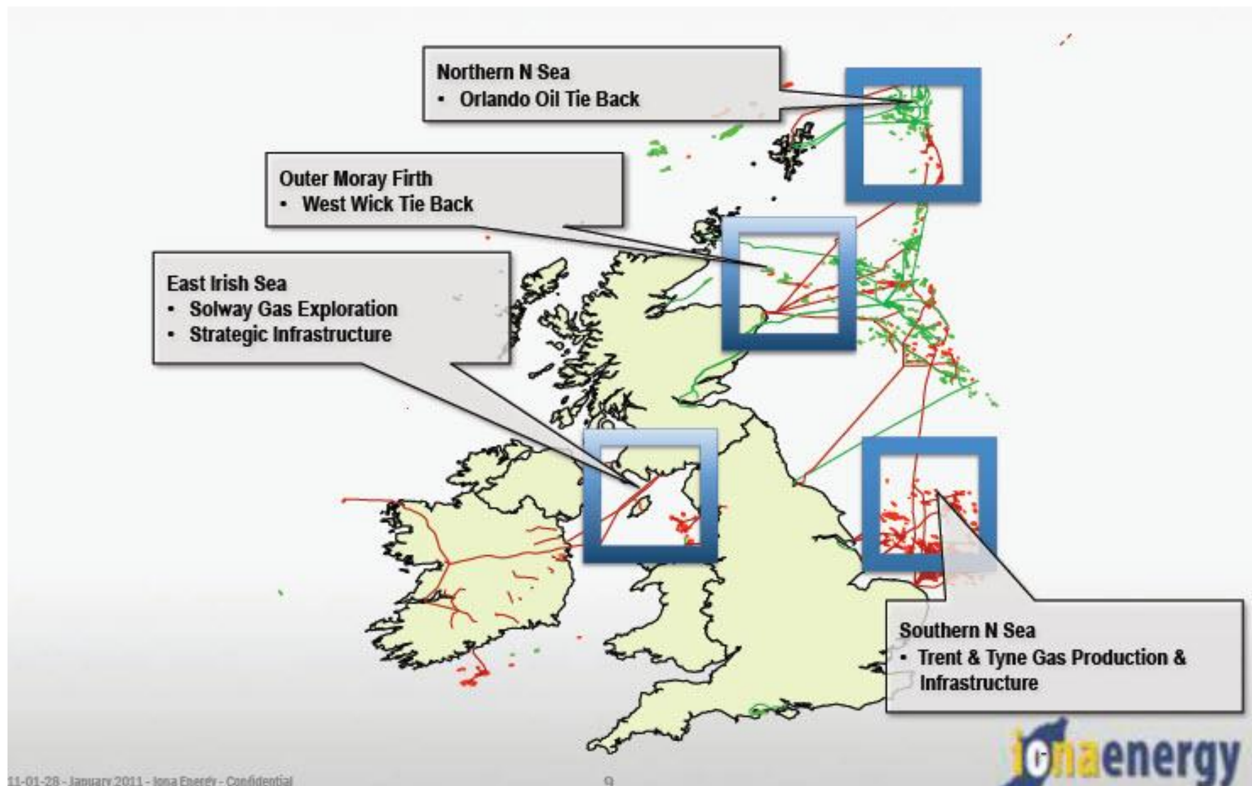
POSITIVES

-management--founders of Ithaca Energy—have built up international junior play before
-low risk development plays—first 2 wells are tapping known productive reservoirs
-exploration on Orlando oil play spuds right away
-cashflow on $8.70/mcf gas in UK is covering G&A

NEGATIVES

-this type of play is out of favour; so I don't see any increase in share price until results are made public—North Sea in particular has had some wells miss lately (Sterling, Ithaca)
-this means that should any new play come along that would require capital, it will probably be raised/issued at big discount to NAV – therefore dilutive

PROPERTIES

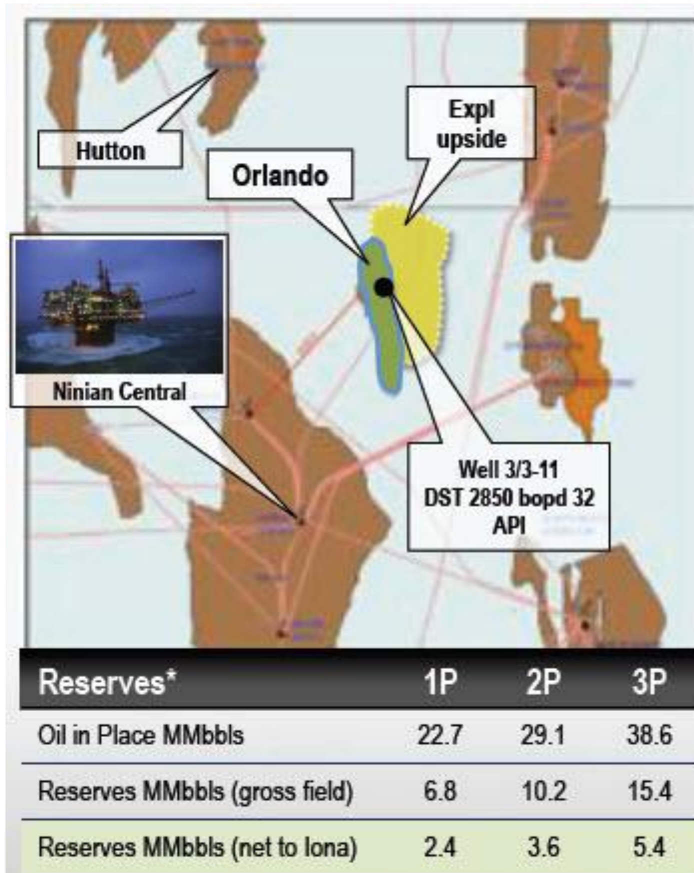


ORLANDO

You can't say any offshore oil well is risk free, but this one comes close. They are twinning a well that was drilled in 1998 that hit oil. The difference here is that they will be drilling updip in the structure from the original well, and expect to hit more pay (a thicker column of oil). The

original oil column is 146 feet. And the second difference is that they will then exploit this well with horizontal technology, which wasn't in the plan in 1998. The well tested 2850 bopd then.

The three partners at Orlando (Iona 35%, MPX 30%, Sorgenia 35%) will spud the Orlando well late July 2011; Iona's share of the cost is $11 million (42.5% for 35% WI—a small promote). Getting it into production - development work - will be another $20 million net to Iona (no promote, straight 35% WI).



Reserves*	1P	2P	3P
Oil in Place MMbbls	22.7	29.1	38.6
Reserves MMbbls (gross field)	6.8	10.2	15.4
Reserves MMbbls (net to Iona)	2.4	3.6	5.4

Iona CFO Brad Gunn said in an interview that when Chevron drilled this well in 1998, big majors like them were looking for fields with 300 M – 400 M boe reserve potential. Orlando is a 30 M boe field. So they plugged and abandoned it. During the financial crash of 2008, some of the players in the well wanted out and Iona paid $3 million to get their 35% interest.

Considering that $3 million got them 3.6 million barrels net of 2P reserves (1P=2.4 M net), that works out to 83 cents a barrel – which they could now sell for $20 per. That's accretive buying (Tuscany Drilling management – please take note!)

Orlando is 9 km away from the Ninian platform owned by Canadian Natural Resources, and there is already a deal between the two companies to have Orlando tied into Ninian via sub-sea pipeline. All the tie-in work, including some changes to the Ninian platform, will be a net cost to Iona of $20 million. Gunn called Ninian a "hungry host", an old platform that the operator would like to keep working as long as possible to avoid high abandonment costs.

Production is expected to be online in Q3 2012 and produce at 9000-11,000 bopd – Iona gets 35% of that (3150 bopd says Iona powerpoint). Gunn said that management expects the well to decline 30% in the first year and 15% thereafter, and have a producing life of just over six years. Payback is 8-9 months; very profitable.

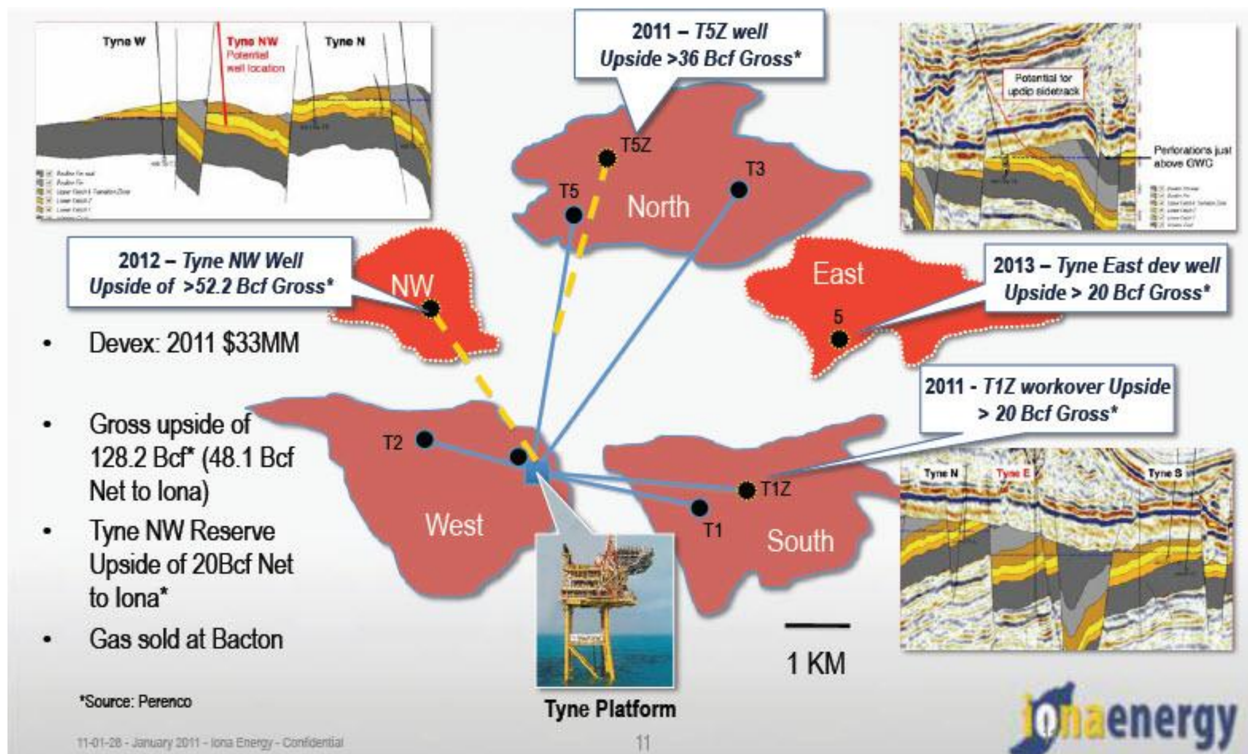
(But remember the market would pays more for longer life reserves – even if that same amount of oil came out over 25 years, and was a sure thing, the market would value the production higher than it does with just a (much more profitable) 6 year reserve life. Strange but true.)

This reservoir has a very porous 17% porosity and permeability of 400 millidarcies to 1 Darcy. At those metrics, the 1000 foot horizontal leg does not need to be fracked. I was surprised to hear they expect to drain the entire reservoir with one small 1000 foot horizontal. It's a great reservoir.

After the well is successfully drilled, management is hopeful they will be able to use the reserves at Orlando to access up to a $25 million debt line that would allow them to delay raising equity (this is important; if they don't get it will affect the stock price).

TRENT/TYNE

Their gas play, Tyne, already has production and Iona's share of that is now 450 boe/d. Late in 2011 Iona will spend $32 million on a gas well that, if it meets expectations, will increase their production to 1300 boe by early 2012.



As with Orlando, Iona is participating in drilling a well at Tyne that will "sidetrack" an existing well. Basically they are drilling very close to the existing producing well, just higher up in the reservoir where they hope to hit 4x the 49 feet of pay the current producer has. They are drilling into the same reservoir as the producer so exploration risk is essentially zero. Execution (drilling problems) should be the only possible problem.

The Trent platform has four wells now producing about 8-10 mmcf/d from each, but historical initial flow rates at the field averaged 49 mmcf/d per well.

As part of Iona's deal into this project – they will spend $32 million to earn a 20% non-operating interest in the entire play -- they received 650 boe/d backdated to last September (2010). This is now providing $400,000 in monthly cash flows, says Gunn.

If this first Tyne well meets expectations – which would be roughly 3000-3500 boe/d, or 650-700 net boe/d to Iona -- their production would go up to 1300 boe/d sometime in the first half of 2012.

If that well is successful then Iona has the option to drill another well for $33 million net cost which would take them to 37.5% of Trent/Tyne (immediately bumping their share of current production to 2450 boe/d at Tyne) PLUS 37.5% of whatever the production would be from this second well (estimated to be roughly net 1900 boe/d). This would happen in a perfect world in April 2012, and would take their net Tyne production to 4350 boe/d.

So there could be $32 M capex for Q4 2011 well + $33 M capex for Q2 2012 well at Tyne for total of $65 million budget just there. Management estimates a 15 month payback for this investment. Management would likely have to raise equity to do the second well because....

WEST WICK

West Wick reminds me of Xcite Energy – a beautiful reservoir. It's shallow, with 30% porosity, 7 Darcy permeability (both of those numbers are **very** generous; good). It is a mid grade oil play in the North Sea, in which Iona could purchase 58.73% for an undisclosed amount. There are 3 previous wells in the reservoir which show a 350 foot column reservoir containing about 50 million barrels of OOIP (Original Oil In Place) of 20 API oil (mid grade, bordering on heavy) that could be sent via sub-sea pipeline to the "Captain" platform 10 km away.

Management estimates the initial well would produce 10,000 bopd gross (5800 net to Iona) and have a 6-7 year life. In a perfect world, they exercise their option to buy the interest, get a deal done with the owners of Captain to take their oil, get the debt from Orlando and use cash flow to buy the interest, and drill the well, with first production in 2013. *Without a deal with Captain, the capital costs of this project get very high very fast.*

There will be a real art in capital management here as the Iona team figures out the best way to allocate funds to minimize dilution between West Wick and the second Tyne well. But that's what they get paid for.

The other art, through all this, is bringing on new assets. All these offshore assets have short lives of 6-7 years, and that's a steep curve of declines.

The Irish Sea asset is not relevant to valuation at this time so I'm going to save a tree and not talk about it.

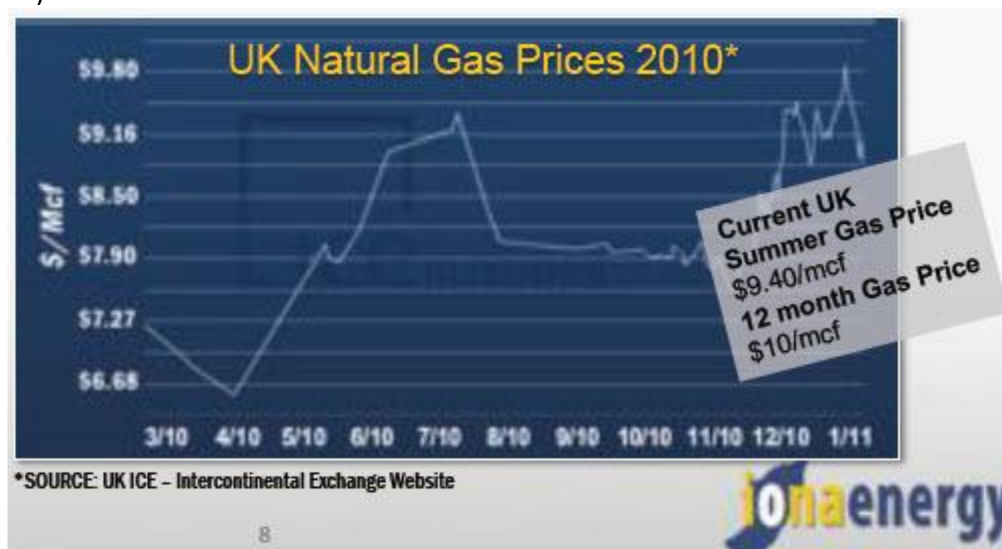
FINANCES

Iona raised $69,859,000 gross on their first public financing, let's say $65 million net after commissions. They are spending $32 M at Orlando ($11 M drilling + $20 M development) and $32 M at Tyne (for one well), for a total of $64 million to the end of 2012. That should take them to a production level of roughly 4450 bopd, with 70% oil weighting. The second Tyne well would cost $32 million but also bump production by 1950 boe/d to 6400 boe/d.

The lone brokerage research report on Iona is forecasting cash flow of $7.9 million this year and $93 million in 2012 (that does include the 2nd Tyne well). Gunn estimated 2012 cash flow AFTER CAPEX would be $38 million.

Combine that with the $25 million debt that Gunn is hoping to access this year leaves the company a lot of options on how to fund the 2nd Tyne well and West Wick. But it will still likely involve raising some equity, unless they bring in a partner on West Wick.

Management estimates total capex in 2011 and 2012 to be $88 million, including West Wick and the second Tyne well. So getting that extra $25 million debt line from Orlando reserves would make a difference in needing to raise equity (raising equity, or issuing shares, acts as a cap on the stock – the market will sell down a stock that needs money. The stockbrokers always win.)



VALUATION

This is a tough one to value. The one research report on Iona says the company has 2P NAV (the Net Asset Value based on a 50% chance of an independent reservoir engineering company estimate of how much oil could be there, actually be there) of $1/share and estimates 2012 cash flow to be 64 cents. According to the June 20 2011 BMO Nesbitt Burns weekly valuation tables, their coverage universe of international producers trades right now at an average of 3.8x 2012 cash flow.

My own sense of fair play says a 0.5x 2P NAV (Net Asset Value) valuation for a start up with no production increases for 7-8 months is valid, if not high in this market. It wouldn't even surprise me to see the orphaned, abandoned ones trade at 0.3x NAV. In January-February this year that valuation would be closer to 0.7x—0.9x NAV, but not now, not in this market. However, it is trading below cash + IP reserves (the Net Asset Value based on a **90%** chance of an independent reservoir engineering company estimate of how much oil might there could be, actually be there), which is cheap.

The stock is trading at less than 1x 2012 cash flow but this isn't unusual given the start up nature of the company. *It will be interesting to see if the Orlando well meets expectations and the market decides to price in some of that cash flow a full year in advance*. Should the overall junior market improve (and I am expecting a much better second half 2011 than most), the rising tide should lift this boat with that news.

(A better website would also help valuation; really.)

WHAT THE ANALYSTS SAY

FIRM	TARGET PRICE
Wellington West	$1.20

STOCK CHART

It's only been listed for 3 weeks – not relevant. It trades 45-50 cents. All internal indicators are negative – OBV, RSI, MACD actually about zero. I'm saving another tree here.

CONCLUSION

I bought this stock in the early spring; in a different market before Sterling missed on its Cladhan oil play in the North Sea and when junior stocks were trading at higher valuations and on more optimism.

So when the stock came free trading, I knew it would trade below its 60 cent issue price. And it likely will do so until management releases news on its Orlando well sometime this fall. Even then, these junior companies with bloated share floats usually have a worse time mounting a comeback without compelling economics (Tuscany, Lynden and Donnybrook shareholders take note).

But the company does not need to raise money and it does have $400,000 a month in cash flow right now. Gas prices in the UK are $9/mcf, better than I would have expected at this time (I suspect mostly due to the Japanese earthquake, when the world said nuclear is out and natural gas is in).

On the positive side, I believe the market really doesn't appreciate my sentiment that these two wells are as close to zero risk as you can get. They are both tapping into reservoirs that are proven commercial, and are very close to wells that hit before.

I am long 100,000 shares at 60 cents.

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