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MARKET UPDATE

COMPANY UPDATES

UPDATES ON 3 OGIB FAVOURITES
PACIFIC ETHANOL—PEIX-NASD

SECURE ENERGY—
SES-TSX; SECYF-PINK

WHITECAP RESOURCES—
WCP-TSX; SPGYF-PINK

Whitecap (WCP-TSX; SPGYF-PINK) and Secure Energy (SES-TSX; SECYF-PINK) and Pacific Ethanol (PEIX-NASD)—three of my favourites right now—all issued year end financials in the last couple days.

PEIX is up 10% in after hours trading. The main reason is they produced a lot more ethanol than the Market thought they would in the fourth quarter—just over 50 million gallons.

Revenue was a quarter million dollars, but the tax rate was lower than the Market expected, so their profitability – 41 cents a share—was way better than the 16 cents a share that consensus earnings had.

One could argue that makes PEIX very cheap—about 3.5x annualized Q4 EBITDA EV, or Enterprise Value. And because of an incredible Q1 and Q2 2014, it's trading at 2.4 x Trailing Twelve Month (TTM) EBITDA.

But the Market looks forward, not back, and right now ethanol margins are razor thin, and could stay that way for awhile.

The refinery strike is helping gasoline prices, especially in the west. The $9-$10 Brent WTI spread is also helping gasoline prices. Corn has been almost a full dollar a bushel higher than I would have expected after two bumper crops in a row—it's been hanging in at $3.80, and I thought corn could have seen a $2 handle on it by now.

Ethanol is now trading about 40 cents a gallon below gasoline, vs. 20 cents above 6 weeks ago. That's what you want to see for strong exports (history says closer to 60 cents a gallon discount is needed). Production is slowly coming down, and inventory growth is slowing. That's likely why PEIX and GPRE were up today after a fairly neutral EIA report on production and inventory.

There was no mention of the Aventine merger in the PEIX year end financial report. So until a regulatory filing on Aventine's financials come out, it remains a black box to investors. However, mid-west ethanol margins (the "crush spread") have been higher than west coast margins, so that should help PEIX. If I had to guess I would suggest that when that news does come to light, it will be bullish for PEIX.

Pacific Ethanol has $62 million cash and paid off $62 million in debt in 2014. That's good manageument. CEO Neil Koehler was a bureacrat for years before he was an entrepeneur here and he has done well minding his Ps and Qs.

Cash position was up almost $6 million from last quarter.

The Pacific Ethanol conference call is at 11 am EST tomorrow, and you can hear it on the company website. Or dial in at (877) 847-6066, passcode 95713528#.

Barring any major (stock price moving) development on the conference call I will not be issuing any update after this call (highly unlikely--Neil is good that way).

I'm neither a buyer nor a seller of PEIX right now.

SECURE ENERGY SES-TSX

Secure does many things—drilling fluids, managing the big new pad well sites (they're like small towns now!) and processing and cleaning oil (called "terminalling").

In their year end numbers, EBITDA was up 54% and EBITDA per share—which is what the Market really pays for—was up 38%.Revenue excluding their business of buying and selling oil for their clients—was just under $800 million.EBITDA was$211 million.Net earnings were $30.6 million.

They built seven new facilities and made eight acquisitions—so great growth organically and in M&A. Another four facilities will open this year.

The Street expects EBITDA to only be down 10% this year, much shallower drop than the rest of the OFS—OilField Services—sector. Terminalling oil—they call that the PRD business, for Processing Recovery and Disposal—could actually be up in 2015, from the organic growth and the fact that all wells increase their water cut every year.

Surprisingly, the DS division—Drilling Services—where they compete with Canadian Energy Services—increased due to the number of metres drilled and the day rate increasing.But into 2015, this division could see a 40% drop in revenue, and higher drop in EBITDA with pricing issues.

The OS division, or On-Site, is expected to see a downturn of 15%.However in all three divisions, cost cutting measures are expected to mitigate lower EBITDA.

The Big News was a Big Drop in capex, from over $200 million to $50-$150 million.I'm thinking that's because producers clean a lot of their own oil—but they may now sell that business to Secure for cash infusions **.I also think that's the reason Secure announced a $140 million bought deal financing after Market close today, 24 hours after their year end financials came out.**There's a good chance they can buy assets as cheap or cheaper than building them.

Both CEU and SES have roughly 2-2.5x debt to cash flow—and SES is $400 million drawn on a $700 million line—but I think they have M&A in mind, not shoring up the balance sheet with this financing.

WHITECAP RESOURCES

There wasn't really much new news here in their year end numbers—production in February was 6% higher than the Street thought at 39,000 boepd. They have a 95% payout ratio because of their strong hedge book in 2015—almost 50% of production at $98/barrel.

Their credit facility was bumped UP $200 million to $1.2 billion. Costs are coming down—in their Viking play wells now cost $740,000, down 13% from $840,000. The company has, a low premium, IMHO, to its peers at 9.9X cash flow vs 8.3x.

Their Reserve Life Index is an impressive 16 years (I'm happy at 9 years), and 2P Finding and Development costs, all-in, are $20/barrel, which is very good for a company that's 76% oil.

I've got a small position in Whitecap, and I'm happy to keep it a small position for now. Oil prices need to show me they're going higher (I will say I'm more impressed than I thought I would be with the way oil trades—way more bullishly than I would expect)—and even then companies like WCP and Raging River—the leaders—are already pricing in $70 oil.

Multiples are as high or higher now than they were with oil at $100/barrel.

At 39,000 boepd, WCP has the size to handle 30 month payouts. Juniors much smaller than this do not. That's the BIG THING—payouts are now longer so growth rates are slower…and as I said, multiples are now getting higher. This is especially true among the leaders.

I get there are cost reductions throughout the value chain on the services side—producers are wont to say that $70 is the new $90, meaning that they can generate the same netbacks at $70/b WTI as they used to at $90 WTI. I'm not convinced of that. That's why I'm keeping my positions small for now.

But technology stocks went through the same thing—continually reducing costs allowed stocks to perform great through lower and lower end product pricing.

And oil and gas producers' stocks could do the same thing in 2015.

MARKET COMMENTS

Because cash flow growth will now be challenged with much lower commodity prices, the leaders in the junior/intermediate markets are getting a scarcity premium. But IMHO, it's better to own small positions in them than larger positions in the more levered names.

If I want to go in that direction however, **Legacy Oil and Gas (LEG-TSX)** is the one I will own. Leverage is only slightly more than the leaders, it's heavily oil-weighted and is over 20,000 boepd.

I'm avoiding Montney stocks—the very liquid rich play on the BC-Alberta border--specifically right now, waiting for the natural gas downturn to come into effect. July-August should be the time to revisit those stocks. They have high valuations and if natgas does what I expect--$1/mcf with the odd weekend Canadian gas going no bid—these stocks will be cheap, and companies like Chinook with great balance sheets (net $70 million cash) will be able to buy up companies quite accretively.

BUT....The Canadian market is very small, and very incestuous. Everybody lives in the same 9 x 9 block downtown core in Calgary. If you look at the deal **Kelt (KEL-TSX) did to acquire Artek (RTK-TSX)**—both have similar Montney assets--it was marginally accretive for KEL and a 57% premium for RTK, which was trading at 4x debt to cash flow. The assets were in the same play. There was a common director, and one of Canada's largest fund managers was also on the board of Artek.

Please don't think I'm being negative here, what happened is very good for shareholders (unless you're a Kelt shareholder). I think that in the more mercenary USA, Artek gets taken under, not taken over, for a much lower price. But because in Canada we have such a small number of companies worth following, and so many funds having to own them, that deals get done at better metrics (i.e. the predator pays more) than the balance sheet of the company being taken over (the prey) REALLY deserves, to keep everyone happy and the money flowing (especially going into what is almost unanimously considered a very bearish spring-summer in natgas).

These gas weighted and liquid rich weighted Montney stocks are in a very tough position right now. And for Canadian institutions, this presents a quandary. They have to own this play, as it's the only non-oily gas play in Canada with any decent economics. But even those are now becoming challenged.

The high liquids content in the Montney (50 API condensate, which has gone from a slight premium to light oil in Canada to a slight discount)...paid for the well and the natgas was just gravy.

But now the liquids value is a lot lower due to low oil prices, and at the same time natgas prices are falling out of bed in Canada--short term and long term.

It's tough to be bullish on this play right now, despite having great economics when commodity prices were back at Q3 2014 levels.

OIL PRICES

This market is just a mess from week to week--and I'll explaine why--but I think overall it's bullish. Consider:

The API numbers—American Petroleum Institute--for oil inventories come out every Tuesday afternoon, and they are generally considered not quite as reliable as the EIA numbers Wednesday morning. But the last few weeks, the API numbers have been so far off the mark vs. the EIA that I sure hope nobody actually PAYS for those statistics.

Before this week (i.e. the last two weeks) the API inventory number was very bearish, and oil stocks declined into the first hour of trading Wednesday morning. Then when the EIA numbers came out—which, aside from today (this week) were much more bullish (i.e. lower inventory builds than API suggested), oil and oil stocks rallied hard through the rest of the day Wednesday. And then for a couple weeks the Market also got bullish (i.e. large) rig count drops Friday morning.

Now this week, the opposite happens. The API inventory build guess for the USA in total is mild at just over 2 million barrels. Then the EIA numbers come in at a staggering 10.3 million barrels, which CNBC said was more than double the amount predicted by analysts and the eighth weekly rise in succession. U.S. crude inventories are at a record high.

The US also said that the economy was expanding, and the Saudi oil minister said the Market was finding balance. ***That trumped rising inventory levels—even the largest build in decades, if not all time.***

That is bullish. To me it doesn't make sense, although most of the build was not in Cushing (only 500K of the 10.3 M b), but DON'T FIGHT THE TAPE.

I was quite surprised that WTI finished up today. And of course that means refinery stocks finished down. The Brent-WTI spread has now contracted to just under $9, down from its $13/b peak last Wednesday. There is no way refinery stocks are going higher when that happens.

I still think the fundamentals support my refinery thesis, but don't fight the tape. My stop loss for these stocks is my cost base (which is around $55 for VLO, and my original purchase price for TSO and NTI).

I repeat—watching the tape all day as I do, I think the oil price is trading bullish. Today's upward momentum—which is seeing follow through tonight in Asia—surprises me.

Fundamentals gave EVERY justification for oil--especially WWTI--to be lower today and tonight—because of the record inventory builds in the US—and WTI is up.

It makes no sense unless you believe the selling is done and higher prices are coming.

This doesn't negate the refinery trade—Brent can run as fast or faster than WTI (and should, IMHO), which would keep these stocks going. But I'm watching closely.

-Keith