Zacks Equity Research

April 4, 2011
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Dejour Energy, Inc. (DEJ-AMEX)

DEJ: Zacks Co. Report – OUTPERFORM

Current Recommendation	**Outperform**
Prior Recommendation	Neutral
Date of Last Change	09/05/2010
Current Price (04/01/11)	$0.43
Six- Month Target Price	**$1.00**

OUTLOOK

Our rating on Dejour's stock remains Outperform based upon increasing production levels due to the implementation of a waterflood project in March. Revenues are expected to more than double this year. In addition, the announcement of a joint venture to help fund of the development of deep oil at Woodrush should accelerate the improvement of the company's production profile in coming years. Lastly, news concerning the exploratory drilling program at the company's South Rangely property should be forthcoming in 2011. Our price target is $1.00 based on NAV analysis.

SUMMARY DATA

52-Week High	**$0.48**
52-Week Low	**$0.28**
One-Year Return (%)	**1.97**
Beta	**1.89**
Average Daily Volume (shrs.)	**2,036,965**
Shares Outstanding (million)	**121.2**
Market Capitalization ($ mil.)	**$53**
Short Interest Ratio (days)	**0.21**
Institutional Ownership (%)	**0**
Insider Ownership (%)	**25**
Annual Cash Dividend	**$0.00**
Dividend Yield (%)	**0.00**
5-Yr. Historical Growth Rates	
Sales (%)	**N/A**
Earnings Per Share (%)	**N/A**
Dividend (%)	**N/A**
P/E using TTM EPS	**N/M**
P/E using 2011 Estimate	**N/M**
P/E using 2012 Estimate	**N/M**
Zacks Rank	**3**

Risk Level	**Above Average**
Type of Stock	**Small - Value**
Industry	**Oil – C$ E&P**
Zacks Rank in Industry	**13 of 14**

ZACKS ESTIMATES

Revenue
(in millions of $ CAD)

	Q1 (Mar)	Q2 (Jun)	Q3 (Sep)	Q4 (Dec)	Year (Dec)
2009	2.72 A	1.68 A	1.06 A	1.33 A	6.79 A
2010	1.31 A	2.77 A	2.54 A	1.54 A	8.15 A
2011	2.37 E	3.81 E	5.30 A	5.37 E	16.85 E
2012					21.11 E

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

	Q1 (Mar)	Q2 (Jun)	Q3 (Sep)	Q4 (Dec)	Year (Dec)
2009	-$0.03 A	-$0.01 A	-$0.03 A	-$0.03 A	-$0.11 A
2010	-$0.02 A	-$0.01 A	-$0.01 A	-$0.01 A	-$0.05 A
2011	-$0.01 E	-$0.01 E	-$0.00 E	-$0.00 E	-$0.02 E
2012					-$0.02 E

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

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 strong confidence in higher production levels from the successful drilling program at Woodrush and the implementation of a waterflood project in early March 2011. Our price target of $1.00 is derived assigning a 40% discount to the company's net asset value of $1.62 (see Valuation section).
- Management continues to develop its prime properties: **Woodrush** in British Columbia's Peace River Arch and **Gibson Gulch** in Colorado's Piceance Basin. During 2010, the company successful drilled three wells at Woodrush, two of which remain production wells and one having been converted to an injection well. Recently, Dejour announced the formation of a joint venture for the exploration and production of deep oil on its Woodrush property. Importantly, the JV partner will fund most of the exploration costs, along with additional land purchases.
- During 2010, revenues increased 20% primarily due to the addition the new producing wells at Woodrush. Also, Dejour successfully accessed the capital markets with four private placements generating net proceeds of $4.0 million, the majority of which is earmarked for an exploratory drilling program at the company's 7,000+ acres on the south side of Rangely field in western Colorado.
- 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 123,000 net acres of oil and gas leases in North America. Net Proved and Probable Producing Reserves were 327 thousand barrels of oil (MBO) and 1,726 million of cubic feet (MMCF) of natural gas, totaling 623 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 nine producing wells. Acreage holdings consist of 13,000 net acres in northeastern British Columbia and northwestern Alberta, and 110,000 net acres (all undeveloped) in Colorado and Utah in the Piceance, Uinta and Paradox Basins. Net Proved and Probable Undeveloped Reserves at **Gibson Gulch** were 1.05 million barrels of oil (MMBO) and 147 billions of cubic feet (BCF) of natural gas[2]. The company is the operator of its developed acreage and approximately 88% of its undeveloped 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.

RECENT NEWS

On March 31, 2011, Dejour reported results for the fourth quarter and full year of 2010 ending December 31, 2010. Quarterly earnings were a loss of CAD $0.01 per diluted share, on target with our estimate. Total revenues for the quarter increased 15.8% year-over-year to $1.54 million, primarily due to increased oil and gas production from the two new Woodrush wells that began producing in May 2010.

[1] As estimated by the independent petroleum engineering consultant firm GLJ Petroleum Consultants as of December 31, 2010.

[2] As estimated by the independent petroleum engineering consultant firm Gustavson Associates LLC as of January 1, 2011.

Operating & transportation expenses declined 4%; however, G&A expenses increased 50%. Operating netbacks decreased 10.5% to $799,000 from $893,000 in the comparable year-ago quarter due to higher royalties (+183%) and increased operating & transportation expenses (+51%). Management was again successful in accessing the capital markets during the quarter, arranging three offerings for $3.6 million in gross proceeds ($3.3 million net).

For the year, earnings were a loss of CAD $0.05 per diluted share, in line with expectations. Total revenues increased 20.2% to $8.15 million, again due to increased oil and gas production from the two new Woodrush wells. Operating & transportation expenses declined 10.6%; G&A expenses decreased 15.2%; and amortization and depletion allowances declined 18.4%. Operating netbacks increased 28.3% to $4.24 million from $3.30 million in 2009 due to higher revenues and lower operating and transportation expenses (-10.6%), partly offset by increased royalties (+130%). Dejour did not record any impairment of oil and gas properties in 2010.

In 2010, Dejour sold interests in two properties for proceeds of $1.6 million: 12,000 net acres in Colorado for $652,405 ($US 650,000) and its entire 90% working interest in the Buick Creek (Canada) area for $951,566. Also during 2010, Dejour closed four private placements for net proceeds of $4.0 million.

In 2011, Dejour's management expects production from the Halfway oil pool at Woodrush to increase due to the recently implemented waterflood. Gross production is expected to increase steadily to 1,400 BOE/D by the end of June 2011. In addition, the newly formed joint venture should result in the acquisition of additional Canadian resources and their development. In the U.S., the high profile development and production by Williams Companies (WMB) and Bill Barrett Corporation (BBG) at Gibson Gulch is encouraging management to proceed in the realization of the value of the company's U.S. properties.

On March 24, 2011, Dejour changed its name to Dejour Energy Inc. to better brand the company's focus on oil and gas exploration and production in Canada and the U.S.

On March 4, 2011, Dejour implemented a waterflood program at its Woodrush oil and gas project in northeast British Columbia. The water injection will increase oil production at Woodrush due to the immediate lifting of the well allowable restriction imposed by the OGC of British Columbia, which has artificially limited gross production to approximately 640 BOE/D. Dejour will steadily increase production in order to optimize the performance of the water flood.

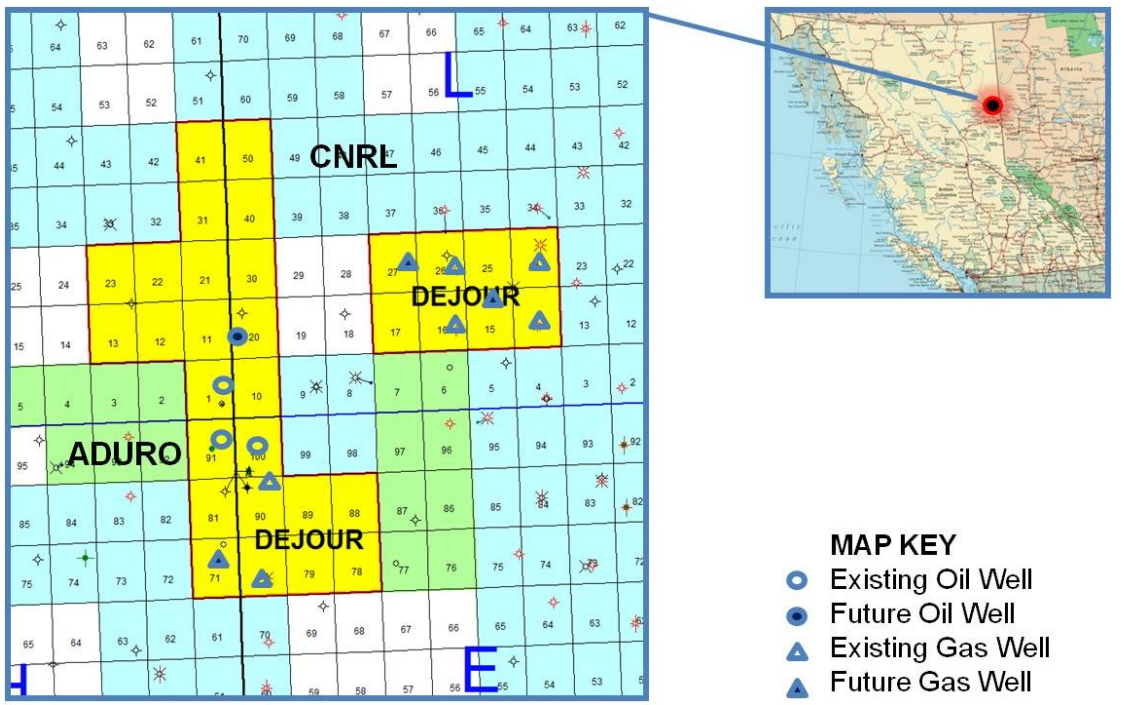
In February 2011, Dejour closed a stock and warrant offering consisting of 11,010,000 shares and 5,505,000 warrants for $US 3.3 million. The proceeds will be used to fund an exploratory drilling program at the company's 7,000+ acres on the south side of Rangely field in western Colorado. This announcement is important for several reasons. First, this is exploratory drilling outside of the company's producing acreage at Woodrush in Canada, potentially providing additional producing acreage for Dejour. Secondly, the offering provides financing for the drilling program; therefore, an additional partner, and the subsequent dilution, is not required to explore and develop this field. And thirdly, insiders are obviously confident in this project, since they acquired 20% of the offering. The area has been analyzed by two deep seismic soundings. In addition, a private company has previously drilled nearby and is currently operating a producing oil well.

On January 20, 2011, Dejour announced the formation of a joint venture for the exploration and production of deep oil on its Woodrush property. Importantly for Dejour, the unnamed partner (a NYSE listed E&P company) will fund most of the exploration costs, along with additional land purchases. This is an important step for Dejour which reduces the risk level for the financing of exploration costs, and potentially outlines the structure of future JVs at Gibson Gulch.

WOODRUSH PROPERTY (British Columbia) in the Peace River Arch

Dejour Energy operates exploration and production projects in 17,300 acres (approximately 13,000 net acres to Dejour) in the Peace River Arch located in northeastern British Columbia and northwestern Alberta. Dejour owns and has a 75% working interest in the **Woodrush** area of 6,000 gross acres (or 4,500 net acres), which is the source of the company's entire current production. The area has production from nine wells (three oil and six gas) with average daily gross production expected to ramp up to 1,300 barrels of oil equivalent per day (BOE/D) by the end of June 2011 from 640 BOE/D[3]. Four gas wells are producing from Notekwin formation (Dejour's parcel in the upper right near CNRL – see map below), and three oil wells and two gas wells producing from Halfway reservoir (Dejour's parcel in the lower left adjacent to ADURO). These three oil wells are in close proximity (500 meters) to each other.

In 2010, Dejour drilled three successful wells at Woodrush, bringing the company's total well count to nine. Of the three new wells, two (one oil well and one gas well) came on line in May, both of which were able to enjoy unlimited production for 90 days before being restricted with well allowables imposed by the British Columbia Oil and Gas Commission (OGC). For the first 90 days, production from the wells was unlimited, and then regulations required that the production be lowered to an allowable level commensurate with maintaining the pressure level in the reservoir until a mechanism, such as the implementation of a water flood, was put into place to maintain the reservoir's pressure and conserve the oil resource. In the fall drilling season, Dejour successfully drilled another oil well at the southeast edge of the Halfway reservoir, which ultimately was converted to a water injection well.



Courtesy of Dejour Energy

In December 2010, Dejour received approval from the British Columbia Oil and Gas Commission (OGC) for the implementation of a waterflood program at Woodrush. The project was completed in the first week of March 2011. The scope of the waterflood project included the drilling of a water supply well and converting one producing well to an injection well. The power generation capacity was upgraded; pumps

[3] Average well production in 2010.

were installed; and the necessary water treatment facilities were constructed. A second injector well will be drilled. The gross cost of the project is estimated to be $3.2 million.

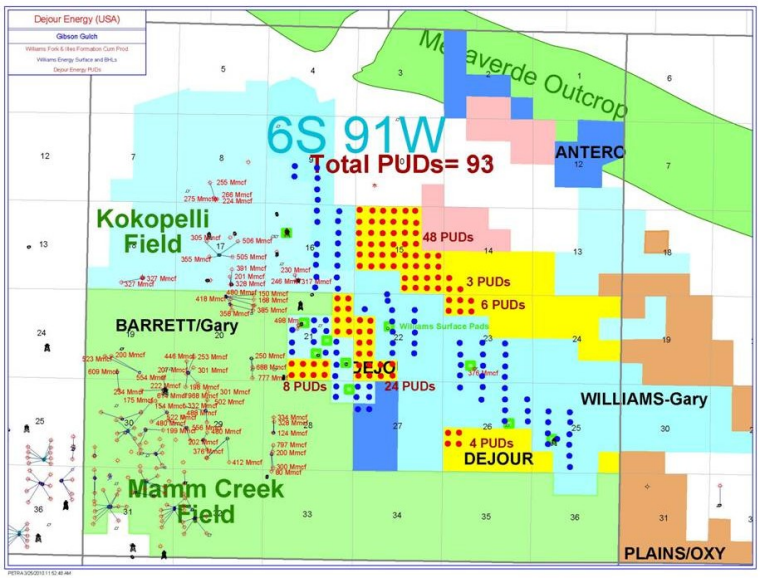
The implementation of a waterflood program provides for sustained oil production at Woodrush for at least five to six years, allowing Dejour to fund further development of oil production with operating cash flow and enhancing the company's ability to access more attractive longer-term funding from conventional banking facilities. Production from the Halfway pool at Woodrush should increase steadily with production peaking at 1,300 BOE/D in the third quarter of 2011.

Ultimately, management expects to have a total of more than 15 producing wells, plus injectors, operating at Woodrush. In addition, multiple oil pools have been detected by the 3-D seismic survey, and in due course, many will be developed. On the cost-side, considerable transportation cost improvement is possible when a seven-mile pipeline is constructed. Currently, oil is trucked over seven miles from the well heads to the nearest pipeline.

Due to the successful drilling of three shallow oil wells at Woodrush, in February 2011, a major un-named U.S. oil E&P company entered into a joint venture (JV) with Dejour to fund and drill two deep horizontal wells to explore and develop deep oil in the Montney oil resource at Woodrush. Up to $1 million will be paid to Dejour on Dejour's achievement of specific objectives in the first quarter of 2011, after which the JV will fund land purchases up to $5 million on a 65/35 basis (U.S. oil company/Dejour). Afterwards, two horizontal wells will be drilled on an 80/20 funding basis (U.S. oil company/Dejour). Thereafter, the JV would continue to develop the project on an ongoing 50/50 basis beyond the earning period.

GIBSON GULCH PROPERTY (Colorado) in the Piceance Basin

Dejour Energy has a 72% working interest of 2,200 gross acres (or 1,585 net acres) in the Gibson Gulch area of the Williams Fork sandstone formation located in the Piceance Basin of Colorado. The acreage is immediately adjacent to the producing properties in the Kokopelli Field, owned by Williams Companies (WMB: NYSE) and Bill Barrett Corporation (BBG: NYSE). The Gibson Gulch acreage is one of the company's leading prospects due to its proximity to the producing properties (some within one mile). Dejour's management plans to ultimately drill 220 wells (158 wells net to Dejour) in Gibson Gulch, based on spacing of 10 acres, beginning with 93 wells into the Williams Fork structure. Management projects drilling 16 gas wells per year from 2012 to 2015, when financing is secured and/or a joint venture partner is found.



There are two structures within Gibson Gulch from which to extract gas: the 7,000 feet deep **Williams Fork** structure and the 13,000 feet deep **Niobrara** formation. The Williams Fork structure in the Piceance Basin is amongst the lowest quartile of supply cost natural gas basins in North America[4] leading to upper quartile after-tax typical well returns[5]. Barrett's average well depth at Gibson Gulch is 7,400 feet and spacing is only 10 acres. Well life is estimated to be 30 years. Barrett's management cites the Gibson Gulch area as a "lower risk development asset[6]." In March, Bill Barrett Corp. increased 2011 natural gas production estimates, primarily due to an accelerated drilling program at Gibson Gulch. Dejour's property is contiguous to the northeast of Barrett's 17,615 acre property. Barrett cited the faster drilling times and higher liquids content as economic motivators. To access the resources in the Williams Fork structure, Dejour Energy has delineated 93 PUDs (Proven Undeveloped Reserves) on 600 of the 2,200 gross acres.

Also, Dejour has exposure to a deep high-pressure gas opportunity in the Niobrara formation at Gibson Gulch. Management estimates the Niobrara gas reserves to be 215 billion cubic feet (BCF). Though the development of this unconventional resource opportunity is several years in the future, another company has drilled five wells into the formation, and land prices are rising in the area.

VALUATION

NAV Formulation

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 $196 million ($1.62 per share[7]) as of December 31, 2010. The $196 million is attained by adding the company's assets of $20 million of land (at cost) and $181 million of PV-10 Proved Reserves ($13 million at Woodrush and $168 million at Gibson Gulch) and deducting $5 million in debt (listed as a current liability on the company's balance sheet). The NAV is then discounted by 40% to attain our target price of $1.00 per share. Though a 40% discount may appear high, it is well within the range of 13% to 59% discounts at which mid-cap E&P companies are currently trading. In addition, with Dejour's stock trading only $125,000 worth of stock on an average day, the stock's illiquidity also factors into the estimated 40% discount.

[4] Based on a study conducted by FirstEnergy Capital Corp. and MGM Energy Corp. in April 2010.

[5] Based on information delivered by Williams Companies at the Jefferies Global Energy Conference in December 2010.

[6] Bill Barrett Corporation press release (March 25, 2011): Bill Barrett Corporation Announces Increased Production Guidance.

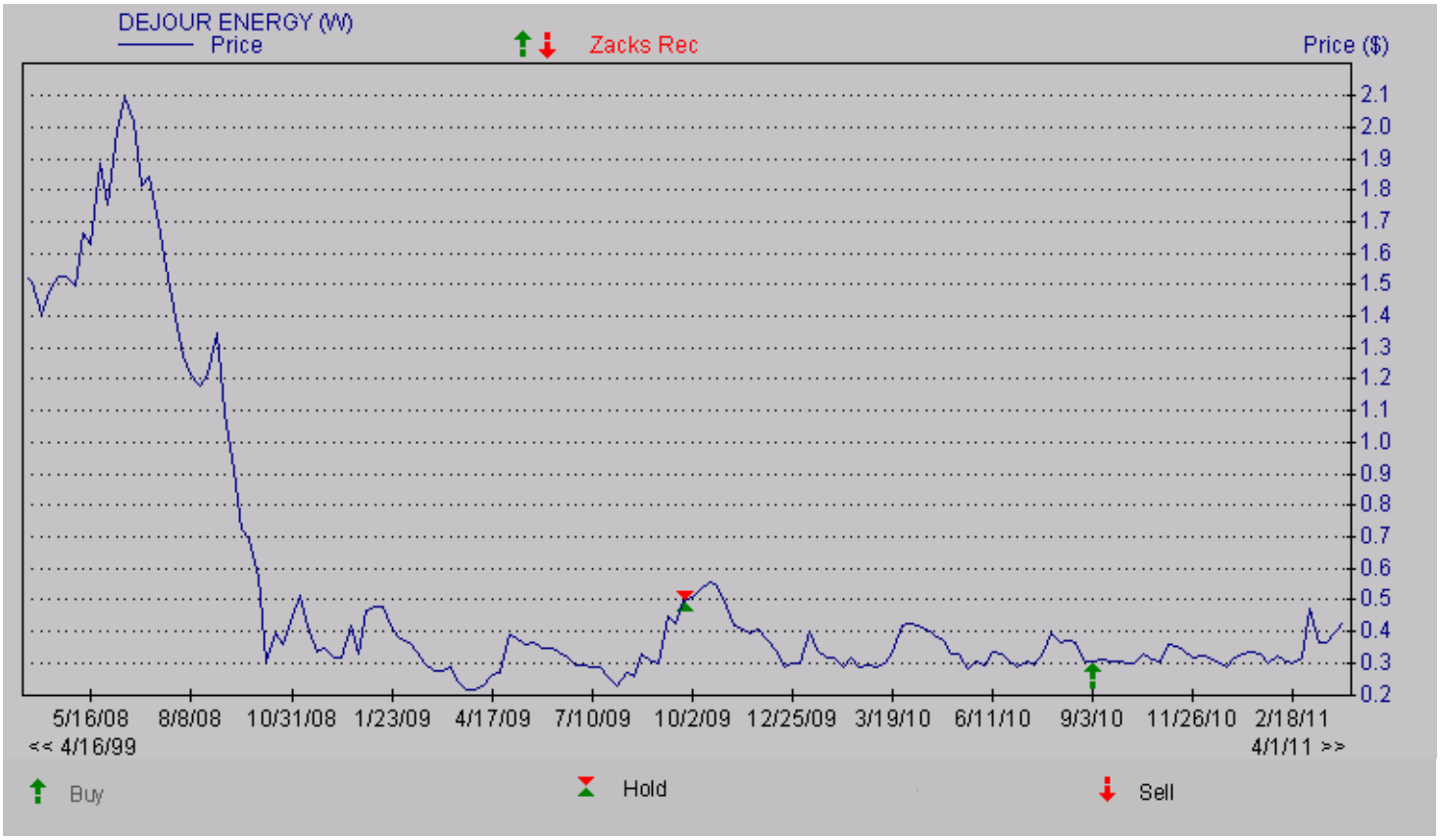
[7] 110,180,545 shares outstanding on December 31, 2010 plus the 11,010,000 shares issued in February 2011.

PROJECTED FINANCIAL STATEMENT (INCOME STATEMENT)

Dejour Energy Inc. Earnings Model

FISCAL YRS ENDING 12/31	Q1	Q2	Q3	Q4	2010	Q1 E	Q2 E	Q3 E	Q4 E	2011 E	2012 E
PROVED RESERVES (net)											
Natural gas (MMCF)					**62,939**					**72,380**	**83,237**
Crude oil (MBO)					**626**					**689**	**930**
Natural gas liquids (MBO)					**4**					**4**	**5**
Total (MMCFE)					**62,963**					**72,404**	**83,267**
Total (MBOE)					**11,120**					**12,756**	**14,807**
PRODUCTION VOLUMES (net)											
Natural gas (MMCF)	96.6	136.5	167.3	148.5	**548.9**	186.3	184.3	184.3	186.3	**741.2**	**750.0**
Crude oil (MBO)	11.8	31.8	28.2	13.7	**85.5**	20.7	34.1	50.5	51.1	**156.4**	**200.0**
Natural gas liquids (BBLS)	0.6										
Total (MMCFE)	100.3	136.5	167.3	148.5	**1,061.9**	186.3	184.3	184.3	186.3	**1,679.5**	**1,950.0**
Total (MBOE)	28.5	54.5	56.1	38.4	**177.0**	51.8	64.8	81.2	82.1	**279.9**	**325.0**
OIL PRICE REALIZATIONS / GAS HUB PRICES											
Natural gas (CAD/MCF)	5.04	4.29	3.81	3.73	**16.87**	3.73	3.80	3.80	3.90	**3.81**	**3.90**
Oil (CAD/BBL)	71.60	65.79	66.77	71.17	**275.33**	81.00	91.00	91.00	91.00	**88.50**	**91.00**
Natural gas liquids (CAD/BBL)	23.58										
INCOME STATEMENT (CAD 000 except EPS)											
Natural gas revenues	487	586	638	554	**2,264**	695	700	700	727	**2,822**	**2,925**
Crude oil revenues	846	2,089	1,885	975	**5,795**	1,677	3,105	4,596	4,646	**14,024**	**18,200**
Natural gas liquids revenues	15		11		**26**						
Total oil and gas revenues	1,347	2,676	2,534	1,529	**8,085**	2,372	3,806	5,296	5,373	**16,846**	**21,125**
Other operating revenues	(42)	93	10	7	**68**	0	0	0	0	**0**	**0**
TOTAL REVENUES	1,305	2,769	2,544	1,536	**8,154**	2,372	3,806	5,296	5,373	**16,846**	**21,125**
Operating expenses											
Royalties	221	551	362	178	**1,311**	498	799	1,112	1,128	**3,538**	**4,436**
Operating and transportation	843	660	543	559	**2,605**	575	575	575	575	**2,300**	**2,461**
Amortization, depletion & acc.	1,149	1,351	1,393	1,357	**5,250**	1,271	2,040	2,839	2,880	**9,030**	**11,619**
General and administrative	987	769	670	997	**3,423**	665	665	675	675	**2,680**	**3,500**
Stock based compensation	164	150	150	156	**621**	165	170	175	175	**685**	**750**
Total operating expenses	3,364	3,481	3,118	3,247	**13,210**	3,174	4,249	5,376	5,433	**18,232**	**22,766**
OPERATING INCOME	(2,059)	(713)	(574)	(1,711)	**(5,056)**	(803)	(443)	(80)	(60)	**(1,386)**	**(1,641)**
Interest expense	(252)	(275)	309	(239)	**(458)**	(275)	(250)	(200)	(150)	**(875)**	**(500)**
Interest income	9	8	9	11	**37**	5	5	2	2	**14**	**12**
Gain (loss) on investments					**0**						
Equity income (loss)					**0**						
Impairments			(10)		**(10)**						
Foreign exchange gain (loss)	(16)	13	(9)	(16)	**(28)**	0	0	0	0	**0**	**0**
Pretax income	(2,318)	(968)	(275)	(1,955)	**(5,516)**	(1,073)	(688)	(278)	(208)	**(2,247)**	**(2,129)**
Inc. tax recovery (expense)	0	0	464	504	**968**	0	0	0	0	**0**	**0**
Net Income before non-reoccuring	(2,318)	(968)	189	(1,451)	**(4,548)**	(1,073)	(688)	(278)	(208)	**(2,247)**	**(2,129)**
Less: non-recurring items	0	0	0	0	**0**	0	0	0	0	**0**	**0**
REPORTED NET INCOME	(2,318)	(968)	189	(1,451)	**(4,548)**	(1,073)	(688)	(278)	(208)	**(2,247)**	**(2,129)**
Weighted Avg. Shares Out.	97,727	98,698	99,198	100,698	**99,789**	111,000	113,000	115,000	125,000	**116,000**	**130,000**
EPS before NRI	(0.02)	(0.01)	0.00	(0.01)	**(0.05)**	(0.01)	(0.01)	(0.00)	(0.00)	**(0.02)**	**(0.02)**
REPORTED NET INCOME	(0.02)	(0.01)	0.00	(0.01)	**(0.05)**	(0.01)	(0.01)	(0.00)	(0.00)	**(0.02)**	**(0.02)**

HISTORICAL ZACKS RECOMMENDATIONS



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