

INTERIM BULLETIN #111 – NOVEMBER 15 2011

PORTFOLIO SALES – OPEN RANGE

ENERGY/DONNYBROOK ENERGY

Today I sold two junior gas producers - 16,000 shares of Open Range (ONR-TSX) at \$1.98 and 50,000 shares of Donnybrook at 45 cents.

Both these companies have high quality management teams and are growing their liquids rich gas production handily....but I expect the natural gas market to deteriorate through what should be the peak season—winter. I see it being increasingly difficult for these stocks (and I mean all junior gas stories, not these two in particular) to have a tough time overcoming market sentiment. Every rally is, IMHO, a selling opportunity.

On ONR, I had a \$2 mental stop loss and it got triggered. I still own some but will be selling it all over the coming weeks as the market allows me to. (Europe may speed that up.)

After reading all the research on ONR after the split, it really comes down to the same basic premise for avoiding natural gas—it's just not profitable.

The cash netback on ONR production is forecast by their lead broker (who should be the most bullish) to be \$18 this year and \$18.65 next year.

Last year their all in costs – which is called FD&A, for Finding, Development and Amortization, and including Future Development Costs (FDC, which includes things like reclamation costs) – was \$17.27. This is called Full Cycle Costs. (When you call these companies you want to ask what their full cycle costs are including FDC—because they're probably telling you their operational or half cycle costs.)

So despite great GROWTH in production, there won't be many profits here. These financials show ONR is likely to have very skinny margins, at roughly 75 cents a

barrel equivalent. The recycle ratio is very close to 1:1. And BTW, they're one of the best in Canada, and they're skinny.

Now, that growth, propagated by the BIBA Machine (Brokers, Investment Bankers, Analysts), could give the stock a lift—even a good lift if a really cold winter draws down storage and gives gas a bid. The stock actually trades really well, which is why I didn't sell ALL of it today. And there could easily be a seasonal trade in this stock if natural gas has a seasonal run. But I'm not convinced.

I like stories like Golar, Coastal Energy, and Poseidon etc. where strong growth and good to great margins always attract buyers of the stock. I have some special stocks like that in my portfolio right now and I notice I only want to own the really good ones right now.

Plus, I have to be honest; sometimes I just have to sell some stock to take the edge off. ;-)

This company split of ONR into two new stocks brings up the issue of cost base. In my portfolio I work on a FIFO basis—First In, First Out. I own the stock in a couple different accounts, and each broker has given me different methods of valuing the cost base of each stock—Poseidon and the new Open Range.

All the ONR stock I bought before September when the split was announced is showing in my account as having a cost base of \$1.18. Of course I bought the stock all over the map between \$5-\$6, but it doesn't show in my account like that. It shows that my overall cost base on the ONR is \$1.18.

I sort of trust them and I'm too busy to check it, so on my first 32,000 shares of ONR that I sell, my portfolio in the Members Centre will show a cost base of \$1.18. So a \$1.98 sale is a capital gain of $80/118=67.7\%$ in five months.

The Poseidon cost shows as \$5.75 on that first 32,000 shares.

Donnybrook has just closed its financing, and I am expecting results from their

Joint Venture (JV) with Cequence at their Simonette property in the southern Montney. Their Bigstone well came in positively, and investors are now waiting on flow results from the first Resthaven well with Celtic. This recent \$12 million financing will allow them to drill another well each at Resthaven, Bigstone and Simonette. There are now 193 million shares outstanding.

In natural gas markets like these, daily stock valuations but takeout values don't suffer as much—though I do think that without a wicked Canadian winter, we will see Canadian gas get shut in come spring time 2012. That will impact takeout values for a time. But again, despite rapidly growing production and a new team that has proved themselves in spades (which is why I'm so keen on their Donnycreek) taking the stock from 12 – 80 cents over an 18 month period, I'm going to generate cash here.

What I'm saying is that in this gas market I don't know how much value discovered in the ground will find its way into the stock prior to a takeout.

There is one wild card here—their Duvernay rights. But with most of their land under joint venture now, if someone does come knocking for these rights, it would be a deal between lots of companies now—harder to do.

So a 45 cent sale on a 23 cent cost base is a gain of 95%.

Craig Nieboer, CFO of **Canadian Energy Services**, (CEU-TSX) and I have been trading calls and not able to connect, so I have not updated their quarterly results yet—but they were good. Revenue was up more than I expected, but margins were a bit smaller. Most importantly, organic growth into the US continues and as I forewarned not long ago, they increased their dividend—this time by half a penny a month to 54 cents a year now. That is now over a 10% dividend on my initial position. I think I will have that on **Golar, Poseidon and Northern Offshore** in 12-24 months.

HOWEVER, one dividend stock that is underperforming is **Eagle Energy Trust (EGL.UN-TSX)**. My full report on this company will be published this weekend

at the latest, possibly Friday. But the stock is performing poorly. Delays in getting production onstream due to permitting issues have reduced cash flow dramatically for 2011, though they had a cushion of capital from their IPO.

Now however, there is concern that the wells at their Salt Flat field are not performing to expectations. These wells are conventional horizontals—they are not fracked—and have high recycle ratios; they are very profitable wells and this is a great asset for Eagle. But the delay in cash flow means their payout ratio will be higher than expected. When this happens, The Street trades the stock at a higher yield, which means a lower stock price.

I don't want to get ahead of myself because we don't know exactly how close these wells are to expectations—called the "type curve". The type curve is a graphic that shows the IP rate, the decline rate and production over time.

But uncertainty creates nervous shareholders, and I'm seeing that in the stock now.

So while the production delays have been fixed and Eagle still believes strongly it can exit 2011 at its previously estimated 2400 bopd—i.e. its production problems are over--psychology on the stock appears to have turned from How Can They Grow to Can They Sustain Monthly Payout.

While I bought this as a proxy to my bank account because I could get a 10% yield, I'm pre-disposed to taking my 15-20% loss and staying in more real cash.

**SAN FRANCISCO SUBSCRIBER ONLY SESSION - SATURDAY EVENING
630 PM--I WILL HAVE DETAILS IN MY BOOTH**

Hopefully many of you visit me in Montreal this weekend. I love that city. It's the only European city in North America.