BULLETIN # 124 – March 5 2013

ARGENT ENERGY TRUST – AET.UN-TSX; ANGYF-PINK

COMPANY ANALYSIS

Argent is the third cross border trust to list on the Canadian markets. The other two, the oil weighted Eagle Energy Trust (EGL.UN-TSX) and the gas weighted Parallel Income Trust (PIL.UN-TSX) have been disasters, but I'll explain how Argent is different.

1. They operate their own assets
2. They have the rights to more than one formation (Eagle's problem)
3. Sustainability ratio under 100% (meaning they bring in more cash flow than they spend on drilling and dividends) once their DRIP is factored in (Dividend Re-Investment Plan; where investors take their dividend in stock, not cash)

The declining stock prices of the Canadian juniors (not the trusts) that have moved to dividend models proves my point that the junior space is not really the place for dividend plays (save Whitecap, WCP-TSX).

Again, what separates Argent from those companies is

1. a very low decline rate in their production—15% vs. 31% for Petrobakken, 25% for Renegade, 24% for Enerplus and 40% for Pinecrest—which wanted to go the dividend route but couldn't because of investor concerns over decline rate
2. Accretive acquisitions. Their latest was a steal at 20% accretive, whereas the other junior dividend players are just merging—zero accretion.
3. Fast growth via acquisition. In seven months, the company has more than tripled its production since launching.

QUICK FACTS:

Trading Symbols:	AET.UN-TSX (ANGYF-PINK)
Share Price:	$10.00 (my price 5000 @ $9.28, with 1000 @ $10)
Current Production:	5,300boed (65% light oil& NGL)
Shares Outstanding:	48.4 million shares (1.1% insider ownership (over $3 M hard money)
Market Cap:	$484.0 million
Net Debt:	$52 million
Enterprise Value:	$536 million
EV per flowing boe:	$101,100/boepd (barrels of oil equivalent)

POSITIVES

- ✓ Lots of running room — 12+years of low risk drilling inventory
- ✓ Higher realized pricing for oil, $10 premium to WTI per barrel
- ✓ Year around operations, no spring breakup or extra winter costs
- ✓ High netbacks – more than $70 per barrel at $100 realized oil price
- ✓ 100% drilling success rate so far
- ✓ Cash flow greater than payouts and capex combined

NEGATIVES

- ✓ Risk of a decline in oil prices hurts cash flow—and I do expect LLS (Louisiana Light Sweet) to drop $5-$10/barrel in 2013
- ✓ Decline rates from new wells could be substantially higher than expected
- ✓ Paying out very close to 100% of cash flow in dividends and drilling (capex)

THE PROPERTIES

Argent Energy assembled a diversified portfolio of low risk, low decline producing assets in Texas and Oklahoma. Texas has been producing oil since the 1880's; these are prolific and predictable long life assets.

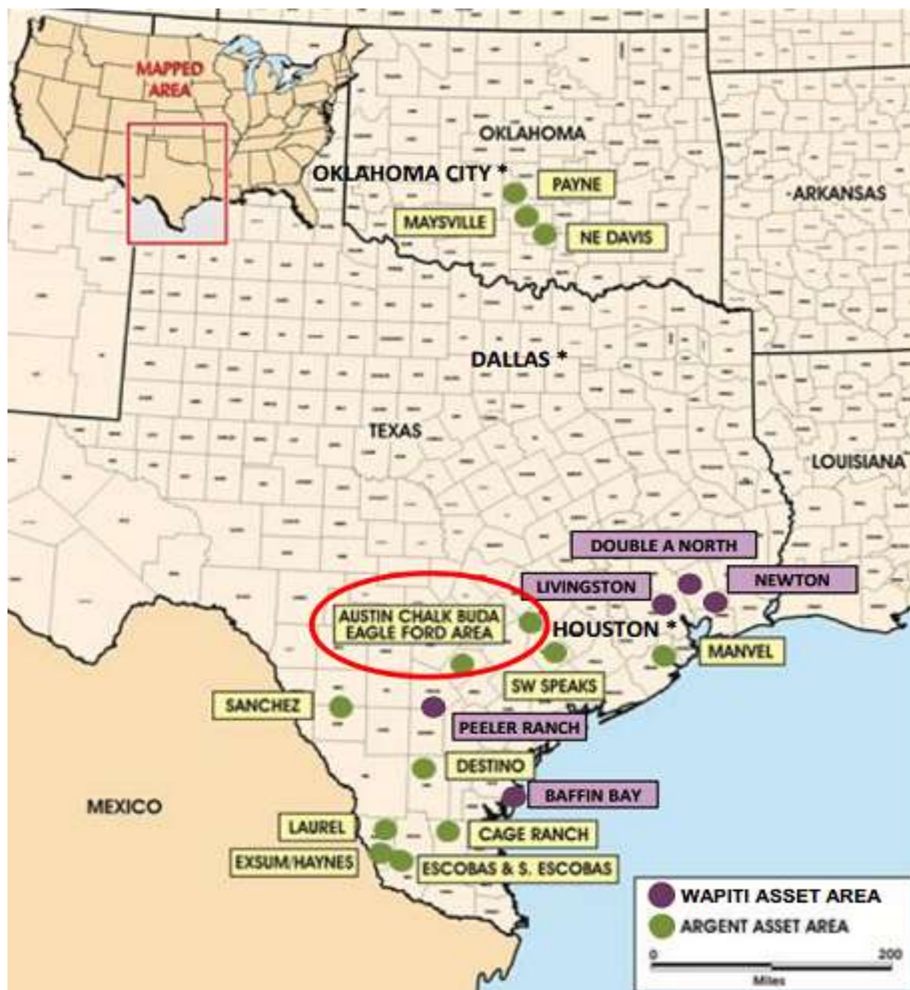
The trust used the proceeds of its IPO in August of 2012 to pay for Denali Oil & Gas Partners' interests in several counties in Texas. The assets comprise various

working interests in ~70 wells covering 117,000 net acres. The two focus areas can be divided into two segments:

1. Austin Chalk/Eagle Ford liquids development
2. Natural gas production in the South Texas Escobas field

Production from these assets currently total about 2,800 boed; 1,800 boed from Austin Chalk/Eagle Ford and about 1,000 boed from South Escobas.

The second acquisition came soon after in October of 2012. The trust acquired working interests in 245 wells covering 4,030 net acres from Energy Quest. These legacy conventional oil wells have a low decline rate of ~10.5% per year providing a stable cash flow base. The assets are located on the Gulf Coast in south east Texas and in Oklahoma. They currently produce about 890 boed (86% oil).

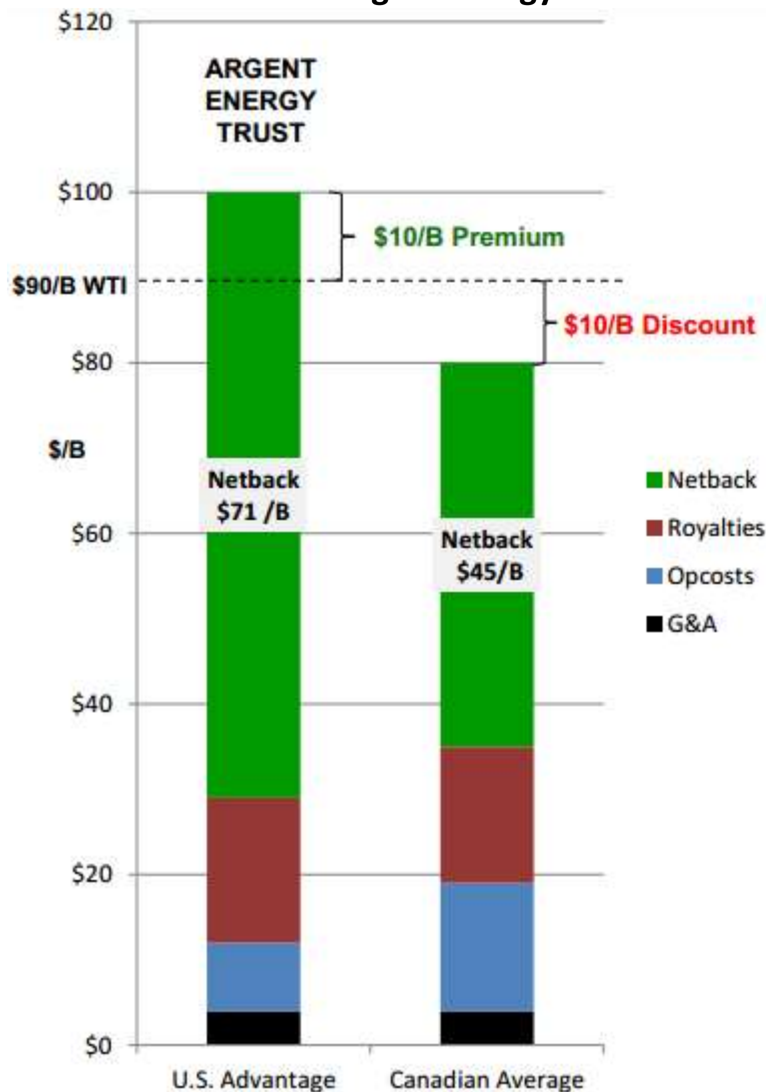


In December of 2012, Argent closed its third acquisition. The trust acquired ~1,400 boed (78% liquids) and 15,000 net acres in East Texas from Wapiti Energy, a private corporation. These assets mainly consist of oil and natural gas liquids weighted production with a low decline rate of ~11%.

Argent's assets are close to the Gulf Coast Refinery Complex (GCRC). This provides the company with two significant advantages:

1. Lower transportation costs
2. Better pricing for their oil--Argent sells their oil at Louisiana Light Sweet oil pricing fetching $10-$12 above WTI per barrel.

Premium Netbacks to WTI – Source: Argent Energy Trust Presentation



Argent operates 96% of their assets. Its drilling inventory is over 170 locations, or 12 years of drilling. Management says the overall corporate decline rate is between 14% and 15%.

LOW DECLINE RATE IS IMPORTANT

Lower decline rates mean less production has to be replaced every year, which means less money is spent on maintaining production. Cash flow not spent on maintaining assets can be used to grow assets or increase dividends.

An 15% decline rate on 5,000 boed means the company needs to replace 750 boes every year to maintain its production steady (5,000 * 0.15).

If the cost to bring a barrel of production online is $25,000, then 25,000 * 750 = $18.75 million. A company would have to spend $18.75 million just to keep production steady.

Now imagine if the decline rate was 30%--that means they have to replace 1500 bopd just to stay even. Then the amount required to keep the same production level of 5,000 bopd jumps to $37.5 million (5,000 * 0.30 = 1,500 * 25,000) leaving less money to distribute or to grow production.

PROPERTIES--Austin Chalk

In 2013, development activity will be focused on drilling 10 wells in the Austin Chalk and two in the Eagle Ford plays. These plays will be the main drivers for production growth so I will take a closer look at each one.

Argent holds more than 25,000 net acres prospective for Austin Chalk formation. The formation runs from the border of Mexico across south Texas and into Louisiana. This is a conventional oil play that has been de-risked by a number of producing vertical and horizontal wells, no fracking is required.

Austin Chalk horizontal wells cost about $3M to drill, complete and tie-in. These wells have a type curve (production profile) of an IP30 rate of 150 boed (83% oil, 8% NGL and 9% Gas). Each successful well adds 180Mboe in reserves. Production typically declines 60% in the first year and 25% in the second but some of these wells keep producing for 35 years. The trust has a drilling inventory of more than 25 locations.

Eagle Ford Shale Oil

The Eagle Ford formation is one of the hottest shale oil plays in the US. The play is 50 miles wide stretching 400 miles to the east with varying depth between 4,000 and 12,000 feet. Located in South Texas, it has attracted many oil companies due to its high liquids yield. BENTEK estimates liquids production growth from the Eagle Ford will increase 500% in 5 years from 71,000 b/d in 2010 to 420,000 b/d in 2015.

Argent owns 25,000 net acres in the Eagle Ford shale oil window. Management believes oil is prevalent across the entire acreage. Over 35 wells were successfully drilled around AET's acreage by the competition. Each well costs about $7.5M to drill, complete and tie-in with an average IP30 rate of 350 boepd. The trust

estimates a recycle ratio of 3.0x and a EUR (estimated ultimate recovery) of 300,000 boe per well.

At a 2,500 meter depth, the Eagle Ford is deeper than the Austin Chalk formation. It's actually considered the source rock or the oil kitchen for the Austin Chalk zone. The trust is able to target both formations from its acreage.

The drilling inventory currently stands at 95 locations based on a 4 well per section spacing. But it could be larger than anticipated since the industry has been down spacing by drilling more wells per section. EOG Resources is currently drilling 10 wells per section or 1 well per 64 acres. The trust's Eagle Ford drilling inventory would more than double in this case to more than 220 potential locations.

South Escobas

Argent has a South Texas natural gas play at Escobas currently producing about 1,000 boed. The Escobas field produces gas from the Wilcox formation, a 240 km trend that has produced over 3.5 TCF to date.

The Escobas field is also adjacent to fields that have produced more than 600 BCF to date. The play enjoys a low breakeven gas price of $0.80/mcf. Production is sold at Henry Hub pricing (US benchmark for natural gas pricing) currently trading significantly higher than its Canadian counterpart. Argent hedged a small amount of NG for 2014 above $4/mcf, a price level where the play becomes very interesting for its high recycle ratio.

According to Sproule (independent petroleum engineering firm), Finding & Development costs are forecasted at $1.04 for proved and probable reserves. At $4/mcf, the recycle ratio gets closer to 4.0x which means that for every $1 invested Argent generates $4.

In the near term, these assets may see a limited amount of drilling aimed at keeping production volumes flat. This is not the main focus of the company as its oil assets currently provide a better return.

This play requires a natural gas price over $4/mcf in order for the economics to equal those of drilling oil. Until then, the South Escobas field provides a call option on a recovery in natural gas prices.

FINANCES AND VALUATION

The trust carries $52 million in debt on its $95 million bank line representing a 0.7x debt to cash flow ratio based on estimated cash flow for 2013.

It's costing them $22.65 to find a barrel of oil organically; through the drill bit. Anything under $25 is good, under $20 is excellent. Via acquisition this number is $13.82 per barrel—that's due to the very accretive acquisition done right at the end of 2012, and the main reason I bought the stock down at $9.28 initially.

The guidance for 2013 calls for an annual average production of 5,500 to 5,600 boed weighted 72% to liquids (65% oil, 7% NGLs and 28% natural gas).

The most important figure to look at with any dividend paying company is the all-in payout ratio, called the Sustainability Ratio. Here is the formula:

(Capital Expenditures + Distribution or Dividends)/Cash Flow = Sustainability Ratio

A sustainability ratio over 100% means the company is spending more than its cash flow. The company must use debt or raise equity to fill that cash flow gap. The Street *hates* that.

For 2013, I will assume the low end of the guidance at 5,500 boed in average production. I will use the following price deck:

- Realized price of oil $100/barrel (equivalent to $90 WTI)
- Realized price of natural gas $3.30/mcf (Henry Hub)
- Realized price of NGLs at 45% of WTI ($90 per bbl)
- Capital expenditures at $41million

The sustainability ratio comes out to 115% for a deficit of ~$12 million this year.

However, the company intends to initiate a Premium Distribution and DRIP program where shareholders recycle their monthly distribution into new shares.

The trust expects a 25% participation rate which takes the sustainability ratio below 100%--about 96%.

How does Argent compare to its cross border peers? Using the same commodity price deck, I get the following sustainability ratios (SRs).

	Argent Energy Trust	**Eagle Energy Trust**	**Parallel Energy Trust**
SR excluding DRIP	115%	136%	100%
SR including DRIP	99%	86%	93%
Debt to Cash Flow	0.7x	0.9x	4.8x
DRIP participation	25%	65%	10%

Argent has the most sustainable dividend, the lowest debt to cash flow ratio and that's after a reasonable DRIP participation rate. A high DRIP rate translates into dilution as the company recycles its distributions into new shares every month.

The risks here are that these assets are still fairly new, despite some drilling around them. Declines could be greater than in the past. And their sustainability ratio is still high, making them vulnerable to a drop in oil prices—though they have hedged a lot—60% of 2013 production at a minimum US$90/barrel.

I'm hoping their organic growth will offset a $10/bbl price drop I expect early Q4 in the Gulf region (see my NTI-NYSE report—Northern Tier Energy—for that). So to a certain degree, the stock is still priced to perfection.

CEO Brian Prokop says no more acquisitions until later in 2013; they want to show the market organic growth. They expect the market to reward them for that with a higher share price that they can use to finance the next set of acquisitions accretively.

The trust is not only planning on expanding its operations further in the US, next year they want to follow up with a listing on the NYSE—if successful that would mean some yield compression (higher stock price). Initially, this will make it much easier for their personnel to buy company stock as well as attract the US investor base.

WHAT THE ANALYSTS SAY

FIRM	12 MONTHS TARGET PRICE
Scotia	$12.25
TD	$11.50
RBC	$11.50
National Bank	$11.50
CIBC	$12.00

STOCK CHART

CONCLUSION

Argent Energy Trust is different from both other trusts and from other junior dividend payers. They've been able to grow fast via acquisition, and do it accretively, and get a sustainability ratio below 100%--not far enough below for me to establish a BIG position, but I like the team, the assets, and the fact I bought it at the bottom. But I did buy some more stock at $10.

Despite an attractive hedge book for 2013, I still believe the stock will be sensitive to volatility in the price of oil. But being in Texas removes a lot of headache. The trust needs not worry about differentials or pipelines. All it has to focus on is delivering on guidance and avoiding operational hiccups.

I'm happy if I get 10% capital gain to $11/share in a year and get my 10% dividend for total return of 20% per year. If they can grow production organically at 10% a year and keep their SR below 100%, I think the stock can gain 10% a year for several years.