

BULLETIN # 74 – SEPTEMBER 12 2011

WEEKLY WRAP

OPEN RANGE

CGX ENERGY

IONA ENERGY

WIND RIVER ENERGY

MARKET COMMENTS/DONY'S TECHNICAL ANALYSIS

Greetings from St. John's NFLD, where today for breakfast I had fish cakes and fried bologna. Tonight I'm out to dinner with a subscriber I have known for almost 10 years but never met. That's what makes these investment conferences so much fun.

Maybe a little writing will take my mind off the markets for....a few minutes.

First, catch up on reporting my trades. I gave notice that I would be selling my 2500 TAG warrants, (TAO.wt-TSX) which I did last week at \$3.66. I confess I wouldn't have done that had it not been for the overall market sentiment.

I also sold my remaining Secure Energy Systems (SES-TSX) at \$7.85. This morning the company announced it was buying a processing facility--that appears to do what their regular Full Service Terminals (FST) do—from Emerge Oil and Gas (EME-TSX and a former OGIB pick) for \$18 million.

The news just hit the wire so I haven't spoken with management or seen any research on it, but I believe this is their first heavy oil project, which opens a new arena for them.

The Silverdale processing facility near Lloydminster (a town that is the hub of heavy oil, and straddles the border of Alberta and Saskatchewan—not an easy thing when one province has sales tax and one doesn't) currently provides oil terminalling, emulsion processing and produced water disposal services. Secure intends to expand the service offerings at Silverdale to include the full suite of services it provides at its other facilities, and to market its services to other producers. Emerge will get priority access and be charged a preferential rate.

After I speak with SES management this week I will report back. Heavy oil is a big market.

I also bought 10,000 more shares of Wavefront (WEE-TSXv) at 83 cents. I said I would be buying about 10,000 a month in anticipation of continually better financials (which of course, come from more orders!), and I have done that now for September.

OPEN RANGE ENERGY – ONR:TSX

What a great win for OGIB subscribers in a subdued energy market (though oil has been holding up well in this panicked market!)

Last Monday the company announced it was splitting into two parts, one part being the Poseidon water handling product and the other being a pure natural gas play.

In reading the (many) research reports on this split, the consensus valuation for Poseidon is that it would trade in the 9%-11% yield range. So the \$1.08 payout = \$9.81 at 11% (\$11.12 at current prices, before the .882 of a share is issued) and \$12 at 9% (\$13.60 at current prices).

However, I could see the stock trading at a higher yield, and therefore a lower stock price, for the end of Q1 2012—the reason being the high payout ratio—almost 95%. Personally I think management purposefully – and prudently—gave low guidance of \$130 million EBITDA for 2012, so I expect that payout ratio to be less by the end of the year. But until the market sees that growth is continuing at this current trajectory of a new Poseidon unit sold every 3.5 days through Q1 2012—I could see a 12-13% yield.

And what will the new (old, pre Poseidon) Open Range trade for? And do I care? As always in the markets, the answer is - it depends. Because I'm not a believer in higher natural gas prices—for now—I am tempted to just sell it. But because they are the second lowest cost producer (after Peyto) with a great growth profile (they say they can exit 2012 at 10,000 boe/d—analysts are openly doubting that though) I may keep the stock and have it be my ETF for natural gas, in the same way I hold Peyto.

My main question on valuation these days is—what's the netback, or profit per barrel or boe (barrel of oil equivalent). For Open Range, pre-Poseidon, it was about \$25. That incorporates all the Natural Gas Liquids (NGL) they have in their gas. I do want to know about reserves, reserve life, and if they own their own processing facilities and pipelines (they do), but you can have a large suite assets but not be able to monetize them—and they're worthless.

So as a very general rule of thumb, I would suggest that any netback under \$30 should roughly trade at 1000x that per flowing barrel. So a \$25 netback would, IMHO, be worth roughly \$25,000 per flowing barrel of ENTERPRISE VALUE, not market cap. You just add the debt or subtract the cash in the company from its market cap to get its enterprise value. The new company will have \$15 million debt which is not much.

And I would add something for the asset value of their own infrastructure, and management—now, this is not scientific at all but rather touchy-feely based on my experience/intuition, but fair value might be \$30-\$35,000 per flowing boe.

$\$30,000 \times \text{roughly } 5000 \text{ boe current production} = \$150 \text{ million market cap} + \$15 \text{ million debt} = \$165 \text{ million} / 74.7 \text{ million shares out} = \2.20 . I think it will likely trade higher than that in the euphoria of the market over this deal. But that's my 2 cents on where fair value is. I confess I'm likely a seller of the gas side and just roll that into Poseidon, depending on what it's trading for.

One analyst report estimated that post-split, Poseidon would trade at a 16% yield through 2012 and Open Range at \$65,000 a flowing barrel. That doesn't mean one of us is out to lunch, rather it means one of us is trying to make sure we're part of the financing syndicate the next time the natural gas producer needs top up equity or expansion capital.

I haven't been able to reach Lyle Michaluk yet, the new CEO of Poseidon and current CFO of Open Range. (I like Lyle—his manner is humble yet confident, and you can tell in talking to him he knows his business, and the wheels are turning about what to do next corporately.) Again, my only real question to him is—do you want Poseidon to be more of an income trust model, paying out a high percentage of cash flow, or do you want it to be more like the standard Canadian energy services company that pays out 30% of cash flow and has a yield of 5%? (think of Canadian Energy Services, CEU-TSX).

Open Range has—at least right now—more than twice the gross margin of other Canadian service companies—whether it's drillers, frackers or fluid handlers, so their options are greater.

What a win, especially in this market. I still think the stock could be \$12 next year, which is \$13.60 under the current share structure—greater than a 50% gain from here. It's still my #1 pick.

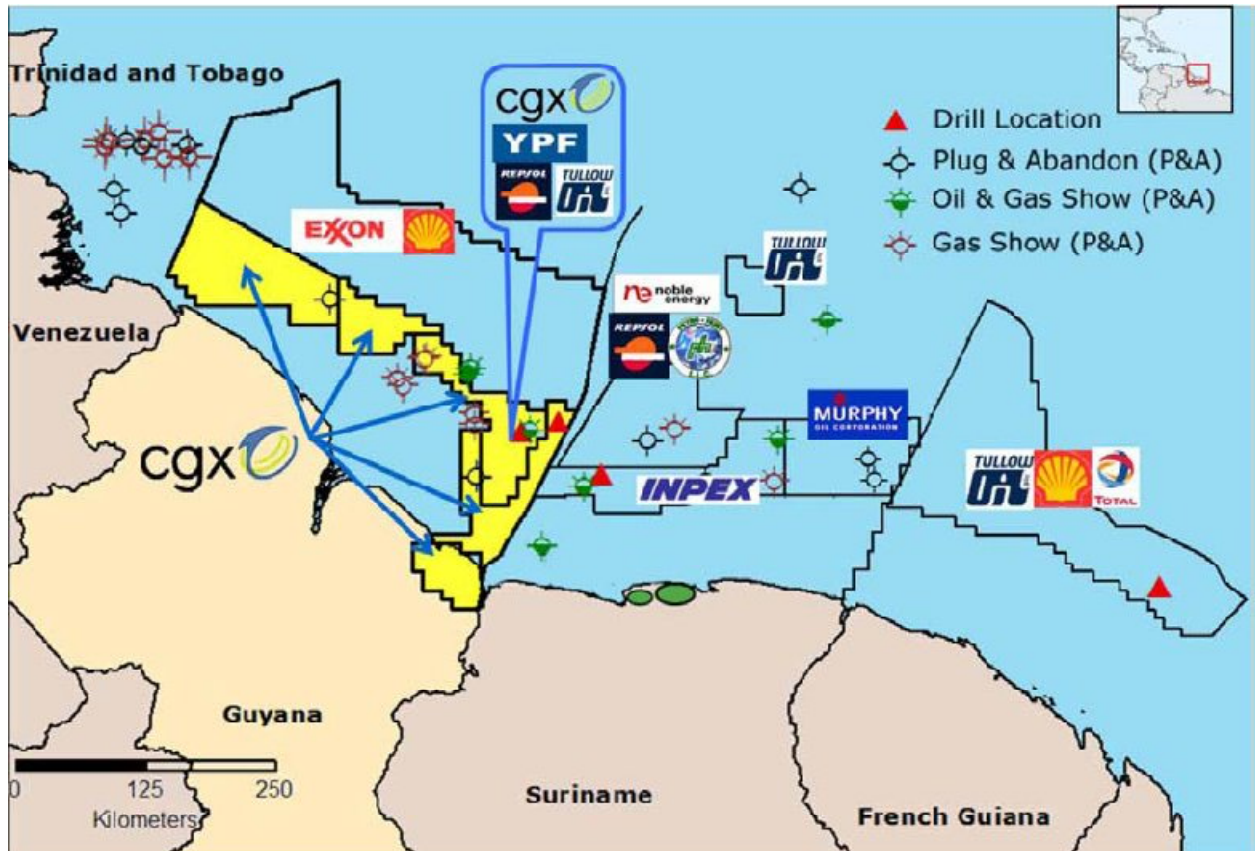
CGX Energy – OYL-TSX

Last week CGX shares shot up on huge volume after (~~I sold it~~) neighbouring Tullow Oil hit the first successful well in the Guyana Basin, offshore the NE coast of South America. Its "Zaedyus" exploration well hit two turbidite fans—the same type of geology that CGX is targeting—with an estimated net oil pay of 72 m. The well will now be deepened to test deeper geology.

In my initial report on CGX I said there were four wells that would be drilled in the Guyana Basin before theirs. The first two, by Murphy Oil, missed, and CGX stock suffered. I was very

encouraged to see the volume in CGX as it responded to Tullow's well—that shows there is an active audience watching the stock. Even today as the stock sells off it is trading good volume.

CGX has \$34 million cash, enough to pay for its net 25% in its first well—the Jaguar Prospect-- which is expected to finally spud sometime Q4 (if you think TAG has drawn out drilling their east coast shale play a long time, well, I first owned CGX for this same drill hole more than 10 years ago!).



But CGX has to finance for their second well, and in this market there is no guarantee they will be able to do that as efficiently as we would all like.

But here is a quick lesson on how this game can work. They are allowed to go to the stock exchange and get approval for price protection on a financing, without announcing that to the market.

Now, I'm not picking on them in this matter, it is the rules and all the management teams do it, but what happens in this game is that retail guys go out and buy the stock in the market after a successful well (assuming it's successful) and bid up the stock---and management uses that to

go give the institutions a discounted and protected financing price that was appropriate before the well hit. Usually there is some give and take over price with the exchange on these matters.

Here's something else—watch how the stock performs after it has run up and then a discounted financing gets announced. If that hardly makes a dent in the stock, you're safe and it's going higher—even from that new level. Think what happened to Secure Energy when they announced their \$6.65 financing.

But if the stock does make a pullback right to, or near, the financing price, then it's likely that financing is going to trade under issue price; i.e. the stock will drop even further. Think DeeThree's \$4.20 financing where the stock dropped from \$5.20 that very day – a 20% tumble! Another good example of this is Xtreme Coil on their \$4.75 financing. The stock couldn't hold up, and it traded right back to its financing price, and then went lower. Sadly, I tell you this from recent experience sitting with losses on those examples, not from a financial-guru place.

Anyway, that's all hypothetical, but the point is that even with success CGX may have a hard time financing in this market.

I'm out of the stock for now, but as you can read I still follow it closely as it's a very big prize – estimated to be over 200 million barrels net to CGX just with its 25% WI if it's as successful as they hope.

IONA ENERGY – INA:TSX

Iona still trades below cash value. In a news release last week they said Orlando would spud the 3rd or 4th week of September—close to its original timing, but 2 months later than updated market guidance right before going public.

Interestingly, they ordered TWO Christmas trees, which you can translate roughly as an underwater wellhead. I suspect that was done to increase financial options for the company. Originally, they hoped to use the reserve base that would follow from a successful well at Orlando as collateral for a debt package.

Management will need cash to purchase/develop Westwick, a high quality heavy oil play in the North Sea. Cash flow from Trent/Tyne gas play and from Orlando may not be enough. But in this market, debt financing on reserves is not possible for juniors. But you can still get debt on cash flow—and if Iona drills two successful wells at Orlando, then more production will allow for more debt.

Management says they're still debating the second well, but are just getting prepared for it.

WIND RIVER – WVR-TSXv

I remind you this stock is now a binary trade; they either hit on Phat City Montana conventional play (which I love) and the stock goes to \$2-\$3 or it doesn't and the stock goes to 20 cents with a huge overhang of people wanting to get their cost out at 25 and 30 cents. Be aware of the risk profile and act accordingly.

It's a great risk-reward play, which if successful could have a recycle ratio of 30:1. A \$1.25 million well producing 700 bopd of OIL with an EUR (Estimated Ultimate Recovery) of 1 million barrels. But even if they get great science, or call it a technical success but no oil production, the stock is going lower—even though they have the money in the bank for two more wells.

Management as yet does not have a great track record in creating shareholder value through the drill bit as senior management of a junior oil and gas play.

Wind River is a binary trade; high risk-high reward. I'm looking for an update on spud dates; it will be either September or October.

MARKET COMMENTS

I see oil holding up much better than I would have expected this morning—even all of last week. Volume in the more junior OGIB stocks dried up as valuations hit new lows—a lot of the OGIB stocks are cheap, but sadly still getting cheaper, and I don't see that happening unless, like ONR, you get life changing news.

Even one set of positive drill results may not be enough to bring volume.

So I will continue to be reducing positions in the more junior stocks in the OGIB portfolio, without a lot of care on price...I just want to raise cash and my nice (very nice) win on ONR allows me to do that. Donnybrook, Bengal, Torquay, Wind River and Black Pearl are all either junior stocks or small positions (Black Pearl) that I may sell to raise some cash in this market.

What is holding up very well are dividend paying stocks like ONR, Eagle Energy Trust, Golar LNG and Canadian Energy Services. That is where I will be looking to increase my positions on any major panic selling.

Technical analyst Donald Dony says that overall, the charts are telling him this is not likely to be a 2008 style collapse, but rather a bear market correction in an overall bull market. He is looking for a bottom in September, a bounce in October and another low in December/January before any real upside momentum is likely to occur.

Here are his comments from last Friday on select OGIB stocks – ones that I am considering to buy on a severe pullback. Remember Technical Analysis is a guide, not a Bible.

ONR: Primary trend is up. Break above previous resistance level of \$7.00 on institutional volume buying positive. Now overbought. Expect a pullback on profit taking.
Recommendations: Wait to buy on the pullback in the \$7.00-\$7.50 range. Stop is placed at \$5.40.

CEU: Primary trend is up. Currently consolidating between \$13.25 and \$10.00. Outlook weakening with flat trading into September. Expect CEU to reach \$10.00-\$10.50.
Recommendation: Wait on the sidelines. Do not buy now. Place stop at \$10.00.

GLNG: Primary trend remains up. 1st support now at \$30.00. Currently consolidating above 1st support and \$34 resistance. Outlook improving. Expected to break above \$34.
Recommendation: start buying small amounts. Stop is placed at \$27.50.

CEN: Primary trend remains up. 1st support at \$9.00. Currently consolidating.
Recommendation: Start buying small amounts. Stop is placed at \$8.90.

IAE: Primary trend is down. Outlook is improving. Hold off on buying.
More evidence of a turnaround is needed. Recommendation: Wait on the sidelines for now. A price break above \$2.10-\$2.15 would signal the down trend has likely reversed.

TAO: Primary trend is flat. Breaking above the \$7.40 resistance level on institutional volume buying is positive. Recommendation: TAO has moved up too fast, too quickly. Wait for minor pullback to about \$7.20 before buying small amounts. Stops are placed at \$6.40.

WEE: Primary trend is down. Outlook is improving. Hold off on any buying for now. Support is at \$0.80. Wait for price to stabilize before buying small amounts. Raise stop to \$0.74.

GFS: Primary trend is down. 1st support at \$7.00. Resistance at \$9.00. Recommendation: Wait on the sidelines. Do not buy. Wait for GFS to trade over \$8.50-\$9.00.

At \$105 a year, his newsletter is the second best newsletter I think you should be spending your money on ;-) -- www.technicalspeculator.com

SUBSCRIBER INVESTMENT SUMMIT MONDAY SEPTEMBER 26

I am excited to announce TAG Oil Chairman Alex Guidi will be joining us for dinner at Joey's restaurant on Burrard Street after the summit. He is a veteran of the junior markets and has done a GREAT job in having TAG's stock reflect the potential of the company. I have always remarked how well this stock trades. FIVE management teams from OGIB stocks will be attending for subscribers to speak with at dinner.

For those attending the summit, you will be getting an email shortly asking you to confirm if you're coming to the dinner. This has been so popular I think the Coffins, Lawrence and I may have to do this in Toronto or Montreal next spring as well.