Zacks Small-Cap Research

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Dejour Energy, Inc. (DEJ-AMEX)

DEJ: First well at Kokopelli drilled and cased. We look forward to announcement of completion and production.

Current Recommendation	**Outperform**
Prior Recommendation	Neutral
Date of Last Change	02/23/2012
Current Price (10/11/12)	$0.21
Six- Month Target Price	**$0.80**

OUTLOOK

Our rating on Dejour's stock remains Outperform. Production levels at Woodrush continue to improve sequentially, though management's expectation for the rate of gross production was adjusted to the 800 BOEPD level. In the third quarter, the company's initial well into the liquid-rich gas Kokopelli field acreage was drilled and cased to a depth of 8,440 feet. The well is expected to be fracture stimulated and completed during the fourth quarter We look forward to the announcement of the well's completion and achieving production. Our price target, which is based on NAV analysis, remains $0.80.

SUMMARY DATA

52-Week High	**$0.56**
52-Week Low	**$0.14**
One-Year Return (%)	**-3438**
Beta	**1.80**
Average Daily Volume (shrs.)	**744,253**
Shares Outstanding (million)	**148.9**
Market Capitalization ($ mil.)	**$31.3**
Short Interest Ratio (days)	**0.29**
Institutional Ownership (%)	**5**
Insider Ownership (%)	**15**
Annual Cash Dividend	**$0.00**
Dividend Yield (%)	**0.00**
5-Yr. Historical Growth Rates	
Sales (%)	**8.3**
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	**7 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	1.55 A	1.48 A	1.62 E	1.71 E	6.37 E
2013					9.26 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 A	-$0.00 E	-$0.01 E	-$0.02 E
2013					-$0.02 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 expected 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) remains $0.80.
- 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 drilled eight producing wells (three oil and six gas). **The third oil production well (AB-1-I) is still in the process of coming online.** Management expects gross production from Woodrush to increase to approximately the 800 BOEPD level before the end of 2012.
  - At the **Kokopelli project in Colorado, one well was drilled and cased in the third quarter of 2012.** The well is expected to be fracture stimulated and completed during the fourth quarter with production expected to commence before the end of the year. Additional drilling has been deferred until 2013. The number of wells will be dependent on NGL prices, but currently management is presenting the expectation that one-to-four wells could be drilled in 2013 followed by 8-16 wells in 2014.
- 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

Production from Halfway E Pool on the Woodrush property in northeastern British Columbia is averaging 527 BOE/day, up 28% from the 411 BOE/day average in the first quarter of 2012. Management now expects gross production to increase to approximately the 800 BOEPD (500 BOPD and 300 BOE of gas per day).

Equity Shelf Offering Renewed

On August 27, 2012, Dejour Energy re-filed a shelf offering with the SEC consisting of $25,000,000 worth of common shares, warrants and units, which could be comprised of any combination of shares and warrants. Since there was no company announcement, the filing pressured the stock down to $0.12 in the subsequent days as investors initially (and incorrectly) interpreted the filing as a need for equity capital and further dilution.

Drilling at Kokopelli

On September 25, 2012, Dejour announced that its first well at Kokopelli had been drilled and cased to a depth of 8,440 feet. Dubbed Federal 6/7, the well targets the liquids-rich gas stacked discontinuous sands in the Lower Mesaverde formation, which is part of the Mesaverde Total Petroleum System designated by the U.S. Geological Survey (USGS). Management expects to perforate, fracture stimulate and complete the well in the fourth quarter. Dejour's stock rallied over 16% on the news.

The well bore encountered strata consistent with the Mesaverde formation and a gas column thickness comparable to nearby wells drilled by Williams Companies and Bill Barrett Corporation. The acreage of Dejour's Kokopelli project is proximate to the Douglas Creek Arch, where the depth of the Mesaverde formation moderates to less than 500 feet. However, the well bore intersected multiple formations of

potentially gas-producing zones that total 2,500 feet. The zone targeted in the Lower Mesaverde formation is comprised of sands, silts, coals and shale, which are typical of the Mesaverde Group in the Kokopelli field. The source rocks for the Mesaverde formation include coals and carbonaceous shales from which gas has been expelled and subsequently has migrated into the sandstone beds.

Dejour Energy has a 71.5% working interest of 2,200 gross acres (or 1,573 net acres) in the Kokopelli area of the Williams Fork sandstone formation located in the Piceance Basin of Colorado. The acreage is immediately adjacent to the producing leaseholds in the Kokopelli Field, owned by Williams Companies (WMB: NYSE) and Bill Barrett Corporation (BBG: NYSE).

As previously indicated by the company, management decided to reduce the number of wells in the initial development of the Kokopelli field from four wells to one well due to weak NGL prices. The successful completion of this single well, including the attainment of a certain minimum quantity of paying gas, will require only the minimum required capital investment to maintain the lease on the 2,200 gross acres. Additional drilling has been deferred until 2013, and the number of wells will be dependent on NGL prices.

Acquisition of Additional Acreage

On September 21, 2012, Dejour announced the addition of **approximately 31,000 net acres in northwestern Colorado** to the company's exploration portfolio. The acquisition of the acreage is a result of a restructuring of an exploration joint venture (JV) with Brownstone Energy (BWN: TSX-V, BWSOF: OTC), which has been in place since 2008.

Second Quarter Results

On August 14, 2012, Dejour reported financial results for the second quarter ending June 30, 2012. Like the first quarter, this quarter was impacted by lower natural gas prices, which fell 44.8% year-over-year and 12.6% sequentially. Again this quarter, management did not attempt to maximize gas production, and as a result, gas production declined 9.8% sequentially. On the other hand, oil production increased 5.4% sequentially as a result of the waterflood; however, the rate of improvement was less than expectations. Total revenues declined 4.9% sequentially to $1,488,586. G&A expenses decreased 7.7% sequentially and 13.6% year-over-year as management continues to implement cost savings. Also, operating & transportation expenses decreased 11.7% sequentially; therefore, operating netback only declined 1.0% to $640,000 from $646,000. For the second quarter of 2012, Dejour reported a loss of $402,628 or $0.004 per diluted share, in-line with expectations despite lower-than-expected oil & gas production.

Production levels at Woodrush in northeastern British Columbia are improving sequentially, albeit modestly, due to the increased effectiveness of the waterflood and the reworking of the third well which was drilled late last year. With the water injection rate having been increased to a higher level during the first half of 2012, management expects a full production response to occur during the second half.

However, due to weak NGL prices, management decided to reduce the number of wells in the initial development of the Kokopelli field from four wells to one well, which will require the minimum required investment to maintain the lease on the 2,200 gross acres. Also, additional drilling is being deferred until early 2013, and the number of wells will be dependent on NGL prices.

In addition, lower NGL prices are delaying the construction of the Williams natural gas pipeline into the area. Originally, construction was to have begun in 2012; however, Bargath LLC, a wholly-owned subsidiary of Williams Midstream, has now indicated that construction will not begin until at least 2013. Known as Kokopelli Phase II, the proposed 16-inch natural gas pipeline is expected extend 22.3 miles and terminate in section 4 of Township 7S-92W, within six miles of Dejour's well pad in section 21 of Township 6S-91W.

Management's decision to adjust the initial development of the liquid-rich gas Kokopelli field from four wells to one well is disappointing. Though the company is modifying the pace of development in reaction to weak NGL prices, it is necessary that the single well not only be successfully completed by year-end, but also attain the minimum paying quantity of gas in order to preserve the lease on the entire 2,200 gross acres (by changing its status to a held-by-production lease). Also, the economies of scale of developing multiple wells from a single drilling pad at the same time are being forgone.

Lower gas prices have also influenced management to defer development of the North Rangely and Roan Creek projects to at least 2013. Management prefers that the company's cash flow support a greater percentage of the costs of developing its leases in Colorado.

The stock reacted negatively to the lower than expected oil & gas production, the adjusted drilling program at Kokopelli and the deferred development of North Rangely and Roan Creek projects, by declining 18% from $0.23 to $0.19 on the day of the earnings release.

OVERVIEW

Based in Vancouver, British Columbia, Dejour Energy (DEJ) is a Canadian independent oil and natural gas company and holds interests in approximately **139,000 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 was reworked with the addition of eight horizontal laterals. Acreage holdings consist of approximately 6,150 net acres[2] in northeastern British Columbia and northwestern Alberta, and 133,200 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[3]. 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. Dejour has a 71.5% interest in the 2,200 acre Kokopelli Project with Brownstone Energy (BWN: TSX-V, BWSOF: OTC) holding the remaining 28.5%.

UPCOMING EVENTS

The successful completion of the Kokopelli well is critical for Dejour to preserve the 2,200-acre lease in Colorado. By changing the lease's status to held-by-production, Dejour's right to operate on the property will be extended in perpetuity as long as the minimum paying quantity of oil and/or gas is being produced.

Dejour is expected to report third quarter results in mid-November. Results should indicate the rate of progress toward management's expectation of achieving production of 800 BOEPD at Woodrush.

We look forward to the annual reserve assessments by Gustavson & Associates for Kokopelli and by AJM Deloitte for Woodrush. These evaluations, which could be announced as early as January, directly drive our valuation model. A critical factor in the methodology used to derive the net present value (discounted at 10%) for Kokopelli will be the pricing assumptions for Natural Gas Liquids, especially ethane, propane and butane.

[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] Dejour has a 75% interest in the Woodrush property located in British Columbia.
[3] As estimated by the independent consultant firm Gustavson Associates LLC as of January 1, 2012.

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 $134.7 million ($0.83 per diluted share[4]). The $134.7 million is attained by adding the company's assets of $20 million of land (at cost), $115.8 million[5] of PV-10 Proved Reserves and net cash of $4.3 million and then deducting $5.5 million in debt (listed as a current liability on the company's balance sheet) [6]. Therefore, **our target price remains $0.80 per share.**

DEJOUR ENERGY, INC.

		Gross Acres	Net Acres	Net Proved Reserves (PV-10)
WOODRUSH	(British Columbia) 51-101 dated 12/31/2011 (AJM Deloitte)	8,200	6,150	19,936,700
KOKOPELLI	(Colorado) 51-101 dated 1/15/2012 (Gustavson & Associates)	2,200	1,573	95,897,000
UNDRILLED LAND	(at cost)		131,000	20,000,000
NET CASH				4,300,993
(DEBT)	(line of credit)			(5,481,300)
	TOTAL	138,723		134,653,393
	Shares outstanding			148,916,374
	Fully diluted shares			179,860,645
	NAV per outstanding share			0.90
	NAV per diluted share			**0.83**

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 ($96 million of the $116 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

[4] After the equity offering in the beginning of June 2012, Dejour Energy had approximately 187 million diluted shares.
[5] Based on $19 .9 million at Woodrush (AJM Deloitte reserve study effective December 31, 2011) and $95.9 million at Kokopelli (reserve study by Gustavson & Associates dated January 15, 2012).
[6] Balance sheet items valued as of June 30, 2012.

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 Kokopelli should be reduced or entirely eliminated. As the a PUD becomes a producing well in the fourth quarter of 2012, the marketplace may eliminate the discount to NAV 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.

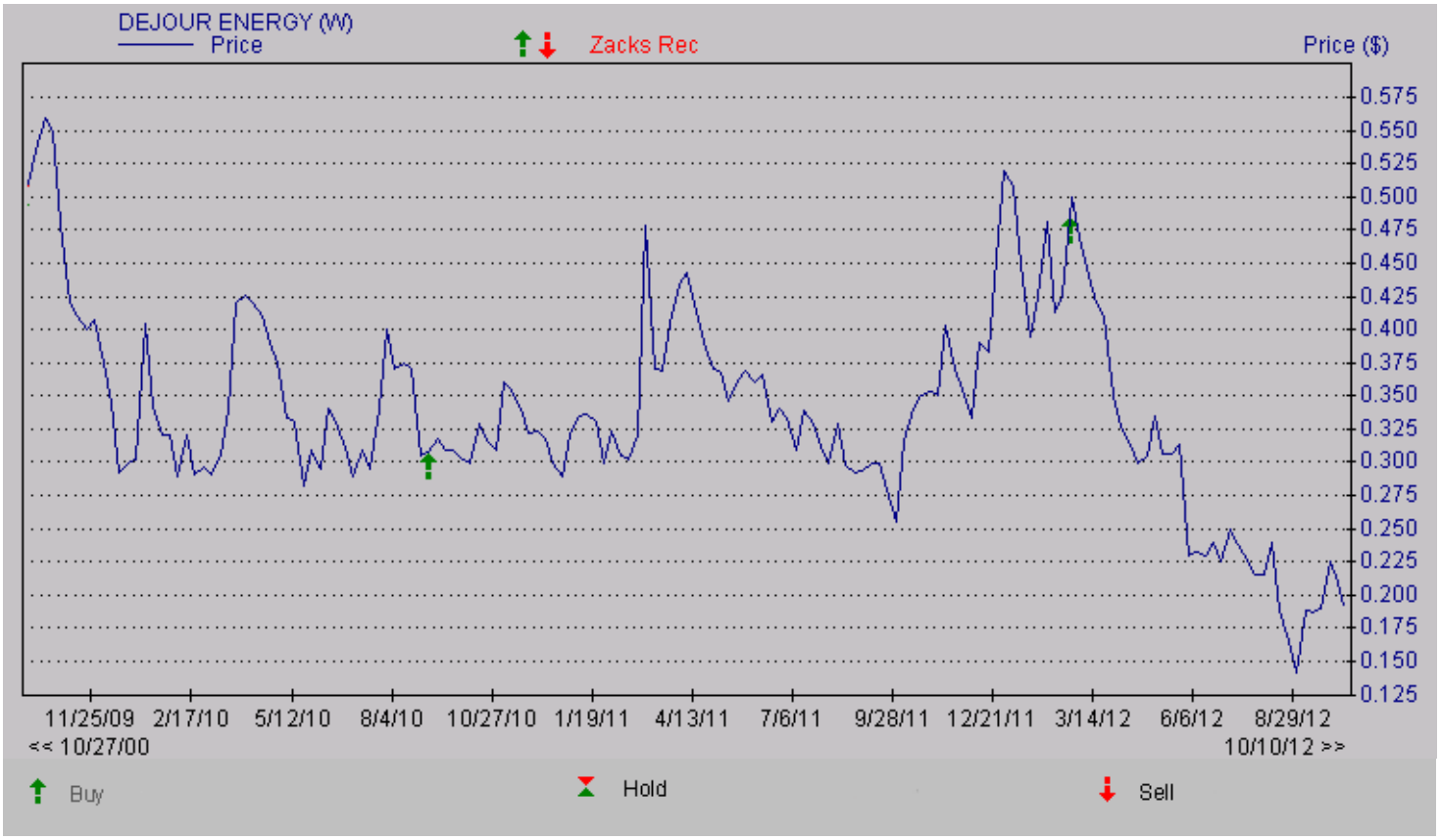
We reiterate our Outperform rating based upon the attractive valuation level of the stock relative to its reserve valuation, along with the company's improving production profile from Woodrush in northeast British Columbia and expected production in 2012 from Kokopelli in Colorado.

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	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	104.3	115.0	115.0	**625.0**	**552.0**
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	19.6	21.0	23.0	**82.1**	**110.4**
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	104.3	115.0	115.0	**1,117.8**	**1,214.4**
Total (MBOE)	28.5	54.5	56.1	38.4	**177.0**	36.7	26.7	47.3	43.0	**153.1**	37.8	36.9	40.2	42.2	**186.3**	**202.4**
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	2.16	2.40	2.45	**2.37**	**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	78.85	82.00	86.00	**83.83**	**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**	286	225	276	282	**1,069**	**1,435**
Crude oil revenues	846	2,089	1,885	975	**5,795**	1,013	1,598	2,570	2,053	**7,233**	1,643	1,543	1,722	1,978	**6,885**	**10,267**
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	1,771	1,998	2,260	**7,954**	**11,702**
Royalties	221	551	362	178	**1,311**	237	348	614	430	**1,628**	331	291	376	551	**1,548**	**2,440**
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	1,480	1,622	1,709	**6,406**	**9,262**
Financial instrument gain (loss)		-	-	-	-	(47)	(12)	0	0	**(59)**	(55)	0	-	-	**(55)**	**0**
Other operating income	9	93	10	7	**68**	8	8	9	8	**34**	8	8	0	0	**16**	**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**	**1,489**	**1,622**	**1,709**	**6,367**	**9,262**
Operating expenses																
Operating and transportation	845	660	543	559	**2,605**	507	471	664	857	**2,499**	952	840	405	458	**2,656**	**2,252**
General and administrative	987	769	670	997	**3,423**	960	990	718	1,374	**4,042**	927	855	850	900	**3,532**	**4,200**
Amortization, depletion & acc.	1,109	1,351	1,393	1,357	**5,250**	718	498	1,417	819	**8,652**	691	696	618	710	**2,715**	**3,686**
Change in fair value of warranty liability	499	-	-	-	-	874	(795)	(543)	2,044	**1,580**	(1,110)	(681)	0	0	**(1,791)**	**0**
Stock based compensation	237	150	150	156	**621**	189	210	150	113	**662**	300	66	100	175	**642**	**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**	**1,777**	**1,973**	**2,243**	**7,753**	**10,988**
OPERATING INCOME	**(2,541)**	**(713)**	**(574)**	**(1,711)**	**(5,057)**	**(1,939)**	**90**	**(66)**	**(3,151)**	**(10,266)**	**(209)**	**(288)**	**(352)**	**(535)**	**(1,386)**	**(1,726)**
Interest (expense)	(256)	(275)	309	(239)	**(458)**	(243)	(283)	(270)	(72)	**(868)**	(125)	(208)	(236)	(347)	**(916)**	**(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)	(84)	0	0	**(104)**	**0**
Pretax income	(2,855)	(968)	(275)	(1,955)	**(5,517)**	(2,266)	(189)	(347)	(8,422)	**(11,231)**	(353)	(580)	(588)	(882)	**(2,406)**	**(2,976)**
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)**	**(353)**	**(580)**	**(588)**	**(882)**	**(2,406)**	**(2,976)**
Foreign currency translation adjustment	(430)					(287)	(66)	991	(347)	**292**	(160)	177	0	0	**0**	**0**
Comprehensive Income (loss)	(3,014)	(968)	189	(1,451)	**(4,549)**	(2,366)	(255)	645	(8,769)	**(10,752)**	(514)	(403)	(588)	(882)	**(2,406)**	**(2,976)**
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	136,165	149,000	152,000	**141,988**	**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)	(0.01)	**(0.02)**	**(0.02)**
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)	(0.01)	**(0.02)**	**(0.02)**

HISTORICAL ZACKS RECOMMENDATIONS



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