

## Energy

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Industry Comment

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## International Oil &amp; Gas

## Int'l Oil &amp; Gas: Notes From Cartagena - A Tale of Two Colombias

- ◆ We hosted the Raymond James Colombia Resources Conference in Cartagena, Colombia last week. The conference was well attended (~35 buy-side representatives), mainly from U.S., Latin American and European buy-side firms. Several in the buy-side audience were new to investing in Colombian oil & gas companies.
- ◆ The overall picture that emerged during the conference juxtaposed narratives of growth and growing pains, of success and its price – thus, a tale of two Colombias. We believe Colombia's oil & gas sector continues to grow, but is now facing various challenges (internal & external) due to its rapid expansion over the past few years. However, we don't expect this dynamic to impact longer term value creation from the sector.
- ◆ Among the themes addressed by the presenting O&G companies, we would highlight: permitting delays, specialized equipment availability (or lack thereof), third party civil disturbances and – amongst the juniors – tight time-lines to meet commitments. We believe these are some of the reasons sector valuations have come off from earlier this year.
- ◆ We believe another reason capital markets might be shying away from the sector is the limited (compared to recent history) direct communication between the various Colombian agencies/ministries and the shareholders (or potential shareholders) of the various oil & gas companies active in the country. This comes at a time when various changes in key personnel, combined with increasing delays and alarmist security-related headlines, would likely warrant increased communication with the investor community. It is our belief that investors are currently seeking to be reassured that the country still acknowledges that it is competing for capital on a global scale, and that it will continue to endeavor to remain competitive in attracting this capital.
- ◆ In our view, fundamentals continue to underline the potential for solid investment returns, although valuations seem to indicate that capital markets might not be as enthused about the sector as in prior years, with several of the Colombia E&Ps in our coverage universe trading below reserve value.
- ◆ Following lengthy discussions with oil company executives and government representatives during our trip, we believe most of the headline issues (such as the above-mentioned permit delays and civil disturbances at various production facilities) are short-term in nature and, in many cases, were magnified by electoral-year dynamics. For its part, current administration acknowledges these issues and is moving to address them.
- ◆ We have received indications by corporate executives that several companies are planning to deploy equal or higher amounts of capital in Colombia in 2012, relative to 2011. Our feeling that there is strong ongoing industry interest in the country was reaffirmed by an informal internal survey, which indicated that the main business hotels in Bogota are fully booked ahead of the International Petroleum Conference & Exhibition, hosted by ACIPET (Colombia Association of Petroleum Engineers) and the ANH (National Hydrocarbons Agency) from November 22 - 25.
- ◆ We continue to advocate that investors maintain exposure to the Colombia oil & gas sector, ideally via shares of companies trading at/below 2P NAV – though we would not exclude paying a premium today for high growth potential. While we expect longer term investment returns, we would caution investors of potential continued sector volatility over the next 3 to 6 months as the various issues impacting valuations require time to be fully resolved.

Company	Ticker Primary	Ticker Secondary	Current Price	Target Price (6-12 mths)	Dividend Yield	Total Return To Target	Rating
<b>International Oil &amp; Gas</b>							
ArPetrol Ltd.	RPT-TSXV		C\$0.07	C\$0.30	0%	362%	Outperform 2
Bankers Petroleum Ltd.	BNK-TSX	BNK-AIM	C\$5.01	C\$10.50	0%	110%	Strong Buy 1
Gran Tierra Energy	GTE-TSX	GTE-AMEX	C\$5.94	C\$10.50	0%	77%	Strong Buy 1
Greenfields Petroleum Corp.	GNF-TSXV		C\$6.75	C\$12.00	0%	78%	Outperform 2
Niko Resources Ltd.	NKO-TSX		C\$50.64	C\$66.00	0%	31%	Outperform 2
Pacific Rubiales Energy	PRE-TSX	PRE-BVC	C\$20.37	C\$42.00	2%	108%	Strong Buy 1
Pan Orient Energy Corp.	POE-TSXV		C\$2.00	C\$5.00	0%	150%	Outperform 2
Parex Resources Inc.	PXT-TSX		C\$7.10	C\$9.00	0%	27%	Outperform 2
PetroAmerica Oil Corp.	PTA-TSXV		C\$0.10	C\$0.30	0%	200%	Outperform 2
PetroDorado Energy Ltd.	PDQ-TSXV		C\$0.22	C\$0.40	0%	82%	Outperform 2
PetroMagdalena Energy Corp.	PMD-TSXV		C\$1.50	C\$2.30	0%	53%	Outperform 2
Petromanas Energy Inc.	PMI-TSXV		C\$0.14	C\$0.40	0%	196%	Outperform 2
Petrominerales	PMG-TSX	PMGC-BVC	C\$20.24	C\$20.00	2%	1%	Underperform 4
Petronova Inc.	PNA-TSXV		C\$0.59	C\$1.80	0%	205%	Outperform 2
Porto Energy Corp.	PEC-TSXV		C\$0.26	C\$0.80	0%	214%	Outperform 2
Shamaram Petroleum Corp.	SNM-TSXV	SNM-OMX	C\$0.44	C\$0.40	0%	-9%	Underperform 4
Suroco Energy Inc.	SRN-TSXV		C\$0.40	C\$1.10	0%	175%	Outperform 2
Talisman Energy Inc.	TLM-TSX	TLM-NYSE	C\$13.49	C\$14.00	2%	6%	Market Perform 3
WesternZagros Resources Ltd.	WZR-TSXV		C\$0.70	C\$0.55	0%	-21%	Underperform 4

## Highlights from the Mid/Larger Cap Presenting Companies Under Coverage

**Pacific Rubiales** - Pacific Rubiales hosted a site and facilities tour at its Rubiales field as part of the conference. Following this trip, and having witnessed the evolution of the company's operations over the past few years, we continue to highlight the excellent track record and superior execution of this management team. We believe recent share price weakness is being driven primarily by negative news headlines which, in our opinion, do not reflect fundamental issues with the company. At current levels, PRE is trading at ~12% discount to 2P NAV, offering investors a free option on the company's extensive exploration program ahead of what we expect will be a strong and catalyst-rich 4Q.

**Gran Tierra Energy** – Gran Tierra continues to be a steady South American growth story. We continue to anticipate y/y reserve growth to be delivered based on the 2011 drilling program results to date, a view re-confirmed with the information discussed during the conference. Outside of Colombia, we believe that Argentina remains an area with improving economics, and also highlight the company's growing presence in Brazil and Peru. With several wells currently drilling/planned, we expect Gran Tierra to be a catalyst-rich story for the balance of 2011 and into early 2012.

**PetroMagdalena** – PetroMagdalena's new management team has delivered on several of its promises since taking over earlier in 2011, including reducing G&A, farming out non-core blocks and increasing reserves. However, in light of current valuation levels (27% discount to 2P NAV), we believe investors might be more focused on the company's balance sheet (relative to work commitments) than on continued operational improvements and growth in reserves and production.

## Highlights from the Juniors Presenting Companies Under Coverage

**Petroamerica Oil Corp.** – The company highlighted 3Q11E production of 512 bopd (net after royalties), projected to increase to an average base case of 1,400 bopd (net after royalties) for 2012. Furthermore, Petroamerica reported operating netbacks of US\$68/bbl from Balay. Looking out to 2012, the company plans to fund its US\$38 mln exploration program (including commitments), from cash and cash flow (management is projecting a 2011 year-end cash balance of US\$16 mln, and estimating 2012 cash flow to come in at US\$28 mln under its base case scenario). Management anticipates the US\$29.3 mln development program (Balay & Las Maracas) would be funded via debt financing.

**Petrodorado** – The company is currently on the cusp of some critical exploration drilling, which should continue into 2012. Mainly, the company has plans for 5 or more wells on CPO-5 over the period, and additional work on its Tacacho block.

**PetroNova** – In 4Q11 the company will commence an ambitious drilling program consisting of 13 wells over the next five quarters. Management notes that PetroNova's exploration campaign is fully funded for the next two years. The company has received its environmental licenses for CPO-6 and CPO-7, and expects approval for its environmental license at CPO-13 in the next quarter. In addition, the company has secured drilling rigs for the first 2 wells at CPO-6, with a third rig underway.

**Suroco Energy** – With current production of 1,108 bopd (net after royalty) expected to grow to an average of 1,800 bopd for 2012, Suroco plans to internally fund its 2012 capital program. In addition to the Charapa-1 exploration well (50% working interest) currently drilling on block 1848A, current plans for 2012 include 7 appraisal wells on the Cohembi field targeting low risk reserve growth, an exploration well on prospect A on block 1947C (49.5% working interest), and two exploration wells on the San Antonio block (28% working interest).

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