

## OGIB INTERIM BULLETIN #481 - May 11th, 2016

### Q1 PORTFOLIO ROUND-UP

PAREX

POLARIS

SILVERSPRING

TAMARACK VALLEY

RAGING RIVER

### PORTFOLIO PURCHASE

WHITECAP RESOURCES

WCP-TSX; SGPYF-PINK

When I'm summarizing the quarterly reports for the producers I own, I only pay attention to what is not expected. If a company does what it says it would, then I pay it no mind and don't bother updating you either. I only write it up if I think the stock is going to stop going up or if it's going to go up faster than I thought before.

Examples would include junior Canadian producers **Raging River (RRX-TSX; RRENF-PINK)** and **Tamarack Valley (TVE-TSX; TNEYF-PINK)**. Both these teams reported production and cash flow per share results where the Market expected, and given flat to slightly rising commodity pricing, these investments are on cruise control.

I want to spend as much time finding NEW investments; the stock and the Street will tell me if there is something really important to understand.

With Raging River, the only comment I would have is that they are now drilling their Viking wells for HALF the price they started at a few years ago—now down to \$650,000. Wow.

RRX, like several producers now, is increasing their 2016 budget with higher oil prices and have added 30-35 well for a total of 215-220. The increased capital is expected to increase 2016 average production from 16,500 boe/d to 16,750 boe/d. 2017 guidance moves up to 18,000 boe/d from the previous exit guidance of 17,000 boe/d. At \$45-\$50/b—which I

think very likely—this is one of the VERY few producers who can grow 10-15% a year. Stunning, really.

Tamarack CEO Bryan Schmidt has also been successful in reducing costs—TVE had operating costs (opex) down \$2/b vs. expectations for Q1. Production—around 9500 boepd—will be flat to slightly down this year, but produce \$10 million in FREE CASH FLOW here at \$44/b, say analysts. The stock is doing great.

But I'm only buying these companies on the financings. I just don't yet quite have enough faith in the price of oil....

### **WHITECAP RESOURCES INC. WCP-TSX; SPGYF-PINK**

**I bought 4500 shares of Whitecap Resources Inc. on the \$9.20 financing** announced late yesterday. This fits with my idea of small positions in the leaders.

Whitecap is one of the premium intermediate oil producers in Canada. This \$470 million financing is to buy 11,600 boe/d of mid-grade (22 API) oil about 10 km west of Swift Current Saskatchewan (SW corner).

It's one of the better deals I've seen—7-12% accretive to cash flow per share, depending on what analyst you read. Payout ratio falls 8-10 points to about 75% next year. This asset has a super low decline rate of 5%; it's almost all under water-flood or polymer-flood. Average well production is 14 bopd (fourteen) with the biggest one being 160 bopd. 96% watercut. That's a lot of water!

It's a new area for CEO Grant Fagerheim. Mid-grade oil is also new; WCP is light oil. The seller is **Husky (HSE-TSX)**, and the \$595 million is less than the \$600 million spent on just waterflooding to date.

There are 500 undrilled locations for more primary production, and Husky has spent no money on the asset for a couple years. The Street was very vocal today that Fagerheim's team can lower costs and increase profits in the play quickly and easily, and grow production as well.

The \$595 million price tag works out to roughly 9x cash flow on the current

low strip pricing...and remember last week's story on how mid & heavy grade oil has SO much leverage if oil goes from \$45-\$55? *This asset will be a steal should oil rise just another \$10/barrel.*

Whitecap, like all the premium domestic producers, is setting themselves to grow slowly in this low price environment. For those of us who invest full time in the junior sector, this is a blue-chip, safe stock with a great team who is using their premium valuation to buy assets at the bottom of the market. But it's tough to do that on a per share basis; this one fits the bill better than most.

You can include Tamarack Valley and Raging River, another OGIB favourite, in this category. Most of the optionality in the stock is based on the commodity price; their production per share will slowly rise.

That's why I *really really really really* like Parex. It has organic per share growth optionality like nobody else—even right here at \$45 oil.

**PAREX RESOURCES INC**  
**PXT-TSX; PARXF-PINK**

First off, the quarterly numbers for Parex were not a big deal to me—like the domestic producers mentioned above, op costs are coming down.

Production is growing; they are now at 30,400 boepd. For Parex, that meant a flat quarter because the discount their oil receives to Brent was a little greater than normal as well.

But the reason I should be buying EVEN MORE Parex is the optionality here. Management says they are willing to double their 2016 capex from \$40-\$50 million to \$80-\$100 million when oil goes up from \$35-\$45.

At \$35 oil, cash flow is \$60 million. At \$45, it's \$100 million. At \$55, it's \$225 million. THAT'S LEVERAGE.

They actually had \$5 million in FREE CASH FLOW last year.

If oil prices stay at these levels, they will 9 exploration and four development wells. Plus, they may put another \$20 million into starting work at Aguas Blancas, which is the high-profile asset they JV'd with

Ecopetrol earlier this year. It's right beside a property that has produced 850 million barrels of oil.

You can bet if that first Aguas Blancas well hits, this stock will do VERY very well.

I don't want to diminish the catalyst potential of any of the other wells, but the Street would easily extrapolate/give credit to the stock for future success if that first well is a Big One at Aguas Blancas.

I'm also very aware Parex has \$300 million in liquidity without raising equity—that kind of money would make a game-changing acquisition.

Small growth here now, real, FREE CASH FLOW over \$45/Brent barrel, prudent spending...nice big valuation for a raise if they need even more money...no other producer I know of has the potential to double or triple in stock price as fast as Parex at \$45 oil. *Big Optionality here.*

### **SILVERSPRINGS NETWORK INC. – SSNI-NASD**

The stock has fallen from the quarterly release because of a YoY decline of top line revenue, based on GAAP, of 66%. Non-GAAP revenue was up 9% to \$68.9 million. Margins were down slightly from last quarter from 47-43%.

Small cap NASDAQ stocks are very volatile, so I'm feeling lucky the stock didn't get hurt more. As it is, the stock is below all its moving averages and will clearly need to recycle or come up with a new catalyst.

The company did announce some small contracts in the international space—in downtown City of London UK, and Jamaica. Pacific Power in Oregon is also a new customer.

Op costs were down, they have \$125 million net cash but SaaS—services revenue—was flat. It's pretty clear the Street wants to see that increase each quarter, even if only by a bit. And they installed another 700,000 endpoints in the quarter--they are now over 23 million.

But they also guided to slightly lower margins at 40-42%--still GREAT, but expensive stocks have to over-deliver.

Folks, this stock is, as we say in hockey, The Next One. The Street has anointed this stock as its go-to junior IoT stock...for now. But SaaS revenue has to pick up; management has to put the Blue Sky back in the stock with either more SaaS or more international deals.

The Market is a petulant child that way. The business is doing OK to great. But it's clear expectations were for a little more.

I'm not a buyer (but I will be) and I'm not a seller for now. This is a very neat space, and a very neat company and I urge subscribers to read the Company Report in the Members Centre. You clearly have some time to do it before the stock runs up.

### **POLARIS INFRASTRUCTURE – PIF-TSX**

Q1 numbers were as expected, however the stock may open lower tomorrow as the company disclosed (in the MD&A, not the release :-() that they have temporarily “concluded” the second well without a production decision.

They did get the fluid circulation losses (meaning they hit a permeable zone of hot water) they wanted at the right depth. There was also an uphole zone potential. But they are going to let the well re-heat and decide in Q3 what to do with it. They have already done one sidetrack well and may have to do another.

And while the injection well workovers are proceeding well, it will mean 5K-8K MW hours downtime in Q2. I'll be asking how that monetizes out on the conference call tomorrow morning.

As well, the first well is heating up much more slowly than expected; it's now not expected to hit its 230 degree C until Q3 2016.

Despite that, some intelligent cost cutting helped give the company strong EBITDA of \$10 million (all USD) for the quarter. Power was down a miniscule 0.2 MW, but the 3% annual escalator more than made up for that.

The record date for the 10 cent US dividend is May 24, payable on May 30.

-Keith