Zacks Small-Cap Research

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# Dejour Energy, Inc. (DEJ-AMEX)

**DEJ:** Update on 4Q and full-year 2011 results

| | |
|---|---|
| **Current Recommendation** | **Outperform** |
| Prior Recommendation | Neutral |
| Date of Last Change | 02/23/2012 |
| Current Price (04/12/12) | $0.32 |
| **Six- Month Target Price** | **$1.00** |

## OUTLOOK

Our rating on Dejour's stock remains Outperform despite disappointing fourth quarter production results. Production levels at Woodrush should increase soon with the rework of the third well. Also, management prudently deferred the drilling its first four wells into the liquid rich gas Kokopelli field acreage until the Williams pipeline is available in the area. Also, additional interest expense will not be incurred until required. The first test well at South Rangely was successfully drilled, cased, fracture stimulated and flow tested in late 2011. A partner is being sought to defray the cost of development. Our price target remains $1.00 based on NAV analysis.

## SUMMARY DATA

| | |
|---|---|
| **52-Week High** | **$0.56** |
| **52-Week Low** | **$0.22** |
| **One-Year Return (%)** | **-23.15** |
| **Beta** | **1.59** |
| **Average Daily Volume (shrs.)** | **1,028,256** |
| **Shares Outstanding (million)** | **127** |
| **Market Capitalization ($ mil.)** | **$40.6** |
| **Short Interest Ratio (days)** | **0.51** |
| **Institutional Ownership (%)** | **14** |
| **Insider Ownership (%)** | **23** |
| **Annual Cash Dividend** | **$0.00** |
| **Dividend Yield (%)** | **0.00** |
| **5-Yr. Historical Growth Rates** | |
| **Sales (%)** | **6.6** |
| **Earnings Per Share (%)** | **N/A** |
| **Dividend (%)** | **N/A** |
| **P/E using TTM EPS** | **N/M** |
| **P/E using 2012 Estimate** | **N/M** |
| **P/E using 2013 Estimate** | **31.5** |
| **Zacks Rank** | **3** |

| | |
|---|---|
| **Risk Level** | **Above Average** |
| **Type of Stock** | **Small - Value** |
| **Industry** | **Oil – C$ E&P** |
| **Zacks Rank in Industry** | **10 of 17** |

## ZACKS ESTIMATES

**Revenue**
(in millions of $)

| | Q1 (Mar) | Q2 (Jun) | Q3 (Sep) | Q4 (Dec) | Year (Dec) |
|---|---|---|---|---|---|
| 2010 | 1.31 A | 2.77 A | 2.54 A | 1.54 A | 8.15 A |
| 2011 | 1.36 A | 1.46 A | 2.34 A | 2.06 A | 7.20 A |
| 2012 | 2.59 E | 2.77 E | 2.94 E | 3.21 E | 11.55 E |
| 2013 | | | | | 16.97 E |

**Earnings per Share**
(EPS is operating earnings before non recurring items)

| | Q1 (Mar) | Q2 (Jun) | Q3 (Sep) | Q4 (Dec) | Year (Dec) |
|---|---|---|---|---|---|
| 2010 | -$0.03 A | -$0.01 A | -$0.01 A | -$0.01 A | -$0.05 A |
| 2011 | -$0.02 A | -$0.00 A | -$0.00 A | -$0.07 A | -$0.09 A |
| 2012 | -$0.00 E | -$0.00 E | -$0.00 E | -$0.00 E | -$0.01 E |
| 2013 | | | | | $0.01 E |

Zacks Projected EPS Growth Rate - Next 5 Years % **N/A**

Quarterly revenues and EPS do not equal annual figures due to rounding.

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## KEY POINTS

- The rating on Dejour's stock remains Outperform due to confidence in higher production levels from the oil and gas project at Woodrush. Our price target of $1.00 is derived from the company's net asset value of $1.02 (see Valuation section).
- Management continues to develop its prime properties: **Woodrush** in British Columbia's Peace River Arch and **Kokopelli** field development in Colorado's Piceance Basin.
  - At **Woodrush**, the company has successfully drilled eight producing wells (two oil and six gas). **A third oil production well is in the process of coming online.** Management expects production to increase to 1,000 BOE/D later in 2012.
  - At **Kokopelli, four wells are expected to be fracture stimulated and completed in the third quarter of 2012** with production expected to commence later in the year.
- Significant fundamental events can considerably increase the company's valuation parameter in a step-fashion. One such event would be the Dejour's achievement of positive profitability, in which case the stock could experience rapid price appreciation.
- Management has a strong track record of developing oil and gas properties. CEO Robert Hodgkinson has twice founded oil and gas companies that mounted successful, large-scale drilling programs. The companies were subsequently acquired by medium-capitalization exploration companies.

## OVERVIEW

Based in Vancouver, British Columbia, Dejour Energy (DEJ) is a Canadian independent oil and natural gas company and holds interests in **122,000 net acres** of oil and gas leases in North America. Net Proved and Probable Producing Reserves were 436 thousand barrels of oil (MBO) and 108 million of cubic feet (MMCF) of natural gas, totaling 570 thousand barrels of oil equivalent (MBOE) [1]. All Proved Producing Reserves (346 MBOE) are in the Canadian **Woodrush** area of the Peace River Arch, which has eight producing wells (six gas and two oil) and two water injection wells. A third oil production well was drilled in 2011 and is currently being reworked with the addition of eight horizontal laterals. Acreage holdings consist of 13,000 net acres in northeastern British Columbia and northwestern Alberta, and 109,000 net acres (all undeveloped, but production is expected to commence in late 2012) in Colorado and Utah in the Piceance, Uinta and Paradox Basins. Net Proved and Probable Undeveloped Reserves at **Kokopelli** are 1.05 million barrels of oil (MMBO) and 147 billion cubic feet (BCF) of natural gas[2]. The company is the operator of its developed acreage. During 2009 Dejour sold its shares in Titan Uranium Inc., but still maintains a 10% carried interest and 1% Net Smelter Return on approximately 966,969 acres in Saskatchewan, Canada.

## 4Q AND FULL-YEAR 2011 UPDATE

On March 30, 2012, Dejour reported results for the fourth quarter and full year of 2011 ending December 31, 2011. Quarterly earnings were a loss of CAD $0.07 per diluted share. Reported earnings were below our estimate, primarily due to a non-cash impairment charge and lower-than-expected production from the new third well at Woodrush. Gross oil and gas revenues for the quarter increased 62.1% year-over-year to $2.48 million as operating & transportation expenses increased 53.4% and G&A expenses increased 37.8%.

[1] As estimated by the independent petroleum engineering consultant firm GLJ Petroleum Consultants as of June 30, 2011, page 36.
[2] As estimated by the independent petroleum engineering consultant firm Gustavson Associates LLC as of January 1, 2011.

For the year, earnings were a loss of CAD $0.09 per diluted share. Gross oil and gas revenues increased 9.1% to $8.82 million, primarily due to the increase of realized oil prices from $69 to $89 per barrel, which was offset by a 13.0% decline in realized natural gas prices and a 4.9% decline in oil production. Though operating & transportation expenses declined 4.0%, G&A expenses increased 18.1% and amortization and depletion allowances increased 64.8%. However, a one-time $5.2 million non-cash impairment charge on non-core leases was included the amortization and depletion allowances total. Operating netbacks increased 9.1% to $4.70 million from $4.16 million in 2010 due to higher revenues and lower operating and transportation expenses (-4.2%), partly offset by increased royalties (+24.1). As mentioned above, Dejour recorded a $5.2 impairment of oil and gas properties in 2011; however, it was reported above rather than below the operating income line as in previous years.

During the first quarter of 2011, Dejour implemented a waterflood on the Woodrush property. There was an early and strong response to the waterflood with the wells producing over 600 BOE/D; however, production peaked in the third quarter. Dejour drilled a third production well during the fourth quarter, but gross production was less than expectations at only 45 BOE/D. Currently, a workover of the third well is being performed with six of the eight planned horizontal laterals having been completed.

In 2011, the company also completed an evaluation well into the Mancos B sand at South Rangely. Having been drilled, fractured and stimulated, the well flowed commercial quantities of rich gas with a high natural gas liquid (NGL) yield. Dejour also received permits for the construction of its first drilling pad in the Kokopelli property, from which production is now expected to begin in the second half of 2012. The delay in drilling the initial four wells at Kokopelli is due to a confluence of several factors, including low gas prices and the economic benefits of waiting for the Williams pipeline to be completed in the area and the terms of the financing, which would require interest accrual upon closing. Importantly, Dejour began operating with positive cash flow during the latter half of 2011.

In 2012, management is focused on increasing oil production from the Halfway oil pool at Woodrush in British Columbia and initiating the drilling program at the Kokopelli project in Colorado, for which the company will utilize debt financing. Management does not expect to require equity financing to further its exploration and production activities in 2012. **Generally, this financing stage for a small-cap company is a major milestone towards the realization asset value in the company's stock.**

## VALUATION

The valuation process for small and mid-cap E&P oil & gas companies is based upon Net Asset Value (NAV), which involves evaluating a company's assets and reserves, and then determining an appropriate discount at which the stock should trade. The NAV calculation entails applying several subjective inputs, such as land valuation (cost or market), a predicted oil price, oil versus gas mix, predicted gas price, drilling costs deep offshore wells versus, drilling success rate, mix of development and exploratory wells, etc. The discount attempts to quantify many factors, including but not limited to the average length of time that will be required to put the reserve additions on the company's books, R/P (reserves to annual production ratio), the company's PUD (Proved Undeveloped reserve) to 2P reserve ratio, and the stock's liquidity.

Dejour's NAV is estimated to be $130.0 million ($1.02 per share[3]). The $134 million is attained by adding the company's assets of $20 million of land (at cost), $116 million[4] of PV-10 Proved Reserves and negative net cash of $0.5 million and then deducting $5.5 million in debt (listed as a current liability on the company's balance sheet)[5]. Therefore, **our target price is $1.00 per share.**

[3] 126,892,386 shares were outstanding on December 31, 2011.
[4] Based on $25 million at Woodrush (AJM reserve study effective June 30, 2011) and $93 million in the U.S. (reserve study - December 2011).
[5] Balance sheet items valued as of December 31, 2011.

We are cognizant that there are nuances concerning the quality of reserves that are not captured in our valuation model. One such feature is that by treating PDs and PUDs similarly, our model does not capture some of the inherent risks of PUDs. Since uncertainties exist about the ultimate conversion of PUDs to PDs, there is an inherent discount valuation related to PUDs that must be considered.

In the case of Dejour, the majority of proven reserves are undeveloped ($83 million of the $108 million). However, these PUDs are within or adjacent to a known producing gas field. In addition, Williams Companies is extending a pipeline from its Grand Valley gathering system to the Kokopelli Field, where Dejour's PUDs are located. This both reduces most of the uncertainties related to the PUDs and also provides an efficient method to transport Dejour's natural gas into a large-scale, high-volume distribution system.

As gas wells begin to produce, the natural gas reserves associated with the wells become proved developed producing reserves (PDs or PDPs) instead of proven undeveloped reserves (PUDs). **We expect a positive valuation increment** in the marketplace **as PUDs at Gibson Gulch become PDs.** When the uncertainties associated with PUDs abate, the discount to NAV that pertains to the PUDs at Gibson Gulch should be reduced or entirely eliminated. As the PUDs become producing wells in the first quarter of 2012, the marketplace may not only eliminate the discount to NAV of the producing wells, but also reduce or eliminate the discount related to a portion or all of the 220 PUDs located at Gibson Gulch. As the certainty of the value of the PUDs increases, we expect the valuation of Dejour's stock to migrate towards Net Asset Value.

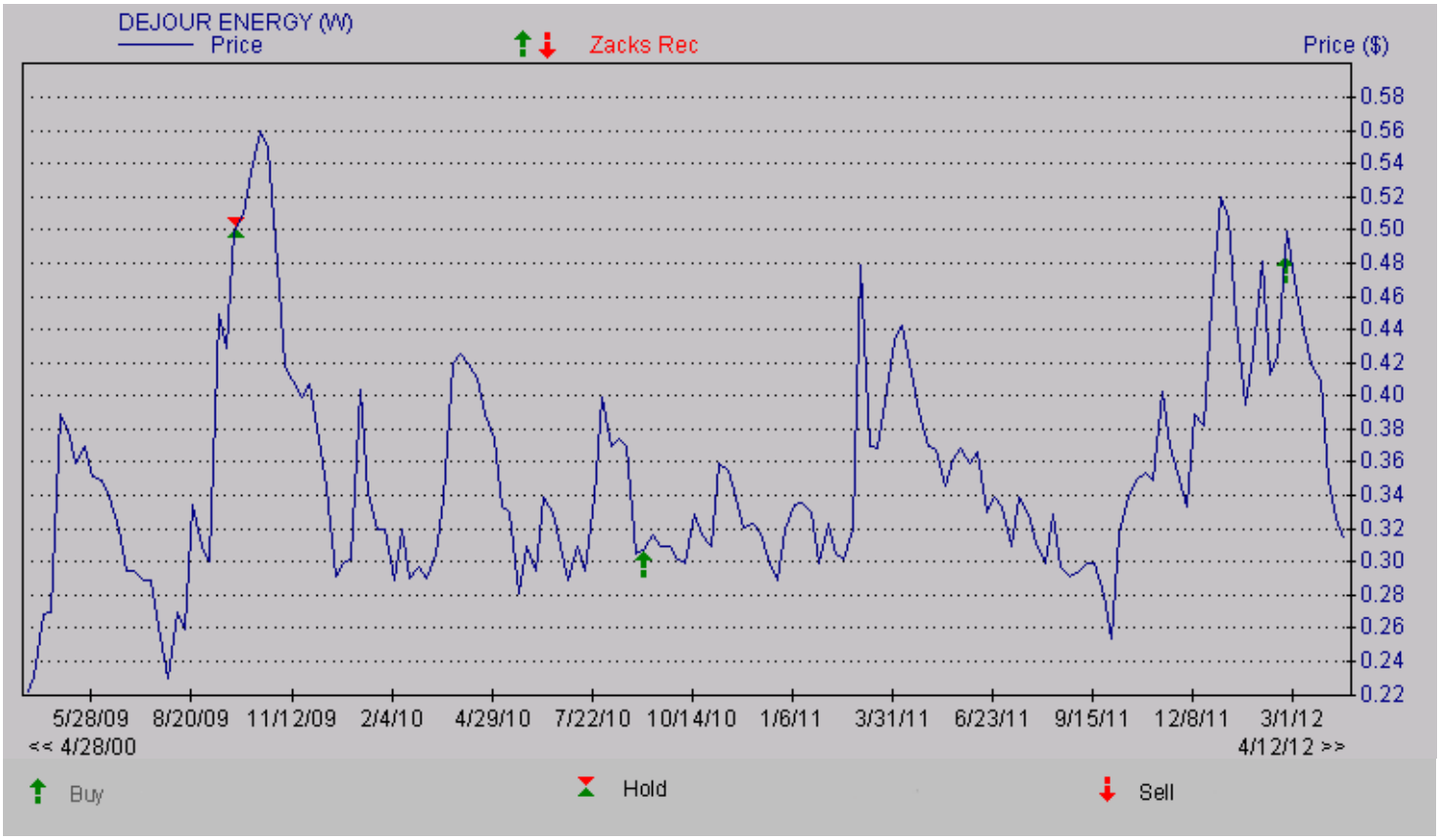
We reiterate our Outperform rating based upon the attractive valuation level of the stock relative to its reserve valuation, along with the company's improving production profile from Woodrush in northeast British Columbia and expected production in 2012 from Kokopelli in Colorado.

## PROJECTED INCOME STATEMENT

### Dejour Energy Inc. Earnings Model

| FISCAL YRS ENDING 12/31 | Q1 | Q2 | Q3 | Q4 | 2010 | IFRS Q1 | IFRS Q2 | IFRS Q3 | IFRS Q4 | IFRS 2011 | Q1 E | Q2 E | Q3 E | Q4 E | 2012 E | 2013 E |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **PRODUCTION VOLUMES (net)** | | | | | | | | | | | | | | | | |
| Natural gas (MMCF) | 96.6 | 136.5 | 167.3 | 148.5 | **548.9** | 146.7 | 55.9 | 103.0 | 125.5 | **431.1** | 126.0 | 126.0 | 130.0 | 145.0 | **625.0** | **696.0** |
| Crude oil (MBO) | 11.8 | 31.8 | 28.2 | 13.7 | **85.5** | 12.3 | 16.9 | 30.1 | 22.1 | **81.3** | 30.0 | 32.0 | 34.0 | 36.0 | **132.0** | **172.8** |
| Natural gas liquids (BBLS) | 0.6 | | | | | | 0.5 | | | | | | | | | |
| **Total (MMCFE)** | 100.3 | 136.5 | 167.3 | 148.5 | **1,061.9** | 146.7 | 58.9 | 103.0 | 125.5 | **918.8** | 126.0 | 126.0 | 130.0 | 145.0 | **1,417.0** | **1,732.8** |
| **Total (MBOE)** | 28.5 | 54.5 | 56.1 | 38.4 | **177.0** | 36.7 | 26.7 | 47.3 | 43.0 | **153.1** | 51.0 | 53.0 | 55.7 | 60.2 | **236.2** | **288.8** |
| **OIL PRICE REALIZATIONS / GAS HUB PRICES** | | | | | | | | | | | | | | | | |
| Natural gas (CAD/MCF) | 5.04 | 4.29 | 3.81 | 3.73 | **4.22** | 3.89 | 3.91 | 3.66 | 3.23 | **3.67** | 3.30 | 3.30 | 3.40 | 3.45 | **3.36** | **3.50** |
| Oil (CAD/BBL) | 71.60 | 65.79 | 66.77 | 71.17 | **68.83** | 82.51 | 94.83 | 85.37 | 93.00 | **88.93** | 95.00 | 96.00 | 98.00 | 101.00 | **97.50** | **110.00** |
| Natural gas liquids (CAD/BBL) | 23.58 | | | | | | | | | | | | | | | |
| **INCOME STATEMENT (CAD 000 except EPS)** | | | | | | | | | | | | | | | | |
| Natural gas revenues | 487 | 586 | 638 | 554 | **2,264** | 571 | 218 | 377 | 425 | **1,591** | 425 | 425 | 425 | 425 | **1,700** | **2,436** |
| Crude oil revenues | 846 | 2,089 | 1,885 | 975 | **5,795** | 1,013 | 1,598 | 2,570 | 2,053 | **7,233** | 2,850 | 3,072 | 3,332 | 3,636 | **12,890** | **19,008** |
| Natural gas liquids revenues | 15 | | 11 | | **26** | | | | | | | | | | | |
| Total oil and gas revenues | 1,347 | 2,676 | 2,534 | 1,529 | **8,085** | 1,583 | 1,816 | 2,946 | 2,478 | **8,824** | 3,275 | 3,497 | 3,757 | 4,061 | **14,590** | **21,444** |
| Royalties | 221 | 551 | 362 | 178 | **1,311** | 237 | 348 | 614 | 430 | **1,628** | 683 | 729 | 783 | 847 | **3,042** | **4,471** |
| Total oil and gas revenues (net) | 1,127 | 2,125 | 2,173 | 1,351 | **6,774** | 1,347 | 1,468 | 2,333 | 2,048 | **7,196** | 2,592 | 2,768 | 2,974 | 3,214 | **11,548** | **16,973** |
| Financial instrument gain (loss) | | - | - | - | - | (47) | (12) | 0 | 0 | **(59)** | - | - | - | - | **0** | **0** |
| Other operating income | 9 | 93 | 10 | 7 | **68** | 8 | 8 | 9 | 8 | **34** | 0 | 0 | 0 | 0 | **0** | **0** |
| **TOTAL REVENUES** | **1,135** | **2,218** | **2,183** | **1,358** | 6,841 | **1,308** | **1,465** | **2,341** | **2,056** | 7,171 | **2,592** | **2,768** | **2,974** | **3,214** | 11,548 | 16,973 |
| Operating expenses | | | | | | | | | | | | | | | | |
| Operating and transportation | 845 | 660 | 543 | 559 | **2,605** | 507 | 471 | 664 | 857 | **2,499** | 664 | 709 | 762 | 824 | **2,959** | **3,163** |
| General and administrative | 987 | 769 | 670 | 997 | **3,423** | 960 | 990 | 718 | 1,374 | **4,042** | 990 | 1,000 | 1,050 | 1,100 | **4,140** | **4,200** |
| Amortization, depletion & acc. | 1,109 | 1,351 | 1,393 | 1,357 | **5,250** | 718 | 498 | 1,417 | 819 | **8,652** | 1,023 | 1,103 | 1,196 | 1,305 | **4,628** | **6,824** |
| Change in fair value of warranty liability | 499 | - | - | - | - | 874 | (795) | (543) | 2,044 | **1,580** | 0 | 0 | 0 | 0 | **0** | **0** |
| Stock based compensation | 237 | 150 | 150 | 156 | **621** | 189 | 210 | 150 | 113 | **662** | 175 | 175 | 175 | 175 | **700** | **800** |
| **Total operating expenses** | **3,677** | **2,930** | **2,756** | **3,069** | 11,899 | **3,247** | **1,375** | **2,407** | **5,207** | 17,436 | **2,852** | **2,987** | **3,183** | **3,404** | 12,427 | 14,988 |
| **OPERATING INCOME** | **(2,541)** | **(713)** | **(574)** | **(1,711)** | (5,057) | **(1,939)** | **90** | **(66)** | **(3,151)** | (10,266) | **(260)** | **(219)** | **(210)** | **(190)** | (879) | 1,985 |
| Interest (expense) | (256) | (275) | 309 | (239) | **(458)** | (243) | (283) | (270) | (72) | **(868)** | (250) | (250) | (250) | (250) | **(1,000)** | **(1,250)** |
| Interest income | 0 | 8 | 9 | 11 | **37** | - | - | - | - | **0** | - | - | - | - | **0** | **0** |
| Gain (loss) on investments | (42) | - | - | - | **0** | - | - | - | - | **0** | - | - | - | - | **0** | **0** |
| Equity income (loss) | - | - | - | - | **0** | - | - | - | - | **0** | - | - | - | - | **0** | **0** |
| Other income | - | - | - | - | **0** | - | - | - | - | **0** | - | - | - | - | **0** | **0** |
| Impairments | - | - | (10) | - | **(10)** | - | - | - | (5,200) | **0** | - | - | - | - | **0** | **0** |
| Foreign exchange gain (loss) | (16) | 13 | (9) | (16) | **(28)** | (84) | 4 | (11) | 0 | **(98)** | 0 | 0 | 0 | 0 | **0** | **0** |
| Pretax income | (2,855) | (968) | (275) | (1,955) | **(5,517)** | (2,266) | (189) | (347) | (8,422) | **(11,231)** | (510) | (469) | (460) | (440) | **(1,879)** | **735** |
| Inc. tax recovery (expense) | 271 | 0 | 464 | 504 | **968** | 187 | 0 | 0 | 0 | **187** | 0 | 0 | 0 | 0 | **0** | **0** |
| **REPORTED NET INCOME** | **(2,584)** | **(968)** | **189** | **(1,451)** | **(4,549)** | **(2,079)** | **(189)** | **(347)** | **(8,422)** | **(11,044)** | **(510)** | **(469)** | **(460)** | **(440)** | **(1,879)** | **735** |
| Foreign currency translation adjustment | (430) | | | | | (287) | (66) | 991 | (347) | **292** | 0 | 0 | 0 | 0 | **0** | **0** |
| Comprehensive Income (loss) | (3,014) | (968) | 189 | (1,451) | **(4,549)** | (2,366) | (255) | 645 | (8,769) | **(10,752)** | (510) | (469) | (460) | (440) | **(1,879)** | **735** |
| Weighted Avg. Shares Out. | 97,727 | 98,698 | 99,198 | 100,698 | **99,789** | 116,652 | 118,000 | 121,391 | 125,159 | **120,300** | 128,159 | 131,159 | 134,159 | 137,159 | **132,659** | **135,000** |
| **EPS before NRI** | (0.03) | (0.01) | 0.00 | (0.01) | **(0.05)** | (0.02) | (0.00) | (0.00) | (0.07) | **(0.09)** | (0.00) | (0.00) | (0.00) | (0.00) | **(0.01)** | **0.01** |
| **REPORTED NET INCOME** | (0.03) | (0.01) | 0.00 | (0.01) | **(0.05)** | (0.02) | (0.00) | (0.00) | (0.07) | **(0.09)** | (0.00) | (0.00) | (0.00) | (0.00) | **(0.01)** | **0.01** |

## HISTORICAL ZACKS RECOMMENDATIONS




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