



INTERNATIONAL JUNIOR OIL STOCKS

How to Find and Play the 10-Baggers Abroad

What were the oil stocks that made me the biggest profits over the last two years?

It was junior oil stocks with international plays. In 2011 it was Coastal Energy, (CEN-TSX), which moved from \$6-\$18 on a string of 10 successes in a row in the Gulf of Thailand. In 2010 it was Xcite Energy (XEL-TSXv) that went from 62 cents to \$6 last year with a heavy oil play in the North Sea, or TAG Oil developing their New Zealand asset, moving from \$2 – \$6 (it's now almost \$10).

These junior international plays are often orphaned stocks with big, high-impact exploration plays – and if they hit WHOOSH! The stock can flow upwards like oil gushing out of a well.

But if they miss...ouch. The investment can be a big win, or a big loss. These international exploration plays are what I call a one-decision stock, or a widows-and-orphans stock (nobody gets out alive) or a binary trade – it's a 1 or a 0.

They have several key differences from the home grown North American oil plays. If investors know what they are, and how to “game” them, they have a much better opportunity at making a profit – whether the well is a gusher or dry.

The three obvious differences is that international plays can have:

1. more political risk that warrants a lower valuation
2. a much bigger prize (bigger well) if they hit,
3. more risk geologically compared to domestic ones, and I'll explain why.

First, though, understand that North American plays are now dominated by shale or “tight” oil plays, like the Bakken or Cardium plays, or the US shale gas plays, like the Bakken, Niobrara or Eagle Ford. In shale oil plays in North America like the Bakken, a really good well might have an IP rate of just over 3000 bopd – but in Canada the best wells are more like 500-600

bopd.

But in countries like Colombia companies like Petrominerales are often hitting 6,000, 10,000 and 15,000 bopd wells. The value of your investment is obviously going a lot higher with those bigger wells.

And the international arena is full of countries just opening up to new levels of investment in oil and gas and investors can expect this trend of big new discoveries to continue – onshore and offshore.

North America is a mature enough basin that all the juicy profitable low hanging fruit is gone, and can't compete with those production numbers.

The other factor that gives (successful) international plays much more profit potential has to do with risk and valuation.

Domestic plays have become denominated by the “Resource Play” which is a large acreage of “tight” oil, or is an “unconventional” play that can hold a large number of low risk wells with highly repeatable results.

With 3D seismic and other exploration tools, investors have become accustomed to companies drilling successfully 80%, 90% or 95% of the time.

This safety factor means that companies with domestic plays can extract higher valuations from the market when they get financed – at a higher percentage of the company's Net Asset Value, or NAV. So not only is the upside capped on domestic plays by small IP rates, the starting point is higher due to less risk. *So the potential profit window is smaller on domestic plays.*

My experience is that most domestic plays get financed between 0.7 – 1.25x NAV. However, international plays can get financed as low as 0.2 NAV – 0.5 NAV, particularly if they are “orphaned” stocks.

What does that term mean? It means the company has no active “sponsorship” in the market; no brokerage firm or controlling shareholder is actively promoting the company. Most retail investors greatly under-appreciate the importance of good sponsorship in a stock.

I will often buy stocks just because the most important investment banker in Calgary or Toronto is firmly behind the company. Besides premium assets, sponsorship creates premium valuations more than anything in the market.

And without it, stocks are orphaned, and can trade at big discounts. And

there are often a lot of international plays that are orphaned. TAG Oil was orphaned from 15 cents all the way up until GMP raised them \$17 million at \$2.50 in 2010. Xcite Energy was orphaned for a long time; no brokerage firm was actively telling the rest of the street – “this is our deal, we financed it, and it’s going to be a big winner”.

And there is truly a very simple way to discover, and play, these high profit potential stocks. If you’re serious about making money in this highly profitable – but higher risk – sector. It will only mean a little bit of sleuthing.

Lastly, I would say these opportunities are likely to become more difficult to find. That’s because after the financial crash of 2008, the oilpatch – like everybody else on earth – reduced risk and stopped spending money. These types of high risk international plays were obviously the first to get canned from exploration budgets. Enough risk appetite has returned to the market that these high impact international plays are now attracting a lot more mainstream attention sooner than before, and getting in REAL cheap, like I did with Xcite, will be more difficult.

But as long as the international play in your sights is not a recognized resource play, then it should still be trading at a good enough discount to NAV to provide some excellent upside potential. If they hit.

One of my subscribers, Craig in Seattle, rode OGIB stock pick Xcite Energy ([XEL-TSXv](#)) and their North Sea heavy oil play from 60 cents to \$6/share and sent me this email just before Christmas: “Thank you many times over – this “plucky” investor has just become a millionaire (on paper) due to you bringing it to my attention and of course me doing my own research.” ***I love those stories.***

Here's how I find these companies, and how I invest in them...

1. My investment philosophy is to have the biggest “deal flow” I can get; create a big hopper of ideas and keep it full. So that means I have accounts with *a lot of smaller, regional brokerage houses* that cover the junior international exploration companies. In Canada this means securities firms like (alphabetically), Cormark Securities, Haywood, Jennings Capital and Union Securities among others.

Some of the national firms cover a few international juniors, (Canaccord Capital, GMP Securities, Macquarie Capital) but these junior companies often don’t raise a lot of money before their first big success, so it’s tough for the larger brokerage companies to make any money covering them.

Whatever firm you're with, have them email you their morning letter and specifically an energy letter if they have it. (I get 6 each day, and get some of my best investment ideas from them.)

In the U.S. the analysts are more myopic and they don't do near the small cap international coverage that the Canadians do – in fact, it's not unusual for US based teams with international projects to list on the Toronto Stock Exchange first.

These companies often get orphaned as the investment bankers in Toronto and Calgary don't know the management that well, and they fall through the cracks – unless management can raise their own money or has a remarkable track record in exploration.

2. Another free and easy way is to sign up for the daily emails from some of the trade magazines – I read the daily email from Rigzone.com – I find that the best one. I also get the daily email from www.platts.com and www.upstreamonline.com.

3. I also have Google Alerts to track some very talented energy writers, like those at the Calgary Herald and the Houston Chronicle. (Another great writer — though he doesn't cover much in the way of international plays — is Allen Brooks' Musings from the Oil Patch <http://energy-musings.com/>)

4. I also create Alerts for areas like “offshore West Africa” or “North Sea oil”.

5. Every six months there is an investment conference of junior oil and gas companies in Calgary hosted by SEPAC – the Small Explorers and Producers Association of Canada (www.sepac.ca) that is worth attending.

6. And if you do all these things, guess what will happen? *You will create the single most important and powerful profit center of your investing career – your network of friends and contacts.*

They send you research. They share talks they've had with other people. They may know of a junior company that has just assembled a big land package right beside a big new discovery in Timbuktu or Nowhere – and they're doing a cheap financing.

OK, so now you are slowly building your information flow and have a list of several exploration stocks you're following. Which ones to buy?

Like any other energy investment, you want to check out management, find out how much production they have, how big their land position is, and

whether or not there is production nearby. You want to know the cash balance, and the share structure, and how transparent or corrupt the country is. (Download my Top 20 Questions to Ask Management by visiting the www.oilandgas-investments.com web site).

I want to find a big play that is getting financed now, but won't get spudded for several weeks or months. I want to put my money in when The Big Money comes in. I may have been watching the company for months, or longer, but I wait for The Money to come in. (I also call this the BIBA Machine – Brokers, Investment Bankers and Analysts.)

Getting the timing right is very important to me on these high-risk, high-reward international plays.

One thing I don't want to do is be too early to the play. Perhaps management is waiting for permits of some kind – the politics and bureaucracy in many countries is very slow. Or maybe the hot property is in a legal dispute. Or there is some negative attribute (“hair on the deal,” it's called) that is keeping **The Money** away. Without **The Money**, the *chances are much less* that the stock can build a speculative premium close to drilling. The Money promotes the stock with management.

And that is key. I like to make my investment several weeks before results are due on the well. That gives management time to promote the stock to analysts, who can get their reports out to their clients. Hopefully management can spend a lot of time doing investor presentations to institutions and other investors to create some excitement around the play. Who organizes most of those presentations? **The Money**.

I want this “excitement” to cause the stock to go up so I can choose to sell enough stock to cover the cost of my investment and ride for free on the results. If the timeline from investment to results is too short, I might not get that opportunity.

High risk, high reward. But these are the plays – for the risk-tolerant investor – that can be 10 baggers over short periods of time.

Keith Schaefer
Publisher, *Oil & Gas Investments Bulletin*

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