

ISSUE #59 – MAY 28 2011-BI-WEEKLY WRAP
COASTAL ENERGY, GOLAR LNG
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COASTAL ENERGY– CEN-TSXv

Coastal's stock chart is looking great after The Bua Ban North B-05 well was drilled to 7,600 feet TVD and encountered 178 feet of net pay in the Miocene objective with average porosity of 27 per cent. That is exceptional thickness and porosity. The analyst at brokerage firm Canaccord Capital who covers the story estimated the well will do at least 1000 bopd.

The company's offshore production is currently averaging 8,500 barrels per day. Onshore production is averaging 2,000 barrels of oil equivalent per day, bringing total company production to 10,500 boe/d.

The company continues to have increasing water cut at Songkhla, its original main field (Bua Ban North could take over that title!) so new production is still just replacing existing declines from other wells, but Coastal is now 6 for 7 at Bua Ban North and those assets should add production over the coming months.

Jennings Capital has the highest target price, now at \$11, and Canaccord has a \$9.25 target. RBC Capital Markets discontinued coverage, saying "In our view, Coastal needs to broaden its portfolio to add significant catalysts and reinvigorate the investment case."

That could mean the short 6-7 year life span of the Gulf of Thailand wells is just too much to bother with, i.e. the company needs a large, long life asset to make it worth their while (think TAG, Petrofrontier, Toreador) or it could be analyst speak for "We are never going to get any corporate finance fees from these guys so let's spend our time where we can make some money."

So this well is great, news and as Bua Ban gets brought onstream I should see higher production numbers out of the company. My only concern right now is that although the stock chart is moving in the right direction, it lacks volume, so this is a low conviction move in the stock.

GOLAR LNG GLNG-NASD

On May 17, Morgan Stanley initiated coverage on Golar with a \$34 target. They had a separate bullish target of \$65 which could happen if:

- LNG day rates go to \$120,000 a day, up from the current \$85K-\$90K (which is up from \$30K nine months ago). This is the price that the Liquid Natural Gas shippers charge their clients
- Golar converts its current 3 idle LNG carriers into FSRUs (Floating Storage and

Regasification Units – basically offshore natural gas terminals) and obviously get contracts for them

-China adopts natural gas as one of their main sources of fuel – it's now only about 4% compared to 27% in US (it's a resource story so we must have the China angle covered).

Nothing they said about the macro LNG shipping or production situation has changed from when I did my initial report in January, though one statistic surprised me – global LNG shipping grew 21% in 2010. That is BIG growth.

Other than that, it's a tight shipping market, demand for gas will outpace the shipping industry's ability to keep up (4% vs 2.5% growth), and almost all the production coming onstream in the next decade – most of it from Western Australia – is already spoken for.

Remember, Golar is a yield play on LOW global gas prices. If gas prices are low, then LNG will supplant oil as the fuel of choice and the shippers will keep busy transporting it around the globe.

For new subscribers, the Japanese earthquake transformed the global investment community's opinion of LNG – they voted with their wallets, saying uranium and nuclear were out and LNG was in. LNG would become a much greater part of the world's total fuel much more quickly than before. And being as Golar is the only US listed company with available capacity that could take advantage of fast rising spot prices for shipping rates, the market has bought it up.

Golar is highly levered to global LNG shipping rates – Morgan Stanley said that every \$10,000 a day change in day rates meant a \$7/share change in the value of the stock.

Morgan Stanley said the \$34 target price represents a 3.5% yield. When I bought the stock it was a 6%+ yield, and I dreamed that one day the market would take it to a 4% yield.

Part of me wants to buy this stock back, for several reasons

1. Stock chart looks good—making me have some seller's remorse...
2. It is now the "Go-to" institutional stock for this sector.

But the market is building in a lot of future growth at this price already. The other thing to keep in mind is that Morgan Stanley said FIVE new contracts for FSRUs are expected to be awarded in 2011.

FSRUs are more profitable than LNG carriers – they are already at \$120,000 a day. In my initial report I wrote – "Each ship will create about 30 cents a share in dividends, which at the current 6% yield is good for \$5 per share on the stock (0.3 / 0.06). A 4% yield – which is where I think this dividend is going - would imply a stock price increase of \$7.50/share. So the market knows, or strongly believes assuming that the ship is operational on time, that an extra 30 cents a year is coming in 2012 dividends."

At \$1.20 annual dividend, the stock is now trading at 3.8% yield, so if the market is willing to keep the yield under 4% - and I would suggest in the post-Japan-earthquake world it will - any new FSRU contract win could theoretically cause the market to add \$7.50 per share to the stock. I would also say that Golar, now in a "honeymoon" phase with investors, would likely get a lot of credit for that very quickly in its stock.

Now, that \$7.50 was under the old share structure and now that they have bought most of Golar Energy, I don't know exactly how many shares Golar has out now. Nor has the company given clear guidance on the dividend policy between Golar LNG and the new Golar GMLP, so valuing the company is a moving target now – you can only believe that Chairman John Fredricksen owns 46% of Golar and he has a great track record in building dividends. His interests are aligned with mine, as a shareholder.

So reading that over, it makes sense I should buy the stock back as it has the 4% yield I expected it to have, the market now loves the story as I expected it to, so it makes sense the stock will hang around this price level until the market smells a new catalyst – either a new FSRU contract or having its 3 ships come out of drydock and take advantage of high spot day rates in the LNG market.

Another potential reason the stock is showing so much strength is what's talked about in this Reuters article

- <http://www.calgaryherald.com/Desperate+majors+seek+scarce+tankers/4841901/story.html>

The article was based on an interview with Ulf Ryder, CEO of privately-held Stena Bulk.

Stena acquired three LNG carriers from Taiwan's TMT in a deal announced last week and since then their phones won't stop ringing, according to their CEO. Mr. Ryder went on to say that "I have never, in 40 years in tanker markets, had the pleasure of an oil company executive calling me up to say they are interested in chartering a ship." He goes on to say that he has received calls from "all the majors" and turned down offers of \$105,000 to \$110,000 per day for up to two year charters in the hopes of securing something closer to \$150,000 per day. A \$150,000 day rate could generate \$50 million in annual EBITDA for an LNG carrier.

But in one sense I don't like buying back stock I sold at a big profit. It's my money now. And I generally don't do well buying back stocks I've sold for huge gains (Wavefront). I think I'm going to be patient, but ready to pounce if I smell something in the chart or on The Street.

IONA ENERGY

I first made mention of Iona in my now infamous "No Brainer" issue – Iona and Lynden Energy. Iona was founded by the founders of Ithaca Energy (IAE-TSX) and is going public on two North Sea assets – one gas (Trent & Tyne; 20%) and one oil (Orlando; 35%).

Iona will likely be going public sometime in early June – possible June 1. The company raised just under \$70 million at 60 cents. It will have 650 boe of gas per day production from Trent & Tyne that will be bringing in \$300,000 a month, and will be drilling its oil play – Orlando – in July. So there is production and a drill play.

There are reserves at Orlando – and independent report estimates proven reserves net to Iona of 2.8 MMbbls ("1P"), proven plus probable reserves of 4.1 MMbbls ("2P"), and proven plus probable plus possible reserves of 6.2 MMbbls ("3P").

I'll do a more comprehensive update on the assets around its listing date, once that is

finalized. But as I explain in more detail at the end of this week's wrap, I bought that stock in a very different market environment than what we have now. First off, Sterling has missed their last two oil wells at Cladhan, putting a damper on all speculative North Sea oil plays like Iona. And the overall junior market is much softer.

As a result, it will be interesting to see if Iona can hold its 60 cent IPO level. Like GasFrac, it could spend the first 4-8 weeks below issue price as the institutions who want out take a 10% loss and move on to wherever the hot money is going now.

Right now I would have to say the charts are telling me we are going to get a BETTER junior oil market than I expected. But these big share floats – 117 million free trading shares - generally don't do well for the first few weeks in this type of junior market.

LYNDEN ENERGY– LVL-TSX

Lynden finally did release company production number – they're doing 268 boe a day. They didn't say much else though. I'm still waiting for some progress report on Mitchell Ranch. In good news, Lynden was included in a recent research report on the Permian Basin (where their Texas properties are located) by Canaccord Capital. Every other company in there was much larger; some over \$1 billion market cap and then Lynden. So that should help with some exposure.

The Canaccord report had several positive things to say (but remember they're chasing corporate finance fees...)

- CrownQuest, Lynden's private company partner, was one of the first producers to deepen its wells down to the Mississippian limestone. So they're innovative, and I know Lynden helped push that agenda.
- In the Wolfberry trend, Lynden/CrownQuest are achieving some of the best results in the industry by drilling the Mississippian – one well is expected to recover 408,000 boe
- But average recovery is modelled at 190,000 barrels—still very good – in fact, spectacular – for a vertical well. There are 180 drill locations.
- CrownQuest also noted the recent “land rush” throughout the Eastern Shelf of the Permian – where the 100,000 acre Mitchell Ranch property is - suggest a horizontal Mississippian play is developing. I'm hoping this will be very good news at some point for the company – it builds up the story on the land play angle.
- At Mitchell Ranch - The Spade 17#1 well was initially fracture stimulated over 9 stages and included zones in the Mississippian, Cisco, Pennsylvanian, Lower Wolfcamp and Upper Wolfcamp. The company recently fracture stimulated the Upper Wolfcamp and is actively flowing this well back. Offset activity in this zone has been very encouraging.

So what this means is that the highly productive well just outside the Mitchell Ranch boundary had Upper Wolfcamp zone as its main productive zone. As the top zone, it would be tested last (but it has still taken several months for Lynden to do this – partially because of power issues). In any event, this Canaccord report says they have now begun testing the Upper Wolfcamp zone in the Mitchell Ranch well and if it is economic, well, Mitchell Ranch is 100,000 acres. That could support A LOT of wells. It's doubtful all of it would hold economic Upper Wolfcamp, but the market would likely start pricing in some of it. That would be nice.

PAINTED PONY (PPY.A-TSX)

Painted Pony issued an operational update which said they were now producing 4000 boe/d, and is now half oil/NGLs and half gas – an increase of 16% in overall production over Q4 2010. Again, the market is rewarding the stock – up 78 cents on well above average volume of 1.4 million shares – for its natural gas plays, not the higher profit Bakken light oil.

The Upper, Middle and Lower Montney formations respectively produced 6.4 million cubic feet of gas per day (mmcf/d), 5.8 mmcf/d and 7.7 mmcf/d from three different wells, but all drilled from the same pad. The upper and Middle tests were done over 10 days and the Lower one over five days. (1 mmcf/d=166 boe, 6 mmcf/d=1000 boe). These are great rates, and even more so when you consider the wells get 20-60 barrels of Natural Gas Liquids (NGLs or “wet gas”) per million cubic feet of gas. These NGLs dramatically improve economics of gas plays.

I find this release interesting because everyone knows there are multiple zones in the Montney but I don’t often hear of companies saying what kind of recoveries they expect to get out of each zone – just one zone.

I’ll be checking this idea out with analysts and management teams over the next couple weeks, but I think one of the reasons the Montney/Deep Basin gas stocks are getting rewarded – despite the fact they have higher “wet gas” counts, i.e. more valuable liquids like propane in them – is because the market and even the industry is still figuring out what they have here in the Montney. There is upside mystery in the play. And what they have is a multi-zone play that doesn’t always trade like one; it trades worse – I don’t think all the economic potential of these zones is factored into pricing in these stocks.

Each of these companies races to get a sexy IP rate out in a press release and then they have to figure out exactly what they’ve got. The many juniors in the play can’t afford to drill more than one zone in a well, and the big guys like Encana aren’t going to be giving anything away – all that data gets buried in their quarterly production numbers.

I am surprised I don’t hear more talk by the producers or see more visualizations for investors in powerpoints on the multi-zone nature of the Montney.

So God Bless Painted Pony Chairman Pat Ward for laying out the numbers in an easily read manner that could get analysts, the M&A guys (investment bankers) and the industry making a little adjustment to what fair value could be for these gas plays.

I was able to see what Tourmaline’s (TOU-TSX) idea of fair value was when they bought Cinch Energy (CNH-TSX) this week for \$1.77 a share. Last summer I bought a series of small gas companies in anticipation of a repeat of the 2009 Sept-Dec run in gas prices. It never happened, and I sold them all except Peyto. One was Cinch, as it was positioned in The Deep Basin in Alberta where Storm had been bought out by Arc Resources (ARX-TSX) last year.

I was right, I just lost patience. (Common theme in my investing life) But the stock did trade flat to down -- right up until the last couple days before the buyout ;0). As a shareholder in

another junior gas play looking to get bought out – Donnybrook - I should remember that fact. Not much joy until the game is over.

Before I get into the math, this deal is typical of what's happening in western Canada. Natural gas is now only a game for the big boys. Operating margins are too slim – if they exist at all - for juniors. (The word “netback” did not appear AT ALL in Cinch's Q1 report) And don't even mention full cycle costs, like including money for land acquisition etc. Cinch was a mostly dry gas producer that didn't have the funds to develop the wet gas component of their properties.

I want to give readers a different perspective on what this deal was worth. One analyst said the \$205 million deal for 3750 boe production = \$54,100 per flowing boe for production or \$18.13 per 2P barrel of reserves, after valuing the land at a standard \$150/acre.

But that is completely backwards. Tourmaline bought them for the land. The production is realistically worth – ok, IMHO its worth – oh, \$23,000 a flowing boe. It's 92% dry gas. And the company's netback (profit per barrel) was \$17.93, so nobody is paying \$18.13 for a barrel. It's all about the land. I'll use an even \$10/boe for 2P for easy math.

So if the deal is worth \$205 million, let's take out \$21 million for debt. It's now a valuation of \$184 million. At \$23,000 per flowing boe, 3750 boe=\$86.25 million, leaving the 87,600 undeveloped acres to be worth \$97,750,000, or \$1,115 per acre. Multiply that # by 640 acres to the section and TOU paid \$714,115 per section.

If I back out the 13.5 million barrels of oil equivalent (boe) reserves at \$10/boe, that's a valuation of \$135 million dollars. $\$184\text{ M} - \$135\text{M} = \$49\text{ M} / 87,600 = \560 an acre – almost half exactly as the cash flow valuation.

So split the difference and undeveloped land in the Deep Basin (assuming it's all prospective) is worth roughly \$840/acre.

That mental exercise is really only worth something to me if I'm looking at other junior buyout candidates with large undeveloped land positions. But it struck me that the analysts were using the wrong metrics to decipher what the real value was in the deal.

Back to Painted Pony and gas – the other notable thing in the release was that they have been able to get drilling a well in the Montney down from 30 days to 19 days. That will also have a clear (positive) impact on economics.

MARKET COMMENTS

A quick mention of the obvious in the junior energy stocks – the market has changed since early April. I bought a lot of the smaller drill punt stocks - Lynden, CGX Energy, Petrofrontier, Canadian Overseas Petroleum, Border – all the more speculative stocks in the portfolio – when the oil price was moving up, when the market was willing to fund these “story” stocks. Their only asset was their “story” about what could happen if they hit on their well.

I bought these stocks in anticipation of seeing some increased speculative premium come

into the stock as the company neared its spud date.

That market is gone—for now. So unless the market changes to the better, companies like Canadian Overseas and CGX will almost certainly not see any significant increase in price before I see actual results. One of the hardest lessons I've learned is that when a stock doesn't do what I expect it to do, sell it and move on – take that first 10% loss, which is the hardest.

Now for me and my tolerance level, I'm fine holding these stocks for now, but judging from some emails I get from subscribers lately -- who bought these stocks with me at the top of the bull market 3 months ago--many people should take a gut check on these drill punt plays. Petrofrontier, Canadian Overseas, CGX and even Bengal (which only has 100 bopd on a good day) will drop in price DRAMATICALLY if their initial wells don't come in exactly as the market expects. They can even be successful but not meet market expectations and the stock will drop. Be aware.

Miscellaneous OGIB Portfolio Stock comments....

Border Petroleum (BOR-TSXv)...stock is trading surprisingly well considering the 25 cent financing comes free trading in two weeks

DeeThree (DTX-TSX)...trading like a gem...well above the recent financing price of \$4.20 now, the market is starting to price in some future success...chart is telling me the market is now confident in the play's success

Secure Energy (SES-TSX)...the stock is up more than \$1 per share in a month from where most subscribers bought the stock in the \$7.20 range...that's 12-15% in a month...

TAG Oil (TAO-TSXv; TAOIF-OTC)...Canadian brokerage firm Cormark Securities initiated coverage with a \$10 target, but saying nothing new...TAG is drilling several shallow wells in the Miocene formation above the Whangai shales on the east coast to see if there is a conventional shallow play there...a no risk proposition as, if there is no oil, then they can say there has been little migration from the shales and if there is they can crow about a new discovery.

Wind River Energy – (WVR-TSXv)...the share price is pulling back closer to the 25 cent financing price—those shares come free trading in early June...they have announced two deals in their TLA area in New Mexico Niobrara...the second one was a bit odd to me, and management has not yet responded to my query – "This second lease covering 7,991 gross acres and 4,262 net acres bears a 12.5-per-cent landowner royalty" – what I don't understand is how there can be a difference between the net and gross acreage if they are the only group with the legal title to the mineral rights? Have they joint ventured some of the acreage? No response yet to my email query on this issue.

LASTLY – early next week I will be publishing the first of what I hope to be a regular monthly service – a brief technical analysis of each OGIB stock. This month's instalment will come from a good friend of mine here in Vancouver, Richard Reinhard, who makes his living by trading small cap resource stocks.

I had the good fortune to sit beside him for a few years and watch him do his charting, trading and talk the markets with him. I'm grateful he is willing to share his expertise with us. He's a Level 3 finalist with the Market Technicians Association to obtain his CMT [Chartered Market Technician] designation. Richard uses www.metastock.ca to do his work.

Richard Reinhard is actually a pseudonym he uses to pen his own micro-cap stock newsletter, Growth Stocks Weekly (www.gsweekly.com). But his charting ability is very real, and I love the idea we get to hear from someone who makes his living in the same markets we do. You look at charts differently in that case.