

OGIB INTERIM BULLETIN #396 - April 23rd, 2015

PORTFOLIO PURCHASES

JUNIOR OIL STOCKS

LEGACY OIL AND GAS PAREX RESOURCES INC. ROCK ENERGY

Two factors made me buy some stock today:

1. Nobody knows where the price of oil is going, but the charts of both the commodity and the leading stocks now have a bias towards being up.
2. I try not to overthink investments. As long as you're humble and realize the Market makes mincemeat of all of us, and you are committed to stop-losses, I'm willing to give a good trade idea a go. Overthink and you worry—and prosperity and worry are opposites.

So with those ideas in mind, I bought small positions in three junior oil stocks—5000 shares each in

1. **Legacy Oil and Gas LEG-TSX; LEGPF-PINK at an average \$2.57**
2. **Parex Energy PXT-TSX (no pink sheets listing I could find) at an average \$9.21**
3. **Rock Energy (RE-TSX; RENFF-PINK) at an average \$3.31**

I'm going to go in reverse order here. I bought **Rock** because I'm intrigued by the mention of a new discovery near Sedalia Alberta, just across the border from their Saskatchewan property. **Rock** has drilled and completed the well and is acquiring more land around there. (This team does need an exploration win, preferably in a conventional style play; not tight or shale oil) At their Onward light oil play they have been able to increase production via using more frac sand, but that play needs still higher oil prices. The Market is rightly giving it limited value at these prices.

Sedalia could give me an extra level of optionality if oil prices keep going higher.

Parex is one of the international leaders in junior/intermediate oil stocks. In fact, **Bankers and Parex** are almost the only ones I would want to own, (**Vermillion (VET-TSX)** would be in that list too but it's so big). It's a leader I should have bought at the same time I bought **Secure, Raging River and Whitecap** in January or February.

North American oil producers have had great success over the past half decade with the Shale Revolution. What they haven't had over the past half decade is free cash flow. Drilling and fracking these shale wells is very expensive and the high decline of shale production requires constant capital reinvestment.

The Shale Revolution was born out of high oil prices and a lack of conventional oil opportunities. The industry has gone after shale in North America because that is all there is left. For lower cost conventional opportunities producers must look internationally.

Colombia is one place where meaningful conventional discoveries are still being made.

Parex was born through a spin-out from Petro Andina Resources and started trading in November of 2009. **Parex** holds a large land base of 2.6 million gross acres in Colombia's Llanos basin.

Parex has a historical 50% success rate drilling exploration wells—resulting in some very rapid production growth. They've gone from 0-26,000+ bopd in six years.

Management has run this company conservatively--always maintaining an excellent balance sheet. With a recent capital raise completed **Parex** finds itself with over \$100 million of cash and no debt.

In 2015 assuming Brent pricing remains between \$50 to \$60 per barrel **Parex** will spend roughly \$150 million drilling eleven exploration wells. Cash flow will pay for all of it. Recent cost reductions have allowed for what was originally an eight well exploration program to be increased to eleven.

One other reason that tipped me over the edge to buy this stock is that competitor **Gran Tierra (GTE-NYSE/TSX)** has recently fired its founding CEO, and now an activist group has come in looking to replace management (unlike most financial based or hedge fund activists, this group is a proven team of international E&P executives).

Parex is now cashed up (\$118 million at \$9.15) and ready to buy any spin-off assets **Gran Tierra** or **Petroamerica** or any other company with Colombian assets may want to do.

Colombia isn't perfect—permits take forever—but security is improving and this team's track record speaks for itself.

Figure 1: Near-Term Exploration Program

Well	Block	Timing/Comments
Tilo-1	LLA-34	Producing since March 29, 2015
Rumba-1	LLA-26	Drilling
Arton-1	LLA-26	Next location
Taringa-1	Cebucan	After LLA-26
Tautaco-1	LLA-10	After Cebucan
Capachos	Capachos	Spudding Q4
Zorro Rojo	LLA-20	Spudding Q2
Guepardo-1	LLA-32	Spudding Q2 (new)
Carcayu-1	LLA-32	Spudding Q2 (new)
Appraisal Well	LLA-32	Spudding Q3 (new - contingent)
Prospect	Cabrestero	Spudding Q4
Prospect	LLA-34	Spudding Q2

QUICK FACTS (from April 2015)

Trading Symbols: PXT-TSX
 Share Price Today: \$9.38
 2015 Production Guidance: 26,500 boe/d (100% oil)
 Estimated 2015 Cash Flow: \$150 million (\$55 Brent)
 Basic Shares Outstanding: 149.6 million
 Market Cap: \$1.403 billion
 Net Cash Position: \$114 million
 Enterprise Value (EV): \$1.289 billion
 EV per Exit Flowing Barrels : \$48,641 / boe



The only negative here is that international stories trade at half the cash flow multiple that domestic producers do, which reduces leverage.

Legacy Oil and Gas is an interesting story now. Only a couple weeks ago I mused that the Street wants to see something happen with this company, as the stock has gone from a premium to discount over the last 3-4 years.

The longtime CFO Matt Janisch has left and now CEO Trent Yanko is under siege as he borrowed money to buy stock and the board of directors had the company guarantee the loan. That has brought in a well-known activist investor group, Front Four, which is out of Connecticut but is headed by Canadian Zach George, son of longtime **Suncor (SU-TSX/NYSE)** CEO Rick George.

There was no one asset that performed badly or no one particular M&A deal that sunk this company. In fact, to this day their low-decline Turner Valley asset and their SE Saskatchewan assets in the Midale area (very near where OGIB favourite **Spartan (SPE-TSX)** is meeting with such good success and making it a market darling) are performing very well; at or above expectations.

On the asset side, reservoirs were good but costs were higher than expected; so they underestimated or poorly guided infrastructure costs to the Street. As debt levels went higher, they continued acquiring assets with a progressively higher cost of capital (read: lower stock valuation).

They hinted they were going to do a big royalty deal; I assume like the two that **Freehold (FRU-TSX)** just bought from other groups. These deals generally go for 10-12x cash flow, so it's a cheap way to reduce leverage. That never happened.

And marriage says pretty clearly that love makes the world go round but money greases the wheels—and when money is tight, you can lose the love. And that rough analogy is what happened between the Street and management at Legacy.

The shareholder base has turned over completely from long only and loving management to short term institutional and retail traders.

Now, it's not clear to me what benefit Mr. George and Front Four can really do other than speed up the tough decisions the board and management should have made in the last 18 months.

But the asset base is—from what I can see--relatively strong for what is considered a distressed company. M&A valuations on the Street have not changed during this downturn. So any asset sales are likely to be quite accretive at these valuations. I think there is a possible 50% gain in the stock if oil prices continue to go up and the company or assets get sold at prevailing metrics. And that's what I look for in all my trades—50% in one year.

So I think this investor activism does help keep an extra speculative bid under this stock in this market.

(Just as an aside that I think means nothing for Legacy stock, Front Four was the activist that ousted the old Renegade Petroleum team and had that company sold to **Spartan Energy**—an OGIB favourite.

Market respect for that asset base was low, as **PennWest** and then **Renegade** were not able to effectively produce from them. Then **Spartan** CEO Rick McHardy and VP Exploration Fotis Kalantzis went and almost TRIPLED the type curve (production levels) from Renegade's assets—immediately; in the first drilling program, sending Spartan's stock soaring and making it a near double for me and OGIB subscribers in just over two months.

I asked Kalantzis why that was, and he replied that it was because they could afford to drill the wells properly; both the previous owners were underfunded and couldn't properly capitalize the wells. He may have been being polite.

Anyway, I don't see that happening with Legacy assets; they are actually performing relatively well. That means I think they get a good dollar for them if they go up for sale.)

CONCLUSION

Repeat—nobody knows where oil is going, though the bias now is up. And just to illustrate, I have a bullish oil story going out Saturday (big drop in spuds in North Dakota) and a somewhat bearish story on Monday (fascinating look at the REAL reason US oil prices are low (hint—I live there)). I think it's a story the Wall Street Journal would publish but little OGIB is getting the scoop.

These are small positions. I will have my regular 10-15% stop loss on them, and have no qualms going back to cash and waiting for a stronger sign that the oil price has truly found its footing.

HOUSEKEEPING—The full report on **PowerSecure (POWR-NASD)** is in the Members Centre now.

I also want to share something I'm doing next week that greatly impacts YOUR wealth. My wife and I are doing our annual meditation retreat in Arizona, so I am away all next week.

But know that I'm working for you, and here's why:

1. In 2013, three WEEKS after I returned from my retreat, midwest refiner **Northern Tier Energy (NTI-NYSE)** hit \$32/share and I sold it—it was the largest win of 2013

2. In 2014, three DAYS after I returned from my retreat, **Pacific Ethanol (PEIX-NASD)** jumped from \$9-\$15 and stayed there, and slowly worked its way up to \$23—it was the largest win of 2014.

Now that does not mean that this year something incredibly profitable will happen in the OGIB portfolio three HOURS after the Market opens the first day I'm back (Tuesday May 5).

But The Universe works in mysterious ways.

-Keith