January 9, 2012

What Can 2011 Tell Us About 2012?

High Growth Names '*likely*' to Outperform

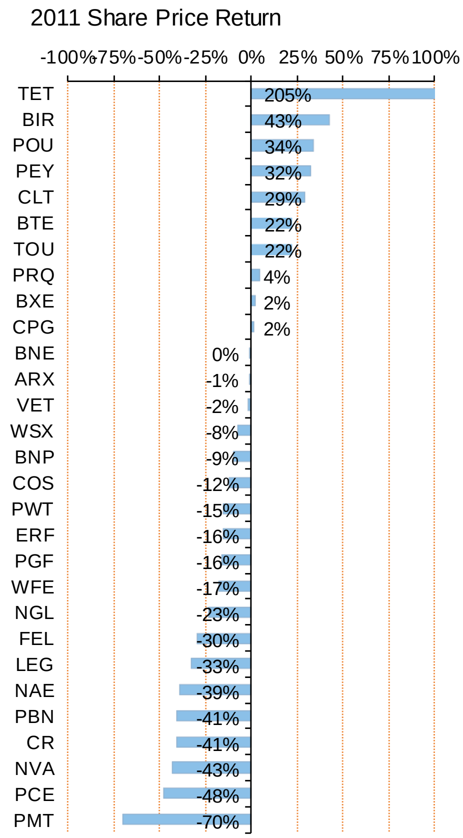

Figure 1. 2011 Share Price Return
Source: Factset, AltaCorp Capital Inc.

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High Conviction with Bellatrix and Trilogy: We examined the qualities of intermediate names that outperformed in 2011 and conclude a key underlying theme was production per share growth. As we show in Figure 1, the top 10 names with the highest production per share growth (PPS) had an average return of 28% for the year. This compares to the 'middle of the pack' names at -4% and the lowest 10 names at -24% (Median: 22%,-2%,-16%). For 2012, Bellatrix (BXE-T, Outperform) and Trilogy (TET-T, Outperform) both have lofty PPS and CFPS growth expectations, a strong balance sheet, relatively attractive valuations (BXE in particular) which is all supported by large resource plays that have some of the most attractive well economics in the basin. We discuss these names in more detail below.

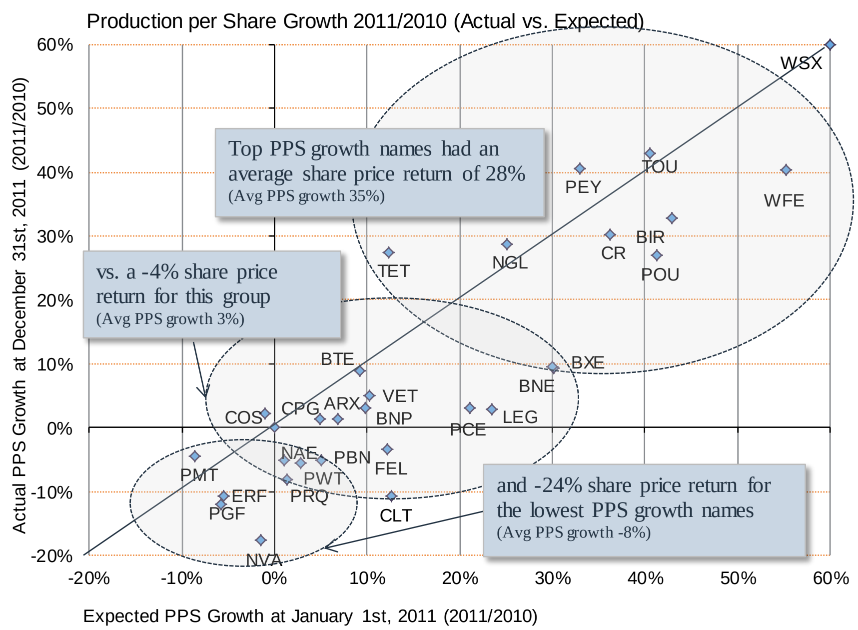

Figure 2. Expected Production per share growth (2011/2010) vs Actual PPS growth
Source: Factset, AltaCorp Capital Inc.

Actual 2011 PPS Growth within 7% of Expectations: In Figure 2 as well, we show the expected 2011 PPS growth at the beginning of the year (January 1st, 2011) versus what the actual PPS growth was at the end of the year (December 31st, 2011). On average, actual growth was within 7% of initial estimates implying a reasonable degree of forecasting from Analysts.

How does 2012 Initially Look? As we show in Figure 3, Bellatrix and Trilogy appear to have some of the highest expected PPS growth for 2012. In addition, Angle (NGL-T, Outperform), Celtic (CLT-T, not rated), Paramount (POU-T, not rated), Tourmaline (TOU-T, not rated), Wild Stream (WSX-T, not rated), Legacy (LEG-T, not rated), Crew (CR-T, not rated) and Peyto (PEY-T, not rated) are other names expected to have PPS growth above 20%. Are these names likely to be top performers in 2012? Perhaps, however we believe CFPS growth as well as balance sheet strength, both of which can influence PPS growth, should also be considered. We show CFPS growth expectations in Figure 3 and balance sheet strength in Figure 4.

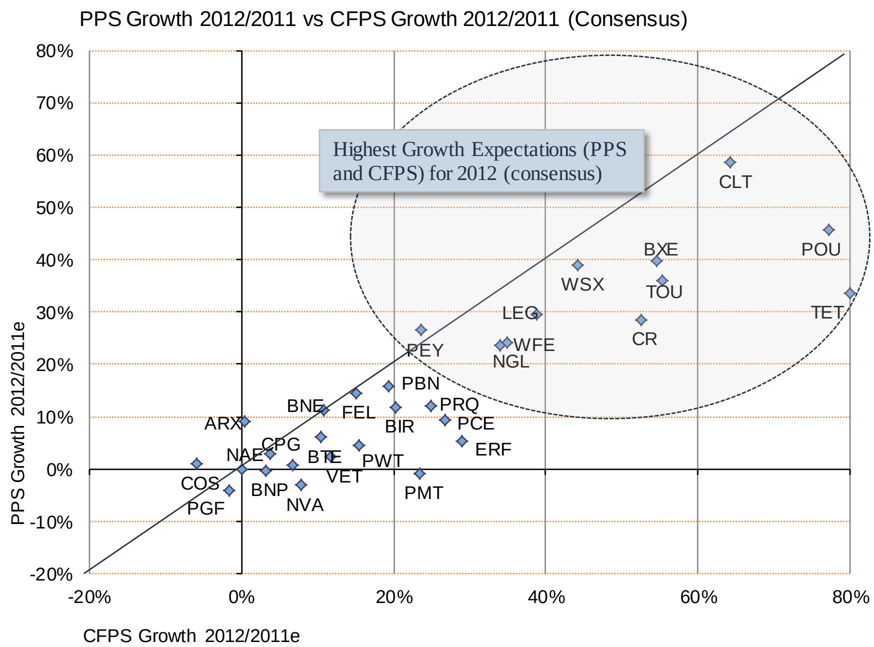

Figure 3. Expected Production per share growth (2012/2011) and Expected CFPS growth (2012/2011)
Source: Factset, AltaCorp Capital Inc.

Caution on Gas-Weighted Names: Generally, gas weighted names have the ability to show higher production growth (6:1 basis) however that may not necessarily translate into higher CFPS. In our recent commodity note (available here), we discuss how Analysts' NYMEX gas price call for 2012 is currently at US$4.28/mcf versus current prices at US$3.05/mcf. As such, declining gas price estimates may force capex programs to be scaled back on gas weighted names slowing PPS growth. In addition, sustained low gas prices may also lead to higher debt levels which may incur potential equity financings or asset sales. Of the top 10 highest PPS growth names mentioned above, Bellatrix, Trilogy, Angle, Wild Stream, Legacy and Crew have much more oil-weighted production currently. Of interest, Analysts' current oil price forecast is US$93.00/bbl compared to current prices of US$102.30/bbl.

Leverage and Over-Spending: As we noted before, higher levered names run a risk of equity dilution, asset sales or scaled back capex programs. We highlight in Figure 4, D/CF consensus expectations for 2012 as well as names that are outspending cashflow ((Capex + Dividends) /Cashflow). We'll note Trilogy, Bellatrix, Wild Stream, Crew and Tourmaline would have a lower risk for dilution than most of their peers.

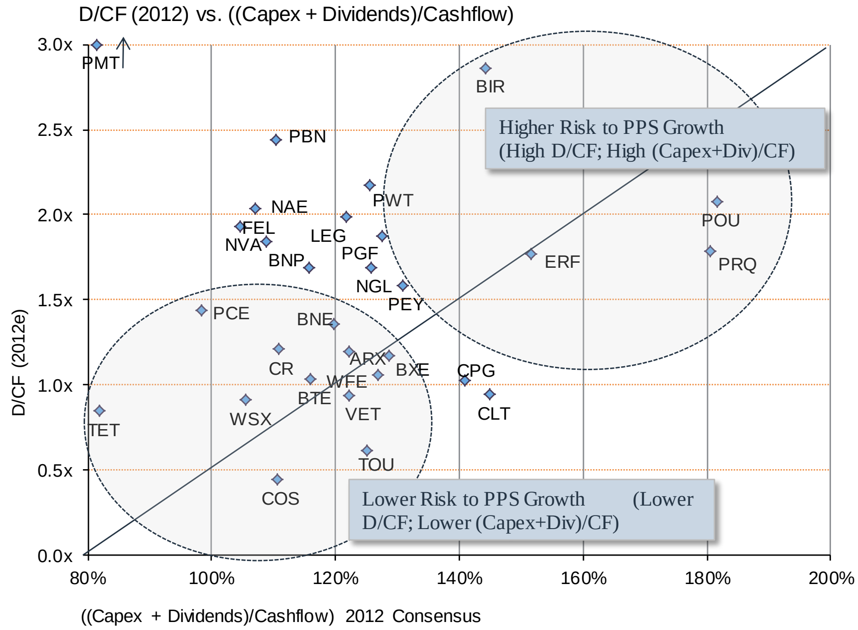

Figure 4. D/CF (2012) vs. ((Capex + Dividends)/ Cashflow)
Source: Factset, AltaCorp Capital Inc.

Low Multiples have Amplifying Effect: In addition, names that have been penalized this year (noted with a sharp decline in their EV/DACF multiple from their historical 2-year average) may also see redemption if they can restore confidence with investors. Recall, it just takes a 10% improvement in the multiple combined with a 10% improvement in CFPS to see a return of 20%. Interestingly, Bellatrix is now the 4th 'cheapest' name in the universe.

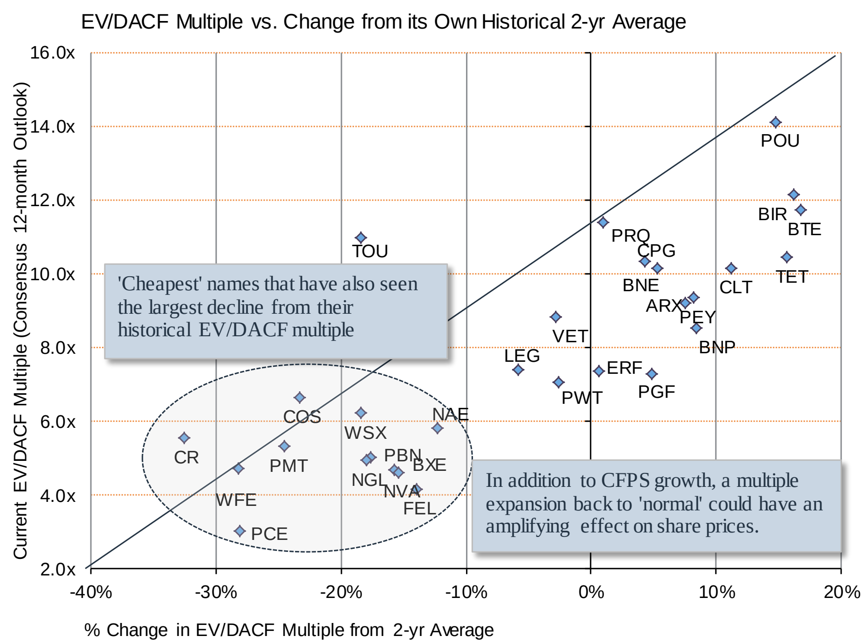

Figure 5. EV/DACF Multiple vs. Change from its Own Historical 2-yr Average
Source: Factset, AltaCorp Capital Inc.

Two Intermediate Names to Outperform in 2012: Bellatrix and Trilogy

Bellatrix (Outperform, $7.25 Target): As we've highlighted above, consensus estimates have Bellatrix growing production per share 40% (ACC estimate: 36%) and CFPS nearly 55% (ACC estimate: 53%) for 2012. With a low D/CF (1.1x) and 43% of production oil/liquids, we see a low likelihood of Bellatrix reducing their $180 million capex budget this year. As a reminder, the company's average Cardium well IP rates (30 day) have been 425 boe/d and are among the highest in the region. With over 350 undeveloped Cardium locations still, (including 155 undeveloped Notikewin locations and upward of 258 Duvernay locations), the company has many years of running room left exploiting highly profitable opportunities.

Furthermore, of all the intermediate names expected to grow CFPS greater than 50%, Bellatrix trades at half the valuation from this small group of companies (4.8x vs. 11.8x EV/DACF). We show in Figure 6, Bellatrix's historical EV/DACF multiple versus its intermediate peer group. Using our 2013 estimates, the current 4.7x EV/DACF multiple would imply a share price next year of $6.80. Its historical multiple would imply a share price of $8.40 and a multiple similar to its peers (7.8x) would imply a share price of $12.15. Once again, Bellatrix's above average growth, the running room at Pembina and its strong balance sheet justify a much higher multiple. – see our most recent report and disclosures here

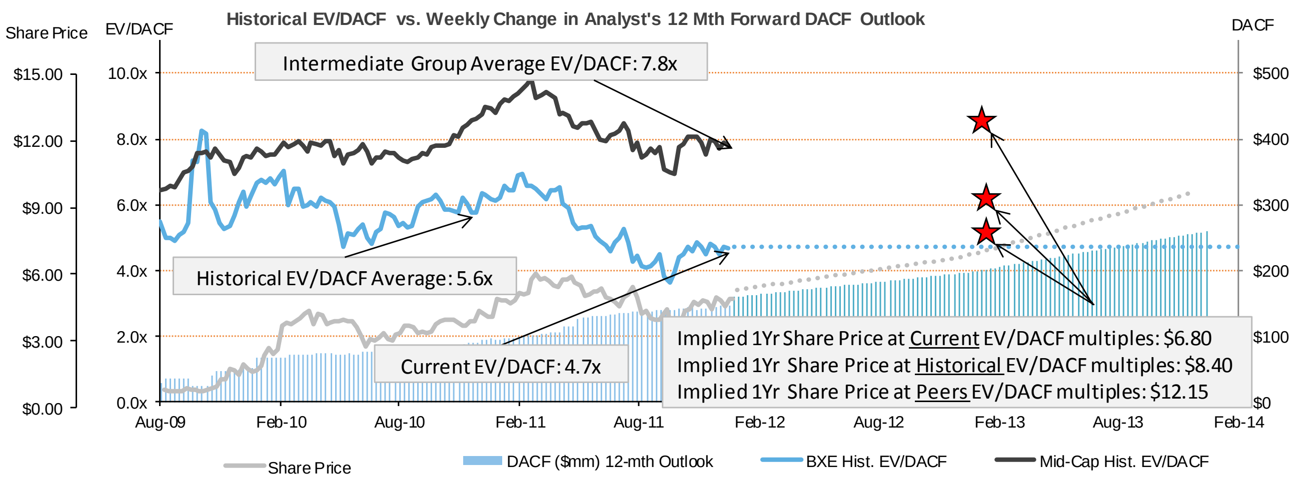

Figure 6. BXE Historical EV/DACF Multiple and consensus DACF estimates (12-month outlook updated weekly)
Source: Factset, AltaCorp Capital Inc.

Although Bellatrix was up only 2.3% in 2011, we believe its disproportional European shareholder base, its skinny, bought-deal financing in May and lower liquidity compared to its peers left its performance slightly muted. As such, Bellatrix has some catching up to do. Near term catalysts include ConocoPhillips (COP-N; not rated) Duvernay well nearby, 2011 upward reserve revisions related to its Cardium wells and a potential JV announcement.

Trilogy (Outperform, $45.00 Target): We recently initiated coverage on Trilogy January 4th (see our full report here). Once again, consensus has Trilogy growing production per share 34% (ACC estimate: 37%) and CFPS 80% (ACC estimate: 81%) for 2012. With a low D/CF (1.0x) and 42% of production oil/liquids, we also see a low likelihood of Trilogy revising their $300 million capex budget this year. In fact, we believe it could be higher after commodity price volatility subsides. Trilogy has three key plays at Kaybob (Montney Gas/Montney Oil/Duvernay) that have proven to generate some of the highest economics in the basin. As such, these wells allowed it to have some of the highest CFPS and PPS growth among its peers that further led Trilogy to have the best share price return for 2011. With equity dilution unlikely and a valuation that still understating its growth potential, we expect Trilogy will be among the top performers again for 2012.