Zacks Small-Cap Research

July 6, 2012

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Dejour Energy, Inc. (DEJ-AMEX)

DEJ: Despite the sequential improvement of production at Woodrush, a dilutive equity offering reduces price target to $0.80.

Current Recommendation	**Outperform**
Prior Recommendation	Neutral
Date of Last Change	02/23/2012
Current Price (07/05/12)	$0.23
Six- Month Target Price	**$0.80**

OUTLOOK

Our rating on Dejour's stock remains Outperform despite disappointing first quarter production results and the recent dilutive equity offering. Production levels at Woodrush are improving sequentially due to the increased effectiveness of the waterflood and reworking the third well which was drilled late last year. Drilling the company's initial four wells into the liquid-rich gas Kokopelli field acreage is slated for the third quarter when the Williams pipeline should be available in the area. Our price target, which is based on NAV analysis, has been adjusted to $0.80, primarily due to the dilutive equity offering in June.

SUMMARY DATA

52-Week High	**$0.56**
52-Week Low	**$0.22**
One-Year Return (%)	**-25.93**
Beta	**1.74**
Average Daily Volume (shrs.)	**452,038**
Shares Outstanding (million)	**149**
Market Capitalization ($ mil.)	**$32.8**
Short Interest Ratio (days)	**0.70**
Institutional Ownership (%)	**5**
Insider Ownership (%)	**15**
Annual Cash Dividend	**$0.00**
Dividend Yield (%)	**0.00**
5-Yr. Historical Growth Rates	
Sales (%)	**7.8**
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	**N/M**
Zacks Rank	**3**

Risk Level	**Above Average**
Type of Stock	**Small - Value**
Industry	**Oil – C$ E&P**
Zacks Rank in Industry	**5 of 16**

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	1.55 A	2.34 E	2.54 E	2.79 E	9.36 E
2013					14.00 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 A	-$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, which is derived from the company's net asset value (see Valuation Section) is now $0.80 due to the recent dilutive equity offering.
- 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 (three oil and six gas). **The third oil production well (AB-1-I) is in the process of coming online.** Management expects gross production from Woodrush to increase to approximately the 1,000 BOEPD level before the end of 2012.
  - At **the Kokopelli project in Colorado, four wells are expected to be drilled, fracture stimulated and completed in the third quarter of 2012** with production expected to commence later in the year. Management plans on drilling nine additional wells in 2013.
- 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.

RECENT NEWS

Production Updates – Woodrush

On June 7, 2012, Dejour Energy provided an update on the oil production from Halfway E Pool on its Woodrush property in northeastern British Columbia. Production continues to increase from the level reported for the first quarter Gross oil production in the month of May increased 15.0% sequentially from an average of 234 Barrels of Oil per Day (BOPD) in April to 269 BOPD.

WOODRUSH (British Columbia)

Gross Production per Day	March	April	May
BOPD	221	234	269
Sequential change		5.9%	15.0%
Net Production per Day			
BOPD	166	176	202
Sequential change		5.9%	15.0%

Also, the company reported that gross production during the first six days increased to an average of 319 BOPD. In addition, total gross field production, which includes gas production, averaged 630 Barrels Oil Equivalent per Day (BOEPD) during the first six days in June, up from 556 BOEPD in 2011.

If the company can continue to increase the oil production rates from wells A-1-I (the northern most producing well) and AB-1-I (the most recently drilled well) as management plans, gross production is expected to reach approximately 1,000 BOEPD (70% oil and 30% gas) by the end of 2012. Currently, production from well A-1–I is being restricted to about 25% of its oil flow potential due to reservoir management constraints. Well A-1–I was completed in second quarter of 2010 and initially tested at rates in excess of 500 BOPD. Production levels of well A-1–I had to be curtailed by at least 250 BOPD in mid-

2010 to conform to British Columbia's allowable quota regime. If wells A-1–I and AB-1-I can attain company-targeted production levels, management expects the gross oil rate at Woodrush to increase to approximately 1,000 Barrels Oil Equivalent per Day (BOEPD) by the end of 2012.

On May 22, 2012, Dejour provided an update on the oil production from the Halfway E Pool on its Woodrush property in northeastern British Columbia. Production from the new third well (AB-1-I) at Woodrush continues to be lower-than-expectations during the first quarter. In addition, Well D-91-H (drilled in 2008) experienced higher-than-expected water production. Under the Voidage Replacement Scheme approved by the British Columbia Oil and Gas Commission in October 2011, Dejour drilled a third producing well (AB-1-I) late in 2011 and increased the water injection rate into the Halfway oil pool. Through the first quarter, the two producing wells (A-1–I and D-91-H) have not yet positively responded to the water injection. However, management expects a full production response to occur in the second half of 2012.

Production began to increase during the initial weeks of the second quarter. Specifically, gross oil production in the month of April increased 6% sequentially versus March, and during the first 15 days of May, the gross oil production rate increased 15% versus the month of March to an average of 254 Barrels of Oil per Day (BOPD).

Equity Offering

On May 30, 2012, Dejour Energy announced an equity financing for 18,130,305 units at a price of US$0.26 per unit. The stock reacted negatively, declining 29% from $0.31 to $0.21. Though the completion of the offering was a required provision for the closing of the $14 million debt facility (which is needed to develop Kokopelli), the price level of the offering and its dilutive effect were recognized by investors. In addition, there were no investor expectations for equity offerings this year.

Each unit in the offering consists of one common share and 3/4 of a warrant, one of which entitles the holder to purchase one common share at an exercise price of US$0.40 between December 4, 2012 and June 4, 2017. The net proceeds will be used towards the development of Dejour's oil and NGL projects. Roth Capital Partners was the sole placement agent for the offering.

Financing for Kokopelli

On May 7, 2012, Dejour announced the signing of a binding commitment for a $14 million revolving credit facility. The financing appears to have been available to the company for at least a couple of months, but was not signed until the management was ready to begin the development of the Kokopelli field. Once drawn upon, the company would begin to incur interest expense, which was prudently delayed. The credit facility closed upon issuance of equity on June 4th. The credit facility is a clear sign that the first four wells at Kokopelli will be drilled in the second half of 2012.

As mentioned in the company's press release, the company has received regulatory approval to expand into the Garfield Creek State Wildlife Area, the final and critical step in the regulatory approval process. Also, management stated that the company is working with WPX Energy (WPX: NYSE) to secure access to the Williams gas distribution network on a cost-effective basis. The cost of the required infrastructure to tap into the pipeline could be up to 25% less than management originally expected.

Importantly, once the drilling has been completed and the wells are in production, the status of the lease on the entire 2,200 gross acres will change from a primary term to a held-by-production lease, perpetuating Dejour's right to operate at Kokopelli as long as the wells produce the minimum paying quantity of gas.

First Quarter Results

On May 15, 2012, Dejour reported financial results for the first quarter ending March 31, 2012. The quarter was impacted by lower natural gas prices, which fell 36.5% year-over-year and 23.5% sequentially. Therefore, management did not attempt to maximize gas production, and as a result, gas production declined by 21.2% versus the first quarter of 2011. While higher oil prices (up 7.2% year-over-year) offset the impact of lower gas production, oil prices were down 4.9% sequentially and total revenue of $1,551,000 was below our forecast. G&A expenses decreased 32.6% sequentially and 3.4% year-over-year. However, operating & transportation expenses increased 11.0% sequentially and 87.7% year-over-year. Operating netback fell 23.2% to $645,000 from $840,000 in the comparable quarter last year, primarily due to the higher operating & transportation expenses. Including a non-cash $1,110,000 positive change in the value of warrant liability (related to the adoption of IFRS), Dejour reported a loss of $514,000 or $0.003 per diluted share, in-line with expectations. However, without the warrant liability, the loss was $1.624 million or $0.01 per diluted share.

OVERVIEW

Based in Vancouver, British Columbia, Dejour Energy (DEJ) is a Canadian independent oil and natural gas company and holds interests in approximately **111,000 net acres** of oil and gas leases in North America. As of the beginning of 2012, net Proved and Probable Reserves were 33 million barrels of oil equivalent (MMBOE)[1]. All Proved Producing Reserves are in the Canadian **Woodrush** area of the Peace River Arch, which has nine producing wells (six gas and three oil) and two water injection wells. The third oil production well was drilled in 2011 and has just been reworked with the addition of eight horizontal laterals. Acreage holdings consist of 8,200 net acres in northeastern British Columbia and northwestern Alberta, and 102,200 net acres (all undeveloped, but production is expected to commence in late 2012 at Kokopelli) in Colorado and Utah in the Piceance, Uinta and Paradox Basins. Net Proved and Probable Undeveloped Reserves at **Kokopelli** are 12.4 million barrels of oil/NGL (MMBO) and 121 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.

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 $132.4 million ($0.80 per diluted share[3]). The $132.4 million is attained by adding the company's assets of $20 million of land (at cost), $112.9 million[4] of PV-10 Proved Reserves and net cash of $5.6 million and then deducting $6.1 million in debt (listed as a current liability

[1] As estimated by the independent consultant firms AJM Deloitte as of December 31, 2011 and Gustavson Associates LLC as of January 1, 2012.
[2] As estimated by the independent consultant firm Gustavson Associates LLC as of January 1, 2012.
[3] After the equity offering in the beginning of June 2012, Dejour Energy had approximately 187 million diluted shares.
[4] Based on $19 million at Woodrush (AJM Deloitte reserve study effective December 31, 2011) and $93.9 million at Kokopelli (reserve study by Gustavson & Associates dated January 15, 2012).

on the company's balance sheet)[5]. Therefore, **our target price is now $0.80 per share.** The primary reason for the decline in our price target was the dilution from the equity offering that closed in June.

DEJOUR ENERGY INC.		Net Acres	Net Proved Reserves (PV-10)
WOODRUSH	(British Columbia) 51-101 dated 12/31/2011 (AJM Deloitte)	8,200	19,000,000
KOKOPELLI	(Colorado) 51-101 dated 1/15/2012 (Gustavson & Associates)	2,200	93,931,000
UNDRILLED LAND	(at cost)	100,000	20,000,000
NET CASH			5,607,831
(DEBT)	(line of credit)		(6,126,243)
		TOTAL	132,412,588
		Shares outstanding	149,000,000
		Fully diluted shares	187,000,000
		NAV per outstanding share	0.89
		NAV per diluted share	**0.80**

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 $113 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 Kokopelli 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 Kokopelli. 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.

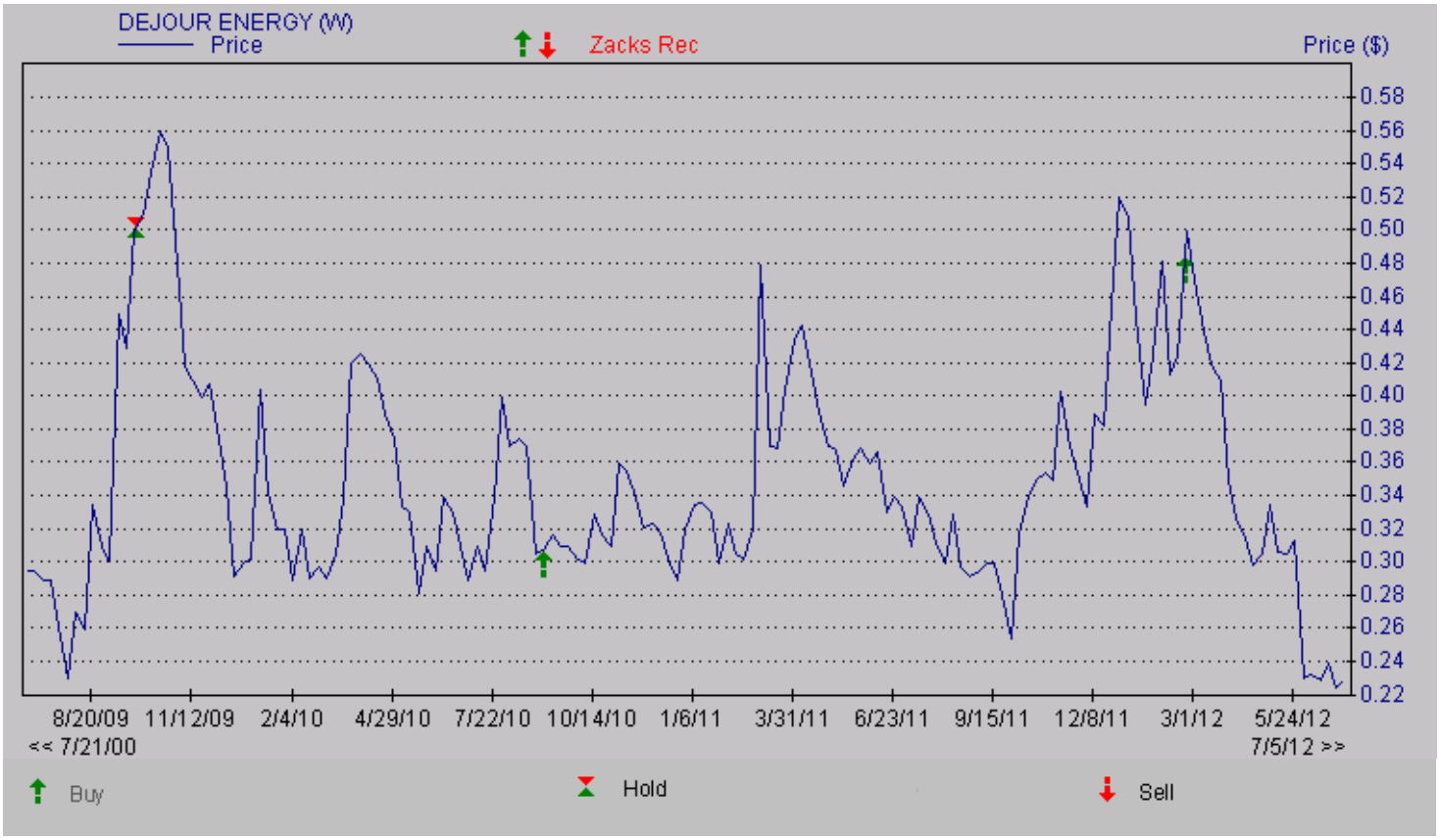
[5] Balance sheet items valued as of March 31, 2012.

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	IFRS Q1	IFRS Q2 E	IFRS Q3 E	IFRS Q4 E	IFRS 2012 E	IFRS 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**	115.7	120.0	125.0	130.0	**625.0**	**624.0**
Crude oil (MBO)	11.8	31.8	28.2	13.7	**85.5**	12.3	16.9	30.1	22.1	**81.3**	18.6	32.0	34.0	36.0	**120.6**	**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**	115.7	120.0	125.0	130.0	**1,348.4**	**1,660.8**
Total (MBOE)	28.5	54.5	56.1	38.4	**177.0**	36.7	26.7	47.3	43.0	**153.1**	37.8	52.0	54.8	57.7	**224.7**	**276.8**
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**	2.47	2.34	2.40	2.45	**2.42**	**2.60**
Oil (CAD/BBL)	71.60	65.79	66.77	71.17	**68.83**	82.51	94.83	85.37	93.00	**88.93**	88.46	79.12	82.00	86.00	**83.90**	**93.00**
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**	**1,622**
Crude oil revenues	846	2,089	1,885	975	**5,795**	1,013	1,598	2,570	2,053	**7,233**	1,643	2,532	2,788	3,096	**10,059**	**16,070**
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**	1,928	2,957	3,213	3,521	**11,759**	**17,693**
Royalties	221	551	362	178	**1,311**	237	348	614	430	**1,628**	331	617	670	734	**2,351**	**3,689**
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**	1,598	2,340	2,543	2,787	**9,408**	**14,004**
Financial instrument gain (loss)		-	-	-	-	(47)	(12)	0	0	**(59)**	(55)	-	-	-	**(55)**	**0**
Other operating income	9	93	10	7	**68**	8	8	9	8	**34**	8	0	0	0	**8**	**0**
TOTAL REVENUES	**1,135**	**2,218**	**2,183**	**1,358**	**6,841**	**1,308**	**1,465**	**2,341**	**2,056**	**7,171**	**1,551**	**2,340**	**2,543**	**2,787**	**9,361**	**14,004**
Operating expenses																
Operating and transportation	845	660	543	559	**2,605**	507	471	664	857	**2,499**	952	600	652	714	**2,917**	**2,796**
General and administrative	987	769	670	997	**3,423**	960	990	718	1,374	**4,042**	927	1,000	1,050	1,100	**4,077**	**4,200**
Amortization, depletion & acc.	1,109	1,351	1,393	1,357	**5,250**	718	498	1,417	819	**8,652**	691	909	1,001	1,112	**3,712**	**5,770**
Change in fair value of warranty liability	499	-	-	-	-	874	(795)	(543)	2,044	**1,580**	(1,110)	0	0	0	**(1,110)**	**0**
Stock based compensation	237	150	150	156	**621**	189	210	150	113	**662**	300	175	175	175	**825**	**850**
Total operating expenses	**3,677**	**2,930**	**2,756**	**3,069**	**11,899**	**3,247**	**1,375**	**2,407**	**5,207**	**17,436**	**1,760**	**2,684**	**2,878**	**3,101**	**10,422**	**13,616**
OPERATING INCOME	**(2,541)**	**(713)**	**(574)**	**(1,711)**	**(5,057)**	**(1,939)**	**90**	**(66)**	**(3,151)**	**(10,266)**	**(209)**	**(343)**	**(335)**	**(314)**	**(1,061)**	**388**
Interest (expense)	(256)	(275)	309	(239)	**(458)**	(243)	(283)	(270)	(72)	**(868)**	(125)	(150)	(236)	(347)	**(858)**	**(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)**	(20)	0	0	0	**(20)**	**0**
Pretax income	(2,855)	(968)	(275)	(1,955)	**(5,517)**	(2,266)	(189)	(347)	(8,422)	**(11,231)**	(354)	(493)	(571)	(661)	**(1,939)**	**(862)**
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)**	**(354)**	**(493)**	**(571)**	**(661)**	**(1,939)**	**(862)**
Foreign currency translation adjustment	(430)					(287)	(66)	991	(347)	**292**	(160)	0	0	0	**0**	**0**
Comprehensive Income (loss)	(3,014)	(968)	189	(1,451)	**(4,549)**	(2,366)	(255)	645	(8,769)	**(10,752)**	(514)	(493)	(571)	(661)	**(1,939)**	**(862)**
Weighted Avg. Shares Out.	97,727	98,698	99,198	100,698	**99,789**	116,652	118,000	121,391	125,159	**120,300**	130,786	133,786	149,000	152,000	**141,393**	**155,000**
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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