OGIB INTERIM BULLETIN #395 - April 15th, 2015

THE TIER 2 LIST

WHAT YOU BUY TODAY IF WTI HITS 65 AND STAYS THERE

A month ago oil congestion in the US was taking oil back down $40. Now, increased demand and lower inventory builds in the US (only 2.9 M barrels this week) has everyone convinced the turn in oil is in, and upstream E&P stocks are flying.

I didn't sell my leaders so I'm making good paper profits watching them go up today. But if sentiment in this market is strong enough to allow the Tier 2 stocks to run....what to buy?

OK let's say WTI oil is going to $65—that's $12/barrel or 25% from here. With most companies having a roughly $40 breakeven op cost, that's a ***doubling*** of cash flows.

Does that mean stock prices double?

For the leaders who are already up 70-100% from their December or January lows, almost certainly not (but never say never).

Let's forget the fact that at US$65 WTI, very few US shale plays work at all for the juniors. Forget that—because really what you're buying here is *a trade*, not a company or group of companies.

In Canada it's different—because of the Low Loonie. My guess is that US$65 WTI would only increase Canada's dollar from 78 cents to 83-85 cents US. A loonie worth 83 cents turns $65 oil into $78.31 oil up in Canada, and that price does work—and what I mean by that is that companies can grow production inside of cash flow (though a bit more slowly than they are used to).

So assuming that WTI oil is rocketing back to $65 and staying there (a distinct possibility given the large demand increase low prices are creating around the world) what stocks would I want to own that allows me to sleep at night. What I mean by that is that they have strong enough fundamentals they won't be too impacted by a big down day in oil once we get up to $65.

Paramount (POU-TSX)

Production has jumped from 30,000 to over 50,000 boepd now, but is mostly dry gas—in fact almost 90% gas, but 15,000 boepd of condensate coming online with new stabilizer plant in May 2015—jump in production and jump in cash flow. It's all sold in Canada, so that gets the 15% premium to Edmonton light prices.

Condensate is now $70/barrel in Canada (Edmonton light = US$49.66 x 1.23 CAD/US = 61.08 x 1.15 = $70.24). Paramount and Seven Generations (VII) are the most highly levered companies to Canadian condensate, at 59% and 57% of revenue. POU is getting 100-200 bbl/mmcf/d in its IP rates at Kakwa near its big new Musreau plant. Current strip pricing creates enough Free Cash Flow (FCF) to take debt:cash flow down from 5x – 3x in 2015 to 2016.

Condensate levels pick up dramatically in the H2 15 and 2016. POU is an incredible growth story and if oil is going back to $65 and staying there, this company's stock should get a slingshot lift up from fast increasing production.

Rock Energy (RE-TSX)

Rock has its two heavy oil plays—the main one at Mantario and a second in the shallower zones of its Onward light oil play in the Viking zone. They are holding production flat at these two assets in the face of lower oil prices and not drilling the light oil play at all. With the reduced royalty (1%) at their Mantario play, they are one of the few showing somewhat decent positive cash flow at US$53 WTI

But with only 50 million shares out, an OK-but-not-great balance sheet and a strong Viking asset that can come online (in a relatively big way) at $65 WTI, it's a stock that offers better than average leverage to oil prices.

Recent analyst reports teasingly talk about a new discovery in SE Alberta, which management has not spoken to. The stock also trades at a low multiple—any increase in multiple obviously helps a lot on only 50 million out.

Legacy Oil and Gas (LEG-TSX)

Surprisingly (to me at least), I find this is the best beta stock to oil in Canada, despite only producing 27,000 boepd (21K of which is oil). This management was one of the Top Teams in Calgary for years—which brought out a great US following and helped liquidity greatly…but high debt and low reserve additions over the years have dimmed their stars.

But they have some really good assets across western Canada, and are now working them. At $65 oil, their asset base does come close to working.

And I think the Street wants to see something happen to this company now—asset sales, company sale, personnel (longtime CFO just left)…so the potential for something BIG to happen this year here is higher than for most companies, and I think that may provide a slightly bigger bid to the stock moving forward.

Synergy—SYRG-NASD

You've heard of the Baby Bakkens? This is a baby-Wattenberg, which is the best US oil play outside The Big 3—Bakken, Permian and Eagle Ford. It's just NE of Denver.

The stock had a great run in the last cycle that I missed because I thought it was always too expensive. It **is** always too expensive. But production is going from 8000 boepd (35% gas) to 13000 boepd by the end of August (their year end) or early September. Those wells have already been drilled, and just need fracking.

I really like the stock because of its optionality in two new areas—the Greenhorn zone in its NE extension of the Wattenberg, and its Nebraska play a bit farther to the NE. With a strong growth rate already, the optionality of these two plays is huge.

Especially Greenhorn. It's a limestone formation that's about 90 feet thick in the Wattenberg extension where they have 35000 acres. It has produced vertically.

I spoke with management just this morning.   The stock barely budged during this downturn. A decade-plus inventory. They think they can get well costs down to $2.9 million which gives a 2 yr payback at these prices. They have $70 million net cash after raising $191 million recently--so they have used their premium valuation wisely. One rig - $100 M capex a year. The Street is expecting they will outspend cash flow this year dramatically, but only have 0.6x D:CF at calender YE.

Expensive stocks don't scare me as much as cheap stocks. Cheap stocks stay cheap, and expensive stocks stay expensive.

Triangle Petroleum – TPLM-NASD

The premiere Baby-Bakken just reported quarterly production of 14,700 boepd, ahead of expectations.   Well performance and better performance from pumps were given as the reasons. *Well costs have come down from $10.2 - $7.8 M million—a big drop.* They have 125,000 acres in the Bakken, just over 80K are in the core area. Like most companies in this list, if oil prices don't rise, their production will FALL this year as they conserve balance sheet.

They are a bit unique in having vertically integrated—they started their own fracking company –RockPile__and have an interest in a pipeline leaving the Bakken. (Yes, management is from the finance side of the business.) And they like to buy back their own stock.

The Bakken doesn't really work much at $65 WTI but the vertical integration saves them here and the Street does rally around this stock as a go-to name.

Baytex—BTE-NYSE/TSX

Baytex is a larger company, about 100,000 boepd, but mostly oil. They made a big acquisition in the Eagle Ford in May last year--close to the market top--that caused its debt to balloon. As soon as the oil price collapsed, so too did BTE.

This management team is very well respected. They now have 51% of their production in the US (no Canadian discounts (though those discounts have narrowed a lot lately)). The Canadian assets are more heavy-to-mid-grade oil. It's listed on NYSE as well. A recent $625 million equity raise did dilute (to just over 200 M shares). They have just under 4x D:CF, but that moves to just over 3x by year end. Total payout is still over 100%.

BUT this list is about what happens to stocks if oil goes to $65 and stays there. This company/stock has a LOT of torque in that environemnt. Repeat—the Street respects management a lot. The Street is modelling debt coming down to 2.6x D:CF in 2016 on current strip.

Two junior international names stand out: **Bankers Petroleum (BNK-TSX) and Parex Resources (PXT-TSX)**. **Bankers'** has many years growth ahead of it with low cost wells in Albania, and produces about 20,000 bopd of heavy oil. A new waterflood (or polymer flood) is being effective in lowering decline rates. There is a full report in the Members Centre.

Parex is Colombia focused. This team has built and sold several juniors; they are probably THE most respected junior international team of all the Canadian E&Ps. Production is now at 25,000 bopd. The geology there lends to a shorter reserve life for their wells. I should do a report on them.

THE WILD CARD JUNIOR--is little **Canamax--CAC-TSXv**. The Flood asset is GREAT--at $65 oil, and with their royalty deal, it only takes 6 vertical wells costing them a net $1.5 million to hold production steady and generate over $5 million in Free Cash Flow.

In closing--psychology is such a funny thing. I am happy today because the stocks I DO own--CEU, SES, Spartan etc...are all doing GREAT today. A lot of stocks are breaking out of short term consolidation; a basing of the last 4 months.

But part of me says...oooohhhh...did I ever leave a lot of money on the table by being too cautious in Q1...

-Keith