

Opportunity Knocks

— DANIEL S. CHENG, CFA, VICE PRESIDENT & PORTFOLIO MANAGER

Where can you make money in the energy sector these days? We believe there's opportunity and it's based on near- and long-term factors such as the following:

- Long-term oil demand remains consistently robust. This year's forecast targets 89.3 mmb/d and above 90.7 mmb/d by 2012—a new record high. China will remain the largest source of growth and is expected to consume more than 17.5 mmb/d by 2030, becoming the world's largest oil consumer.⁽¹⁾
- Global demand for natural gas is expected to grow more than twice as fast as oil demand at 2.1% per annum to 2030.⁽²⁾ Worldwide natural gas prices are at a significant premium to North American prices, highlighting different growth scenarios and increasing demand due to the Fukushima nuclear incident in Japan. Liquefied Natural Gas (LNG) will continue to be a key part of increasing Canadian gas prices. Export infrastructure development and recent approval of initial LNG export licences for Kitimat LNG and Cheniere Energy opens access to new markets.
- Recent land sales highlight ongoing interest in specific plays, particularly the emerging Duvernay Shale in Alberta. In 2011, provincial land sales revenue has been more than \$3 billion and is on track to set a new record for the highest calendar year total. Land sales support a robust energy sector in the medium term.

Our View

- We're focusing on companies with quality assets, strong management teams and low leverage to withstand the volatility. These aren't necessarily the cheapest stocks and we're wary of possible value traps. However, there are great opportunities as junior/intermediate energy stocks have sold off indiscriminately.
- We expect increasing merger and acquisition activity given depressed valuations. Many stocks are close to, or at, 2009 lows when oil prices were half of what they are today. Some junior companies are now trading below 3x 2012 EV/DACF and below \$30k/boe/d. As a result, it's currently cheaper to buy than drill. Companies working with reduced capital expenditure budgets may choose to add production growth in that manner.



Opportunity Found

- Pinecrest Energy Inc., one of the largest holdings in the Matco Energy Fund, represents the type of investment we favour. The company is managed by the former executive team of Peerless Energy Inc., an early pioneer in the Bakken formation, which sold to Petrobank Energy & Resources in 2007. Pinecrest's current production sits at ~ 2,100 boe/d and is expected to exit 2011 at above 3,200 boe/d, marking nearly 52.0% growth from now to year-end. The company is targeted to produce above 5,000 boe/d in 2012. Pinecrest has no debt and 99.0% of its production is light-oil- focused and derived from the Slave Point play in Red Earth where competitors like Penn West Petroleum Ltd., Harvest Energy Trust, and Lone Pine Resources Inc. are very active. Given numerous catalysts over the next few months—ranging from drilling results to longer-term potential from waterflooding and EOR—we expect this stock to continue performing well even in the current volatile environment. ■

(1) BP Statistical Review of World Energy, 2011.

(2) BP Statistical Review of World Energy, 2011.

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