

OGIB INTERIM BULLETIN #392 - April 7, 2015

OIL AND GAS

SIMPLE, RIGHT?

PARTIAL REFINERY SALES COVER USO SHORT

I changed my mind on natural gas while in Hawaii—I was checking the charts once a day, looking at prices and thinking...gas should be dropping at least a bit now as the Market prices in warmer weather and continued production builds....

But that didn't happen. Now true, colder weather did stay longer (and is still staying in parts of the Northeast USA) but...sometimes I just look at something and get a funny feeling. So now I'm not an uber bear on natgas, just a bear.
(More on natgas in the charts below....)

The oil price is giving me the same sense right now. Despite all the bearish supply fundamentals right now—domestically and fears of it happening internationally—the leading oil stocks are moving up.

Valuations are sky high now, up in the teen times cashflow, but that is what you would expect just before a turn up.

So I have to honour that in my trading, and I'm reining in a couple bearish trades—**the 1000 share short on USO for starters--at \$18.98 for a 12% loss**. That trade has a great theory behind it, (if you learned a lot from it, that eases the pain of my financial loss) but especially this week when the weekly Cushing storage build is expected to be under 250,000 barrels—vs. a 2 million weekly build lately—that could give oil prices a big boost tomorrow. Next week is expected to be back up much closer to two million.

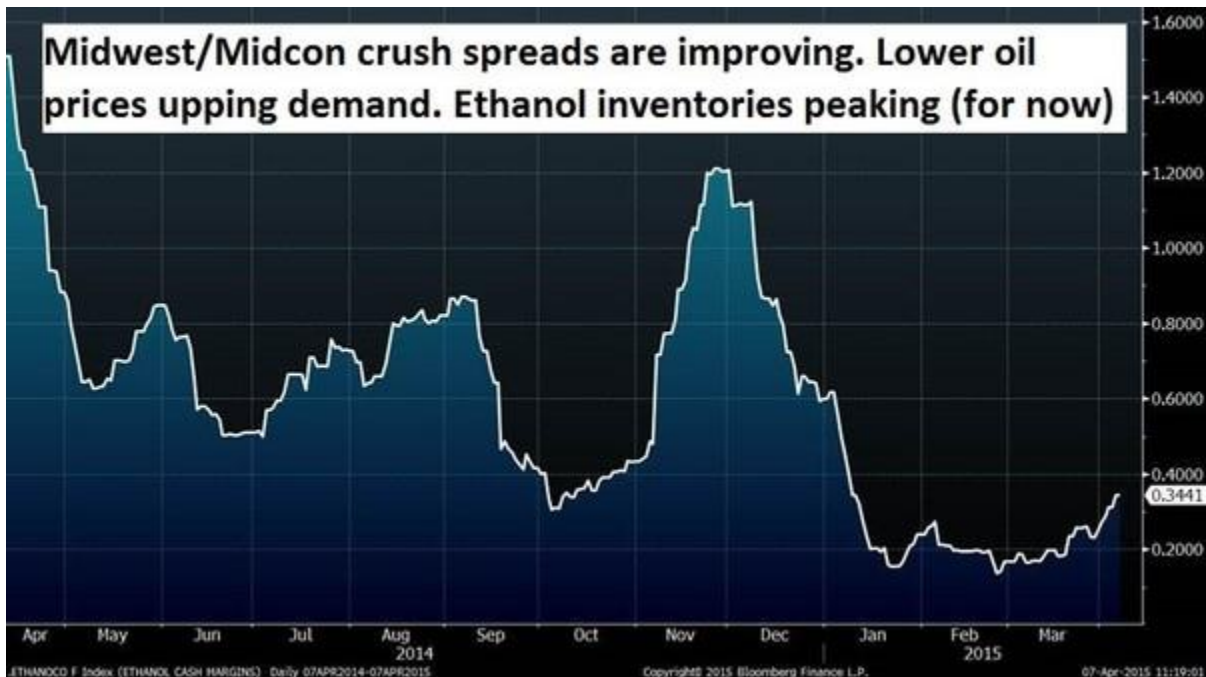
I'm also selling 2000 shares of my Valero (VLO-NYSE), the large Gulf Coast refiner at \$58.46. That means I still hold 1500. (Gains were 13.8% on 500 shares, 8.5% on 1000 shares and 7.2% on another 500 shares).

I suspect global oil demand is increasing as much as US oil demand is, and so that 2 million barrel oversupply the world's economists thought we had in December and

January is likely much less now.

I am keeping my **Northern Tier** for now and both my ethanol stocks—**Green Plains and Pacific Ethanol**. Crack spreads and crush spreads are actually still quite good, especially in the inland, mid-continent area. (The west coast crush spread is back up above break even to 5 cents/gallon)

Here is an updated chart on mid-con ethanol margins—I would buy that chart.



Again, PEIX has TWO potentially major catalysts in the coming 12 months. One is the Market getting some comfort with the Aventine acquisition—which is all Midwest. I think this has potential to add \$2-\$5/share.

(But remember that Aventine shareholders have had no liquidity for 4 years, so they may not care what a great company I think PEIX is and just dump their stock indiscriminately. They all probably HATE ethanol stocks right now.)

The second is PEIX turning its Kinergy division—3rd party ethanol marketing—into some form of MLP structure like Green Plains has done. PEIX trades 2-4x cash flow, and MLPs trade 10-20x cash flow. NO BRAINER. If that happens this calendar year I suspect it will be towards the very end of the year; digesting Aventine successfully is CEO Neil Koehler's Big Job this year.

Oil stocks are already pricing in \$75 oil, so I don't feel the need to rush out and BUY oil stocks. And because I own some of the leaders—**Raging River and Whitecap and Secure Energy and Cdn Energy Services**—they are benefitting from this improved psychology.

If I was looking to buy more oil stocks, there are three considerations:

1. Which stocks have the best fundamentals; i.e. lowest cost production and
2. Which stocks will get the first big inflow of institutional money (often but not always the same as 1)
3. And of course, which mid-tier or lower grade stocks—because they either have just a bit too much debt or a slightly higher costs—have the most leverage or beta to oil and will provide the best swing trades. Just like we are seeing today, the much higher levered debt companies like Legacy, Lightstream and Long Run are having big runs when there is optimism in the Market.

But oil is still under \$65/barrel, and very little really works in the junior sector under that price. But there is a lot of excitement between here and there, so it's possible—and the charts are now saying likely—stocks continue their upward moves.

Reality doesn't have to hit until quarterly financials come out. ;-)

During this 3-4 month downturn, I haven't been diligently researching new well results or recycle ratios on individual companies or plays. The main thing I have been tracking during this downturn is the order of companies in the Street's pecking order—in the junior dividend space, has this downturn changed whom the Street will buy first, second and last? Same for the junior growth stocks.

For now, there hasn't been any movement.

I've got a couple teams I want to speak with this week.

POWDER MOUNTAIN AND ENTERPRISE GROUP

I spoke with a couple last week—**Bruce Murray at Powder Mountain and Des O'Kell at Enterprise Group.**

Bruce was drilling his first two wells into his SE Saskatchewan ground this winter.

This company was the merger of two other companies, and they were both rolled back significantly (you can read about it in the Members Centre). The company was attractive to me because it was a low market cap company with a large position in the new Torquay play, located beneath the Bakken (in the US they call it the Three Forks) in SE Saskatchewan.

This was near where Crescent Point had just made a big discovery near the US border and was crowing very loudly about its great economics (I did a story in the blog on this and if you use the search function on the right hand side of the page you can find it). The stock was well capitalized, and had GREAT leverage to what I

considered a low-risk discovery. It still does...but...

As I said when I bought the stock originally, junior stocks like this go no-bid when the Market turns south, as the Market did, and as did Powder Mountain.

Sadly, Bruce and his team missed on one of his wells, and in my conversation with him he was very honest and said they weren't sure why they missed. Bruce is a wonderful man, but that is not good news. They tested one well at 120 bopd and figure it could do even better, but there is no point in putting that well on right now in these low oil prices.

They are now pouring over the data, trying to figure out how to better interpret their seismic. The good news is they are trading below cash value, which is supporting the stock. Some value investors like that; I don't. I'm not a buyer down here.

With **Enterprise Group**, the business continues to perform...not bad. Volume is good but the management team has never been able to produce the profit margins they said they could through 2013 and early 2014 as they raised money. It should be said however that they have (significantly) better margins than their junior OFS (oilfield services) peer group. Enterprise management is quick to point out that almost half their business is non-OFS; it's utility.

Regardless, the Street is now punishing the stock price. With a cautious-at-best outlook for the western Canadian economy due to low commodity prices (especially natgas) plus with Enterprise having a lot of debt—and they didn't pay much down in Q4—institutions will give Enterprise a pass for now. And this stock has a big enough float it needs institutional buying.

This is now a “show me” stock for the Street for 2015, and I suspect the company will have to get at least a couple quarters of very strong utilization and financial data out to the Market before it finds a really strong bid again.

NATURAL GAS

I had a lot of feedback on the story I ran on the weekend by my colleague Bill Powers. Bill wrote a book a year ago--on Amazon--called **Cold Hungry and In the Dark**--about how natgas in the US was not economic at current prices and that someday gas would have to return to at least its cost of production.

The Street has bought in completely to the idea that cheap natgas will flow forever from the Marcellus and elsewhere in the US.

That obviously cannot be true; but rather it's a question of timing. When Bill and I were talking a couple weeks ago he said--Keith, the Marcellus doesn't have to go down in production for prices to go up....the Marcellus just has to peak and the

declines everywhere else will drive up prices. That could be true, and so I thought that was worth a story--which you saw on the weekend.

There are several very well respected organizations who make a living off projecting energy data. One of the principals of those firms once told me "in general estimating current and historical production is a dash of art sprinkled primarily on science (i.e. state well data). Bentek, IHS, Wood Mac, PIRA all have their own secret sauce but the main ingredient is that well data."

And Bill uses original state data as well.

I don't know when Bill's thesis will be right, but his data on the core Marcellus counties finally declining in production could be "the canary in the coal mine" for higher natgas prices.

Other than **Memorial Development (MRD-NYSE)** I haven't looked at US natgas stocks for awhile. As Bill says, they don't make money. But just in the interest of getting to know them, I produced some charts of the top Marcellus producers. If natgas prices do have a run, Marcellus producers should be the most levered as their realized price is now very low compared to the rest of the US due to pipeline constraints. (MRD is a Louisiana play, not Marcellus)

Those constraints are now being alleviated (see the story I wrote on the blog called The Very Bearish Case for Canadian Gas). If natgas prices rose significantly (\$4-\$4.50/mcf) in the US, then Marcellus producers should have the greatest increase in cash flow year over year.

So here are the charts of the major Marcellus producers, with some brief annotations. Cabot would be considered the cream of the crop, and--IMHO--would attract large institutional inflows first with EQT a close second. But the bigger leverage is likely with Chesapeake.

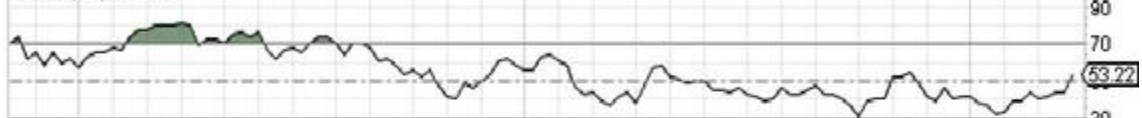
COG Cabot Oil & Gas Corp. NYSE + BATS

© StockCharts.com

2-Apr-2015 3:51pm

Open 28.90 High 30.77 Low 28.57 Last 30.77 Volume 19.8M Chg +2.11 (+7.36%)▲

▲ RSI(14) 53.22



COG-NYSE--arguably the BEST natgas stock in USA

COG (Weekly) 30.77

MA(50) 32.10

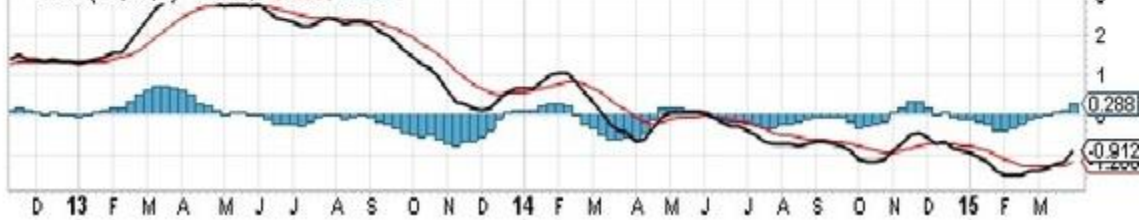
MA(200) 27.55

Volume 19,768,878



Cabot is still in longer term downtrend despite recent +ve action. See how volume spikes are on the down days

MACD(12,26,9) -0.912, -1.200, 0.288



Historic Chart for US EQT by Stockwatch.com 604 687 1500 - (c) 2015
Thu Apr 2 2015 Op=81.97 Hi=84.57 Lo=81.97 Cl=84.29 Vol=1,046,994 Year hi=111.47 lo=43.69



Historic Chart for US RICE by Stockwatch.com 604.687.1500 - (c) 2015
Thu Apr 2 2015 Op=21.32 Hi=22.34 Lo=21.32 Cl=22.04 Vol=2,329,919 Year hi=34.34 lo=16.04



Historic Chart for US:CHK by Stockwatch.com 604.687.1500 - (c) 2015
Thu Apr 2 2015 Op=14.225 Hi=14.689 Lo=14.20 Cl=14.61 Vol=28,159,275 Year hi=35.95 lo=13.32

CHK is highly levered to natgas but chart is horrible. Should natgas turn for real, this stock should do well--but certainly no signs yet. YUCK.



Historic Chart for US:SWN by Stockwatch.com 604.687.1500 - (c) 2015
Thu Apr 2 2015 Op=22.81 Hi=24.12 Lo=22.72 Cl=24.04 Vol=9,679,173 Year hi=49.16 lo=21.455





-Keith