

April 28, 2009

OIL & GAS

## International E&P

### Internationals: Poised To Outperform

**Internationals Positioned To Outperform:**

With oil prices expected to improve through the remainder of 2009 and into 2010, we believe the international E&P group is positioned to outperform.

**Lower Rig Utilization Could Lead To Lower Service Costs:**

Lower commodity prices and tighter credit markets have resulted in less drilling worldwide, which could put downward pressure on some international service costs.

**Recent Major Discoveries Have Been Outside North America:**

With North American basins becoming increasingly mature, most of the new, major discoveries have been in international basins, which are relatively underexplored.

**Valuations Have Moved Such That Exploration Potential Can Be Had For 'Free':**

With valuations on international producers having come down significantly, many are trading at or below net asset value implying investors are getting a free option on exploration potential.

**If Investors Do Not Pay, Someone Else May:**

With valuations having come down significantly, we believe that majors and national oil companies will look to purchase reserves and potential resources at 'bargain' prices.

**Balance Sheets Remain Focus For Investors In The Near Term:**

While credit markets have shown some signs of improvement, balance sheets will continue to be a key focus for investors.

**Top Picks:**

Our top picks focus on producers with strong balance sheets, visible catalysts and liquidity. The top international picks in our coverage universe are ♦**Pacific Rubiales**, ♦**Petrominerales** and ♦**Niko Resources**.

Disclosure statements located at the back and inside back cover

♦During the past twenty-four months, Cormark Securities Inc., either on its own or as a syndicate member, participated in the underwriting of securities for these companies or a predecessor company

## Introduction

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The past 12–18 months have been a rollercoaster ride for investors in the international oil and gas space. In the time leading up to oil prices reaching highs in July 2008, investors looked to international producers for exposure to higher risk/higher reward exploration, and were willing to pay premiums to a company's underlying NAV for exposure to the upside potential. However, with the steep decline in oil prices in the second half of 2008, the international group was also among the hardest hit, with investors looking to reduce exposure to what were viewed as higher risk investments. Since hitting their lows, many of the international producers have had a nice rebound but remain well below the highs of a year ago. We believe the decrease in valuations provides an opportunity for investors to increase their exposure to this group, while paying little value for the exploration potential offered. In addition, with oil prices expected to improve through the remainder of 2009 and into 2010, we believe the group is positioned to outperform once again. Our top international picks are ♦**Pacific Rubiales**, ♦**Niko Resources** and ♦**Petrominerales**.

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## International E&P – Positioned To Outperform

Through the first half of 2008, the international E&P peer group was one of the hottest sectors for investors in the oil & gas space. Unlike many of their domestic peers, the internationals offered investors exposure to large resource-in-place opportunities. Combined with large land bases and rising oil prices, large resource opportunities made exposure to higher risk exploration drilling worth the potential reward that could come with a major discovery.

This risk/reward balance changed significantly as oil prices fell from their peak in July 2008. No longer were investors willing to take the risk that came with exploration drilling as oil prices fell, making the discovered resource less valuable. Further complicating the issue was the limited access to equity capital and a virtual freeze in credit markets, making it nearly impossible for some internationals to move forward with their exploration programs, taking away (for a time) something that made owning internationals attractive to investors.

Since the end of 2008, we have seen a rebound in oil prices from their lows to the US\$45–55/B range recently, where they looked to have stabilized for the time being. With the rebound in oil prices, we have also seen a recovery in equity values of many of the internationals, though we note that they remain well off their highs. We believe that with oil prices expected to strengthen through the second half of 2009 and into 2010, there is further upside for the group from current levels.

Figure 1

### Price Performance

Average	H1/07	H2/07	H1/08	H2/08	YTD 2009
<b>Cormark International Producers</b>	<b>38%</b>	<b>67%</b>	<b>12%</b>	<b>-78%</b>	<b>55%</b>
Cormark Mid-Cap Producers	4%	-14%	75%	-63%	-5%
Cormark Small-Cap Producers	-3%	-30%	84%	-73%	21%
S&P TSX Composite Index	8%	-1%	5%	-38%	5%
West Texas Intermediate	16%	36%	46%	-68%	12%
NYMEX Natural Gas	3%	15%	78%	-58%	-42%

Source: Bloomberg

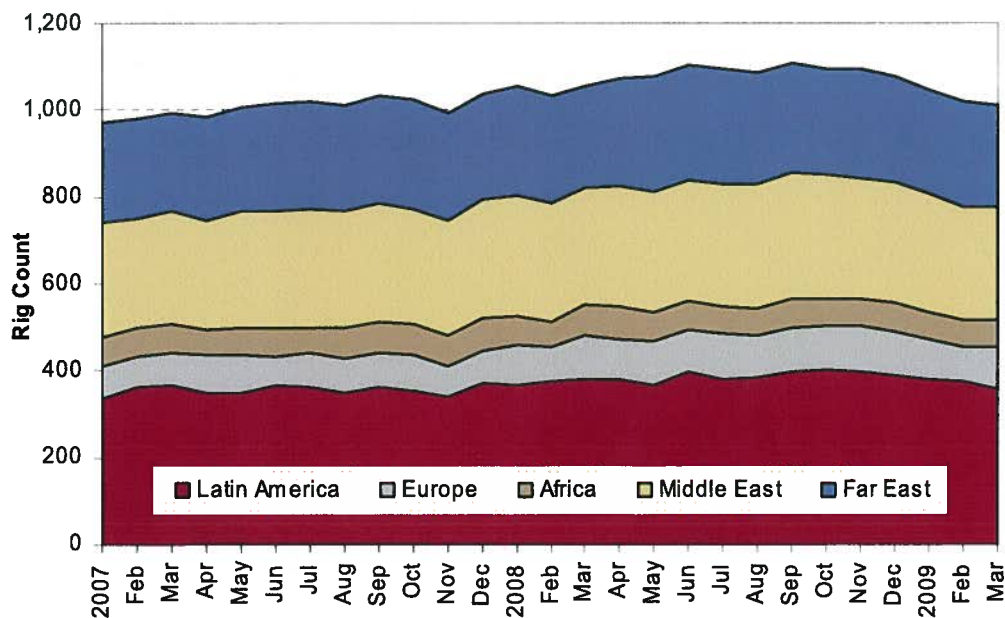
## Lower Utilization Could Lead To Lower Rates

In response to the rising commodity prices over the past several years, we also saw an increase in international rig counts as the economics of drilling in many underexplored basins around the world became more attractive. Since bottoming at 556 rigs in mid-1999, the international rig count (excluding North America) increased to a recent high of 1,108 rigs running in September 2008. As expected, with higher commodity prices and the lower number of available rigs, rig rates continued to rise, making it more expensive to drill.

With the fall in commodity prices since the highs of last summer, we have also seen a decline in the rig count from the recent peak to 1,012 rigs in March 2009. It is also important to note that rig utilization has fallen in all five geographic regions tracked. Although it is tough to quantify, the consensus among international producers in our peer group is that they are witnessing an easing in rig and service costs. For example, in the North Sea, ♦ Antrim has indicated that its remaining project costs at Causeway have fallen by as much as 50%. While we note that not all cost reductions will be as material, if global rig counts continue to fall it would likely provide savings on the cost side. This would help in improving international drilling economics, making more of the plays in current portfolios increasingly attractive.

**Figure 2**

**International Rig Count**



Source: Baker Hughes

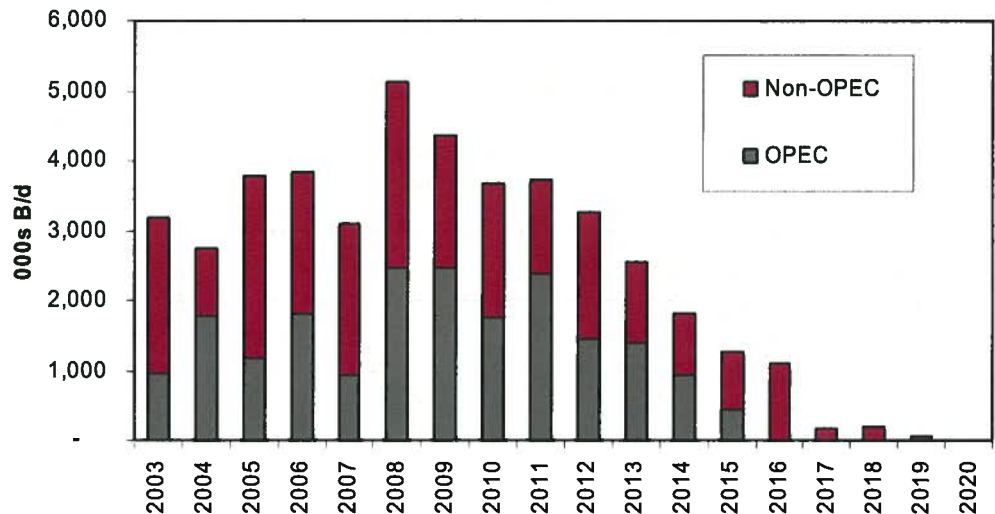
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## Larger Discoveries Have Been International

Though the rumblings of ‘peak oil’ have subsided somewhat with the lower demand stemming from the economic recession, the number of major oil discoveries over the past several years has been low, with production additions from new mega-projects expected to drop significantly after 2012 (see Figure 3). Further, discoveries that have been made have primarily been outside of North America as many of the basins in Canada and the US have been fully explored and are now considered mature, though we note that the emergence of resource plays in North America has added to the reserve base.

Outside the North American resource plays, we believe that international producers offer investors the biggest resource potential, as many in the group have exposure to lands in underexplored basins. With oil prices appearing to have stabilized in the short term, and the medium- to longer-term bias for expected prices to be higher, with an eventual recovery in the global economy, we believe investors will once again look to international producers for their resource potential.

**Figure 3** **Projected Additions From Oil “Mega-Projects”**



Source: Oil Megaprojects Task Force

## Little Value For Exploration Potential

As we have mentioned, the majority of the international producers in our universe have accumulated large land positions in highly prospective oil and gas basins. The exploration potential inherent in these land positions is generally in addition to booked proved plus probable reserves under NI 51-101, which underpins a company's net asset value.

In the time leading up to the highs in WTI prices in July 2008, investors were willing to pay premiums to these underlying net asset values for exposure to the larger resource-in-place potential. This exploration upside potential was built into valuations on a risked basis as investors were willing to put a value on this undiscovered resource.

Fast forward to today, with valuations having come down significantly and independent reserve reports having been updated to year-end, the majority of the companies in our group are now trading at a discount to their underlying net asset values (which are based on their engineers' blow down value for the reserves, discounted at 15%, less net debt) and well below the multiples they were trading at a year ago on the previous year's booked reserves. This would then imply that investors can now get the exploration potential as a free option, which we believe provides an excellent entry point on these stocks.

Figure 4

### P/NAV Multiples

	Price 27-Apr-09	2008 NAVPS	P/NAV	Price 25-Apr-08	2007 NAVPS	P/NAV
♦ AEN	\$0.46	\$1.99	0.2x	\$4.10	\$1.57	2.6x
♦ CNS	\$0.15	\$1.32	0.1x	\$1.43	\$0.62	2.3x
CYR	\$1.35	\$1.81	0.7x	\$3.85	\$1.13	3.4x
♦ EPS	\$0.75	\$2.78	0.3x	\$3.01	\$2.55	1.2x
GTE	\$2.91	\$3.68	0.8x	\$4.33	\$2.21	2.0x
♦ NKO	\$60.00	\$23.17	2.6x	\$92.12	\$28.32	3.3x
♦ PRE - High *	\$5.77	\$7.01	0.8x	\$8.28	\$10.06	0.8x
♦ PRE - Low *	\$5.77	NA	NA	\$8.28	\$7.23	1.1x
♦ PDP	\$1.80	\$4.27	0.4x	\$10.11	\$4.97	2.0x
PMG	\$11.10	\$9.30	1.2x	\$16.75	\$7.94	2.1x
<b>Average</b>			<b>0.8x</b>			<b>2.1x</b>

\* For the 2007 reserves report, the Rubiales field was evaluated on two production cases, a high case which was based on a maximum production rate of 126,000 B/d with the construction of a pipeline, and a low case which was based on a maximum production rate of 50,000 B/d without a pipeline.

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Sources: Cormark Securities Inc., Bloomberg, Company Reports

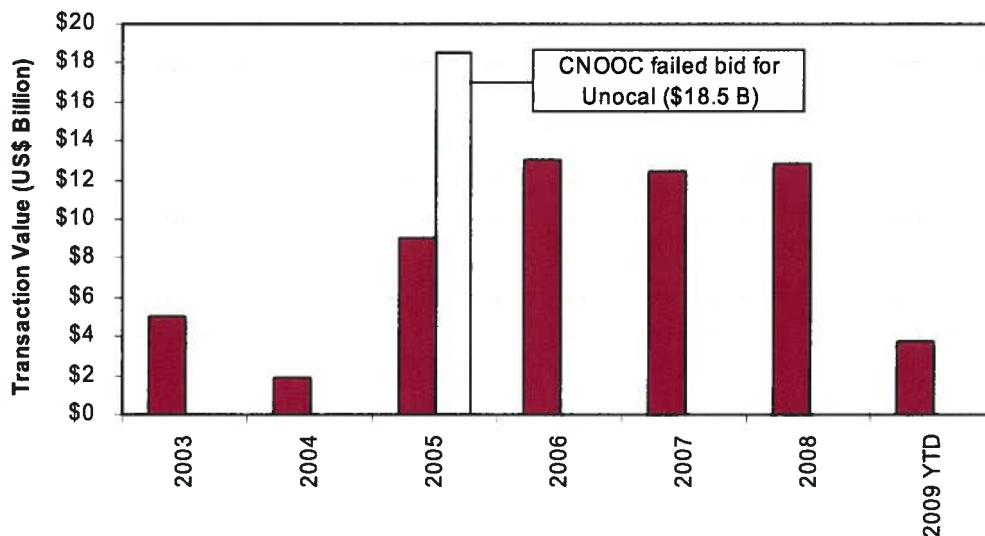
## If Investors Do Not Pay, Someone Else May

With valuations no longer reflecting as much (or any) premium for exploration potential, and in many cases reflecting a discount to the recent NAVs, several of the international producers could be acquisition targets, attractive to national oil companies (NOC) looking to secure reserves to help offset expected future demand.

Over the past couple of years, we have seen a number of NOCs—Chinese, Indian and others—strategically acquire reserves around the world in anticipation of increasing future demand in their local markets. Most recently, we have seen the successful acquisition of Tangyanika, which had assets in Syria, by Sinopec (China) at a 21% premium, and a bid by China National Petroleum Corporation (CNPC) at a 35% premium for Verenex and its Libyan assets, which was later matched by the Libyan NOC. With no shareholders to answer to and a low cost of capital, we believe the NOCs are well positioned to continue to be active players in the acquisition market.

Figure 5

### Government Directed International Acquisition Activity



Sources: Bloomberg, Cormark Securities

Included in the above chart are purchases of Canadian listed international juniors that have been acquired by government controlled entities, such as Tanganyika and Verenex noted above. It is also important to note that other major oil and gas companies have been active in acquiring Canadian listed, internationally focused juniors, and for the most part these acquisitions have been done at healthy premiums to prior trading prices. Like the NOCs, majors have a lower cost of capital and are willing to pay-up for targeted reserves and resource. Below we list some notable Canadian junior internationals that have been acquired.

**Figure 6 Notable Canadian Junior Internationals Acquired**

<b>Canadian Junior</b>	<b>Buyer</b>	<b>Year</b>	<b>Value (C\$MM)</b>	<b>Estimated Premium <sup>(1)</sup></b>
Verenex Energy	CNPC	2009	\$499	35%
Bow Valley Energy	Dana Petroleum	2009	\$240	70%
Tanganyika Oil	SINOPEC	2008	\$1,809	21%
First Calgary Petroleum	ENI S.p.A.	2008	\$1,021	53%
Arawak Energy	Vitol Group	2008	\$183	186%
Rally Energy	Citadel Capital	2007	\$898	15%
Pan Ocean Energy	Addax Petroleum	2006	\$1,605	26%
Centurion Energy	Dana Gas	2006	\$1,150	61%
Petro Kazakhstan	CNPC	2005	\$4,368	21%
<b>Total / Average</b>			<b>\$11,772</b>	<b>54%</b>

(1) Premium to closing price before bid or announcement of sale process.

Sources: Company Reports, Bloomberg, Cormark Securities

## Balance Sheets Remain A Key Focus

Although we have seen an improvement in commodity prices from their lows, cash flow levels are still expected to be well below year-ago levels. This, combined with tight credit and equity markets, continues to make balance sheet strength a key focus point for investors.

Without the necessary funding to move forward with planned projects, a producer can become less active and therefore less attractive to investors. In some worse-case scenarios, overspending borrowed funds has taken some international companies to bankruptcy. However, we believe that at this stage of the economic recession, most companies have taken actions necessary to ensure their survival until the economy recovers.

In the meantime, we believe investors should continue to focus on international producers with the strongest balance sheets. We have outlined balance sheet positions of our international coverage list in Figure 7.

Figure 7

Balance Sheet Comparison (International Producers)

	D/CF		Net Debt <sup>(1)</sup> (\$MM)	Current LOC (\$MM)*	Borrowing Capacity (\$MM)	Net Debt / LOC
	2009E	2010E				
◆ Antrim Energy Inc.	NA	NA	(43.0)	50.0	93.0	NA
◆ Argenta Oil & Gas Inc.	NA	NA	(0.7)	NA	0.7	NA
◆ Canoro Resources Ltd.	NA	0.0x	(14.7)	NA	14.7	NA
◆ CGX Energy Inc.	NA	NA	(37.6)	NA	37.6	NA
Cirrus Energy Corp.	NA	0.8x	(64.0)	47.5	111.5	NA
◆ Epsilon Energy Ltd.	0.3x	0.3x	(19.3)	31.7	51.1	NA
Gran Tierra Energy Inc.	NA	NA	(162.1)	40.3	202.4	NA
◆ Niko Resources Ltd.	1.3x	0.6x	(124.2)	235.3	63.3	NA
◆ Pacific Rubiales Energy Corp. <sup>(2)</sup>	1.0x	0.3x	211.1	402.2	191.1	52%
◆ Petrolifera Petroleum Ltd.	0.7x	0.5x	57.2	103.4	46.3	55%
Petrominerales Ltd. <sup>(3) (4)</sup>	NA	NA	28.7	214.3	185.6	13%
<b>Average</b>	<b>0.6x</b>	<b>0.4x</b>				<b>40%</b>

\* Line of credit

(1) Last reported net debt / (positive working capital) position converted to Canadian dollars, if necessary.

(2) Pacific Rubiales net debt and LOC includes \$240 million of convertible debentures.

(3) Petrominerales net debt and LOC includes US\$81.7 million of convertible debentures.

(4) Petrominerales is expected to exit 2009 and 2010 with net cash compared to a current debt balance of \$28.7 million.

Source: Bloomberg

## Investor Focus

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While we believe that the international group as a whole stands to benefit from stabilizing and strengthening commodity prices and improving investor sentiment ahead of a broad recovery, we believe the initial focus will be on producers with strong balance sheets, visible catalysts and liquidity. Thus far this year, companies with these characteristics have been the first movers, and we continue to believe that they will be the go-to names for investors. In the following pages, we provide a company-specific summary on each of the international producers in our coverage list. In addition, we highlight Pacific Rubiales, Petrominerales and Niko Resources as the top picks in our group.

**Pacific Rubiales (PRE-TSX, Buy, \$10.00 Target)** - Having secured the lines of credit needed to carry out its 2009 capital program, we believe that Pacific Rubiales is one of the best positioned international producers. The 2009 program will focus on completion of the ODL pipeline, which will connect its Rubiales field with the sales point at Monterrey. This pipeline will allow the company to materially increase gross production from the field over the next 1.5 years from ~58,000 B/d currently to 100,000 B/d by the end of 2009 and up to as much as 170,000 B/d in 2010. Pacific Rubiales has a net (after royalties) working interest of ~35.5% in the field. In the longer term, the company has assembled a strong portfolio of exploration opportunities in Colombia, including additional heavy oil opportunities. As a result, we believe PRE should be a core holding for any oil and gas portfolio. A more detailed summary of Pacific Rubiales is available on pages 27 and 28.

**Petrominerales (PMG-TSX, Buy, \$20.00 Target)** - Petrominerales' Corcel discovery has given it the drilling momentum that is much needed in the international E&P space. This year, the company will continue to drill prospects identified on its initial 3D seismic shoot, with Corcel-D3 most recently testing at 8,400 B/d and Corcel-E1 currently drilling. The company has also shot further 3D seismic on the block with a view to potentially expanding its opportunity base at Corcel. In addition to drilling at Corcel, Petrominerales will drill one exploration well on each of its three heavy oil blocks in the Llanos Heavy Oil Belt. These wells give investors exposure to material resource upside as these blocks are located in one of the most highly prospective areas in the basin. With its development and exploration opportunities in Colombia, we believe the company should be a go-to name for investors. A more detailed summary of Petrominerales is available on pages 31 and 32.

**Niko Resources (NKO-TSX, Buy, \$90.00 Target)** - With its interest in the D6 gas discovery offshore India, which was recently brought online, we believe Niko should be a focus name for international investors. In addition to its interest in D6, the company has assembled a highly prospective exploration portfolio, with interests in Pakistan, Indonesia, Madagascar, the Kurdish region of Iraq and additional opportunities in India. With D6 generating free cash flow to reinvest in some of these opportunities, Niko will provide investors with upside potential through several years of drilling inventory. A more detailed summary of Niko is available on pages 25 and 26.

# ◆ CGX Energy Inc.

(OYL - C\$1.08, TSX-V)

**Recommendation: BUY (S)**

**Target Price: C\$2.25**

Unless otherwise denoted, all figures shown in US\$

**Figure 14** **Estimates & Statistics**

Current Price (C\$)	\$1.08	Target (C\$)	\$2.25
52 Wk High (C\$)	\$3.11	Proj. Return	108%
52 Wk Low (C\$)	\$0.26	Basic Sh. (O/S)	122.9
NPV (1) - C\$	\$2.98	FD Sh. (O/S)	132.6
P/NPV	0.36x	Mngt. & Dir.	5.0
Working Cap. (MM)	\$22.4	- Pct. of basic	4%
D/CF	NA	Mkt. Cap. (C\$MM)	\$132.7
DPS	NA	EV (C\$MM)	\$105.4

(1) Risked NPV analysis based on the Eagle Shallow Fan and Eagle Deep West Prospects; assumes 50% farm-down

Note: Positive working capital position is as of Dec. 31<sup>st</sup>, 2008

Sources: Cormark Securities Inc. Estimates, Company Reports

## Investment Thesis

An investment in CGX offers investors exposure to billions of barrels of oil reserve potential as the company has interest in four exploration licences, encompassing over 9 MM gross acres located largely offshore Guyana in South America. With the resolution of the border dispute between Guyana and Suriname in 2007, the region has reopened to exploration and business development activities. Given the lack of a precedent for a commercial discovery in the waters offshore Guyana, we view this as a speculative investment opportunity.

**Figure 15** **Price Chart**



Source: BigCharts (April 28/09)

## Highlights

In late 2008 and early 2009, CGX participated in a 3D seismic survey on its Corentyne (100% WI) and Georgetown licences (25% WI) offshore Guyana. The purpose of the survey over Corentyne is to improve the definition of a number of existing prospects, which were independently appraised at 2.7 billion barrels (unrisked, recoverable) prior to the seismic. The Georgetown seismic should help in the appraisal of a number of prospects that are conceptually similar to those on Corentyne; however, given that CGX is a non-operated partner, the company is focusing its efforts on maximizing the value potential of Corentyne.

Owing to the lack of a precedent for a commercial discovery offshore Guyana, the fiscal terms are very attractive and offer an excellent rate of return even in a low oil price environment. We believe that “the majors” in the E&P business may view a frontier region with very large oil resource potential and favourable fiscal terms such as Guyana offers as an attractive region for investment well ahead of the next up-cycle in oil prices. We note that Exxon holds an exploration licence offshore Guyana and the basin is populated with other notable global oil and gas players such as Repsol, Tullow, Maersk, Murphy, and Noble.

◆ During the past twenty-four months, Cormark Securities Inc., either on its own or as a syndicate member, participated in the underwriting of securities for CGX Energy Inc.

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**Upcoming/Potential Catalysts**

Processing of the seismic over Corentyne is ongoing and should be completed this summer (targeting July). The completion of seismic processing, along with the identification of drilling prospects, should aid in the process of signing a joint venture or farm-out partner and help CGX move closer to a firm drilling timeline.

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**Financial Flexibility**

At the end of Q3/08, CGX had a positive working capital of approximately \$35 MM. We estimate that with the spending on seismic during Q4, positive working capital was likely drawn down to just over \$20 MM at the year-end and, based on the spending contemplated between now and the completion of its seismic work this summer, the company will continue to have a positive working capital balance entering the fall of 2009.

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**Recommendation And Valuation**

We believe that CGX's considerable land holdings in the hydrocarbon frontier offshore Guyana should represent meaningful option value to a large, well-financed oil explorer that needs to make a billion barrel-type discovery to be material to its reserves base. We have attempted to value CGX based on two of the four identified prospects on its Corentyne licence using risked economics, while assuming a farm-down of 50% interest in the licence in exchange of a carry on the first exploration well. Our C\$2.25 target price also includes a discount factor to account for the timing and capital risks, over and above the risks associated with making a discovery. It may go without saying, however, that a 100% success on a discovery would offer considerable share price upside relative to our target.