Zacks Small-Cap Research

July 5, 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 (07/01/11)	$0.33
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 At Woodrush. Revenues are expected to increase by 30% 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. Also, details of the exploratory drilling program at South Rangely should be forthcoming in the third quarter, which should expand on the announcement that hydrocarbon bearing siltstone was encountered. Our price target is $1.00 based on NAV analysis

SUMMARY DATA

52-Week High	**$0.48**
52-Week Low	**$0.28**
One-Year Return (%)	**15.00**
Beta	**1.55**
Average Daily Volume (shrs.)	**342,831**
Shares Outstanding (million)	**121.2**
Market Capitalization ($ mil.)	**$40**
Short Interest Ratio (days)	**2.08**
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	**11 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	1.36 A	2.34 E	3.68 E	3.89 E	11.17 E
2012					16.69 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	-$0.03 A	-$0.01 A	-$0.01 A	-$0.01 A	-$0.05 A
2011	-$0.02 A	-$0.01 E	-$0.01 E	-$0.01 E	-$0.04 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 implementation of a waterflood project at Woodrush in early March 2011. Our price target of $1.00 is derived from the company's net asset value of $1.03 (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.
- 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. Another event could be the discovery of an oil and/or gas resource at South Rangely.
- 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 109,000 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. 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 June 21, 2011, Dejour announced that **an exploratory vertical 3,863 foot well at South Rangely has encountered approximately 90 feet of hydrocarbon bearing siltstone** in the Lower Mancos "C" sands. The company is thoroughly reviewing the well data before releasing specific information. In addition, the well will be completed, fractured and flow tested to determine the commercial potential of the Lower Mancos "C" Sand. Management expects to make an announcement in the third quarter.

[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.

On June 14, 2011, Dejour announced Dejour reported results for the first quarter of 2011 ending March 31, 2011. Quarterly earnings were a loss of CAD $0.02 per diluted share. Total revenues (net of royalties) for the quarter increased 19.4% year-over-year to $1.36 million, primarily due to increased oil and gas production from the Woodrush wells that began producing in May 2010 and the lack of a gas compressor issue that existed in the first quarter of 2010. The ramp up of production after the implementation of the waterflood has been gradual and did not benefit first quarter results. Operating and transportation expenses declined 40%, and G&A expenses decreased 2.8%. Operating netback increased 199% to $0.84 million ($24.08/BOE) from $0.28 million ($9.95/BOE) in the comparable year-ago quarter due to higher revenues and lower operating and transportation expenses. Due to the adoption of IFRS with its required non-cash warrant expense, the company reported a loss of $2.37 million of $0.02 per diluted share. Without the warrant liability, the loss was $1.21 million of $0.01 per diluted share. **Management was again successful in accessing the capital markets during the quarter, receiving $3.07 million in net proceeds** from the issuance of stock and the exercise of warrants.

Concurrent with the earnings announcement, management outlined exploration and development plans for 2011. On the company's first earnings call, **management stated that current oil production at Woodrush is 430 BOPD, up 30% from the production level in the first quarter indicating that there is now traction to the ramp up. Third quarter production should be impressive.**

In addition to the improved production profile at Woodrush in the second half of 2011, the company will begin drilling for natural gas at Gibson Gulch, Colorado in the Piceance Basin. Having chosen three sites (PUDs - Proved UnDeveloped reserves) in close proximity to proven wells drilled by Barrett Corp. (BBG: NYSE) or Williams Companies (WMB: NYSE), the first two-to-three wells should be drilled in the fourth quarter this year. After financing the initial wells over the next couple years with non-equity funding, management expects that the remaining wells of the 93 planned in the drilling program will become self-funding in 2014. In addition, a test well is planned for South Rangely in the second quarter. With two targets to test both the upper and lower Niobrara sections of the Mancos Shale, Dejour is targeting both the oil potential and natural gas.

On June 13, 2011, Dejour announced that AJM Petroleum Consultants (independent reservoir engineering consultants) updated the NI 51-101 compliant reserve report on the Woodrush field. Using data from a 3D reservoir simulator, PV-10 with proved and probable reserves increased 158% from C$17 million to C$44 million.

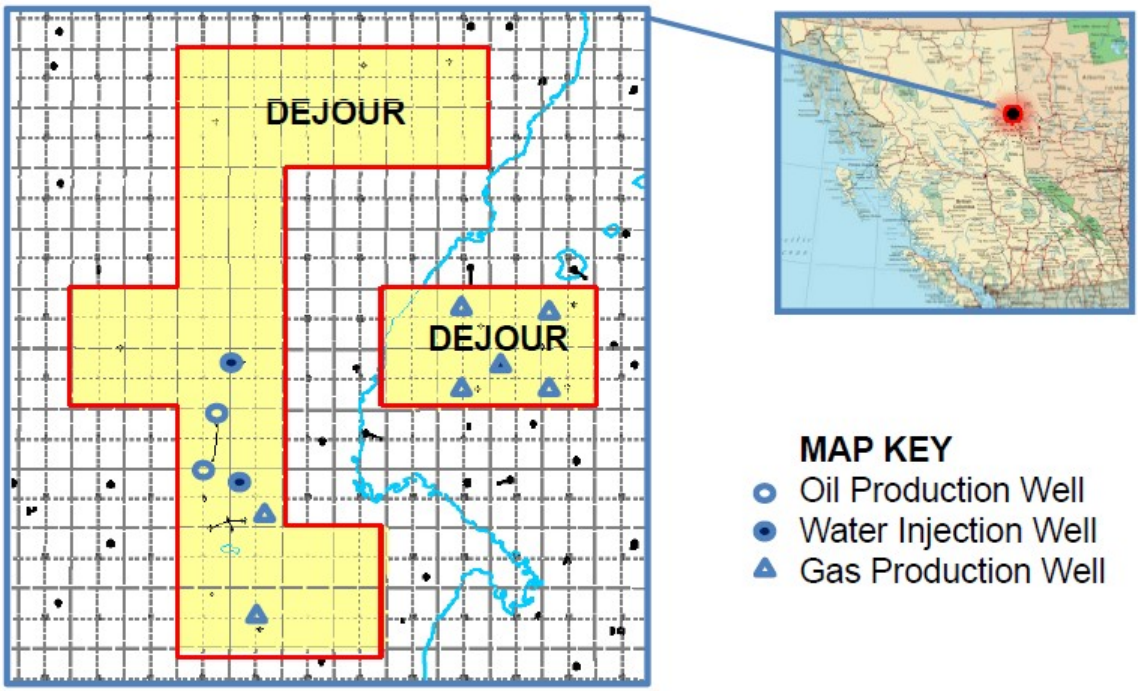
On April 25, 2011, Dejour announced that the waterflood at the Woodrush field has been successfully implemented. After two months of water injection, the producing gas/oil ratio (GOR) indicates that the secondary recovery process has been effective, having declined from 2,700 CF/BBL to less than 900 CF/BB. Since production is no longer constrained by the well allowables imposed by the British Columbia Oil and Gas Commission (OGC), well production can be gradually increased from 180 BOPD (barrels of oil per day) to 400 BOPD in July, bringing gross field production (oil and gas) to more than 800 BOEPD (barrels of oil equivalent per day). Management expects to further increase oil production throughout 2011 and into 2012, when peak oil production should reach 900 BOPD and gas production should be maintained at 400 BOEPD, bringing gross production to 1,300 BOEPD, 100 BOEPD above management's prior guidance of 1,300 BOEPD.

On March 31, 2011, Dejour reported results for the year of 2010 ending December 31, 2010. Annual 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.

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) sometime in 2012 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 were installed; and the necessary water treatment facilities were constructed. A second injector well will be drilled.

[3] Average well production in 2010.

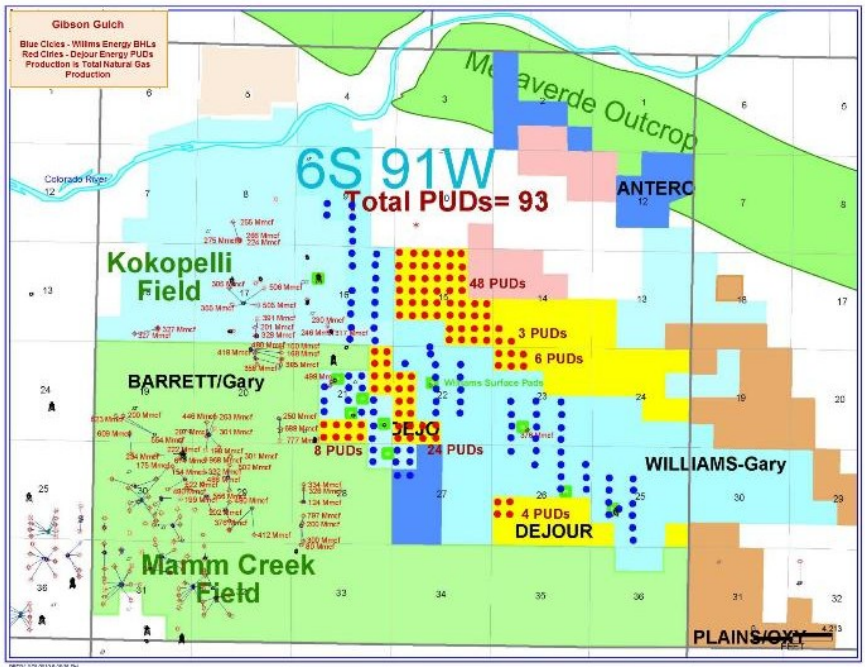
The implementation of a waterflood program provides for sustained oil production at Woodrush for at least five to six years, allowing Dejour to fund further development of oil production with operating cash flow and enhancing the company's ability to access more attractive longer-term funding from conventional banking facilities. Production from the Halfway pool at Woodrush should increase steadily with production peaking at 1,300 BOE/D sometime in 2012.

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.

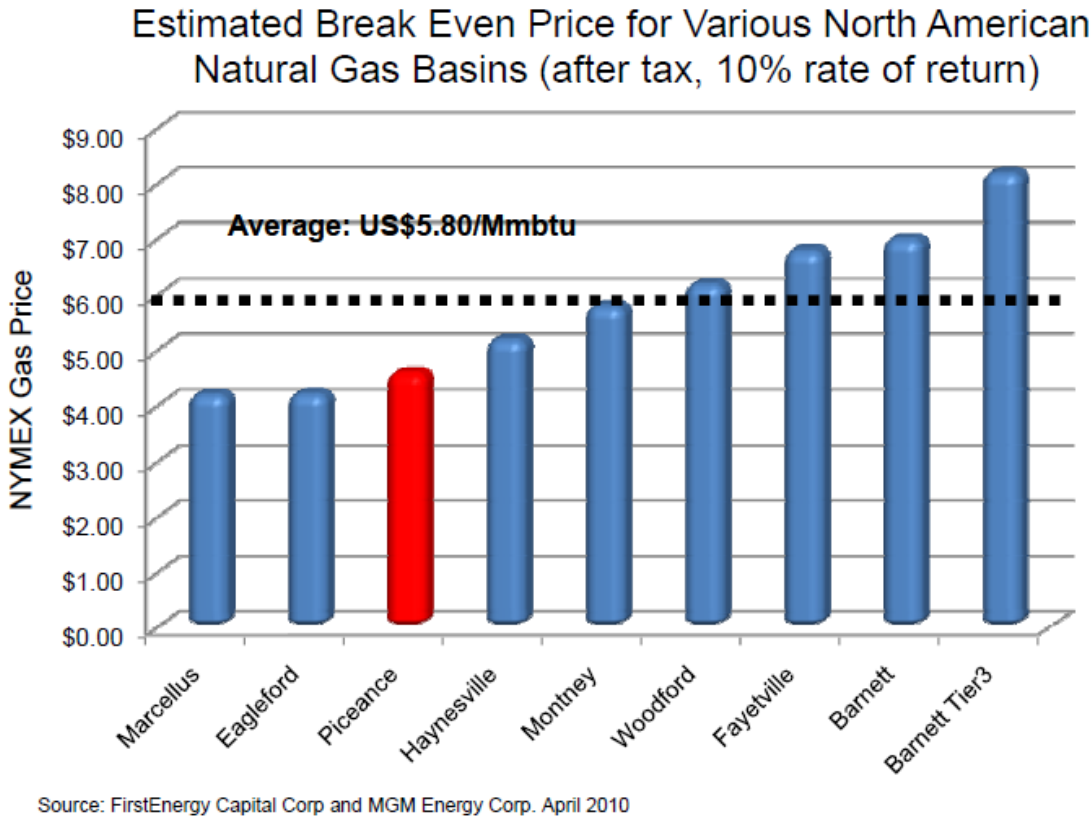
Due to the successful drilling of three shallow oil wells at Woodrush, in February 2011, a major un-named U.S. oil E&P company entered into a joint venture (JV) with Dejour to fund and drill two deep horizontal wells to explore and develop deep oil in the Montney oil resource at Woodrush. Up to $1 million 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 12 to 16 gas wells between 2011 and 2015. The first two-to-three wells should be drilled in the fourth quarter of this year. After financing the initial wells over the next couple years with non-equity funding, management expects that the remaining wells of the drilling program will become self-funding in three years.



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]."



Source: FirstEnergy Capital Corp and MGM Energy Corp. April 2010

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.

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

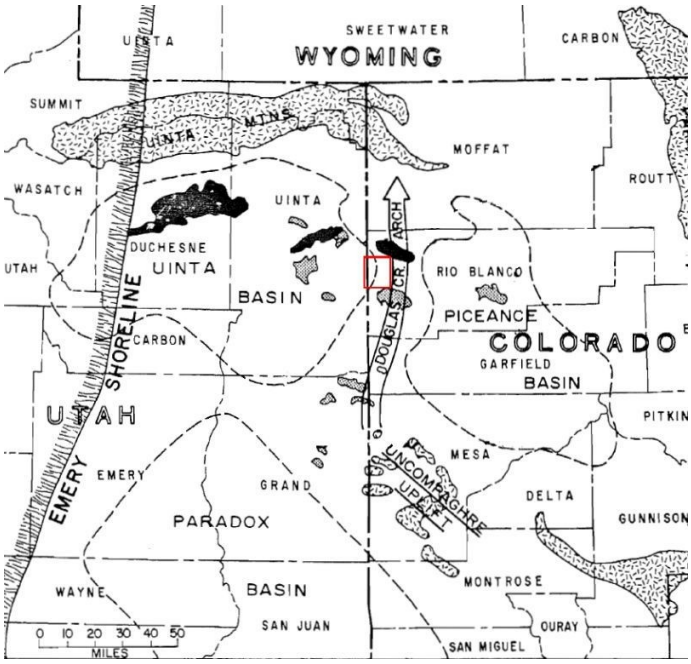
[5] Based on information delivered by Williams Companies at the Jefferies Global Energy Conference in December 2010.

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

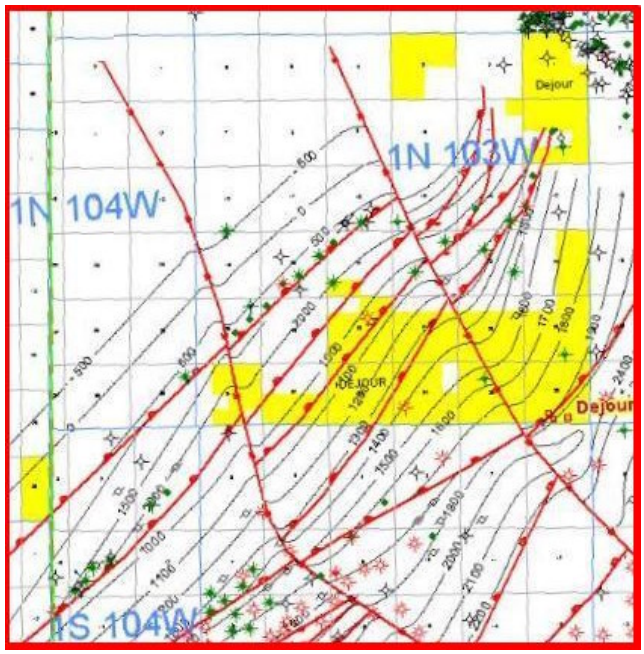
SOUTH RANGELY PROPERTY (Colorado)

Dejour Energy has a 70% working interest of 7,100 gross acres (or 5,000 net acres) in South Rangely area on the western flank of the Douglas Creek Arch, which is directly south of the Rangely Oil field that has been operated by Chevron since the 1960's. The Dejour's acreage is adjacent and approximately six miles northeast from an oil producing property operated by a private operator, RW Bayless.

Dejour conducted exploratory evaluation drilling at South Rangely, financed by the stock and warrant offering in January. Having conducted two deep seismic soundings, a vertical well at South Rangely was drilled to test both the upper and lower Niobrara sections of the Mancos Shale, which consists largely of offshore marine shale with a middle sandy interval. The shale deposited by the western Cretaceous Seaway, a quiet inland sea that crossed the North American continent throughout the Cretaceous era, 145 to 65 million years ago. Considerable geological research has been conducted concerning the Mancos Shale and the hydrocarbon deposits that exist within it.



Mancos and Douglas Arch



Dejour's Properties

In June 2011, the vertical 3,863 foot well encountered approximately 90 feet of hydrocarbon bearing siltstone in the Lower Mancos "C" sands. The company is reviewing the well data before releasing specific information. In addition, the well will be completed, fractured and flow tested to determine the commercial potential of the Lower Mancos "C" sand. If warranted, Dejour will follow-on with a horizontal well program. An announcement is expected in the third quarter. Dejour has a 30% working interest in the test well and an average 56% working interest in the surrounding acreage

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 $125 million ($1.03 per share[7]) as of March 31, 2011. The $125 million is attained by adding the company's assets of $20 million of land (at cost), $108 million of PV-10 Proved Reserves and net cash of $1.5 million and then deducting $4.5 million in debt (listed as a current liability on the company's balance sheet). Therefore, our target price is $1.00 per share.

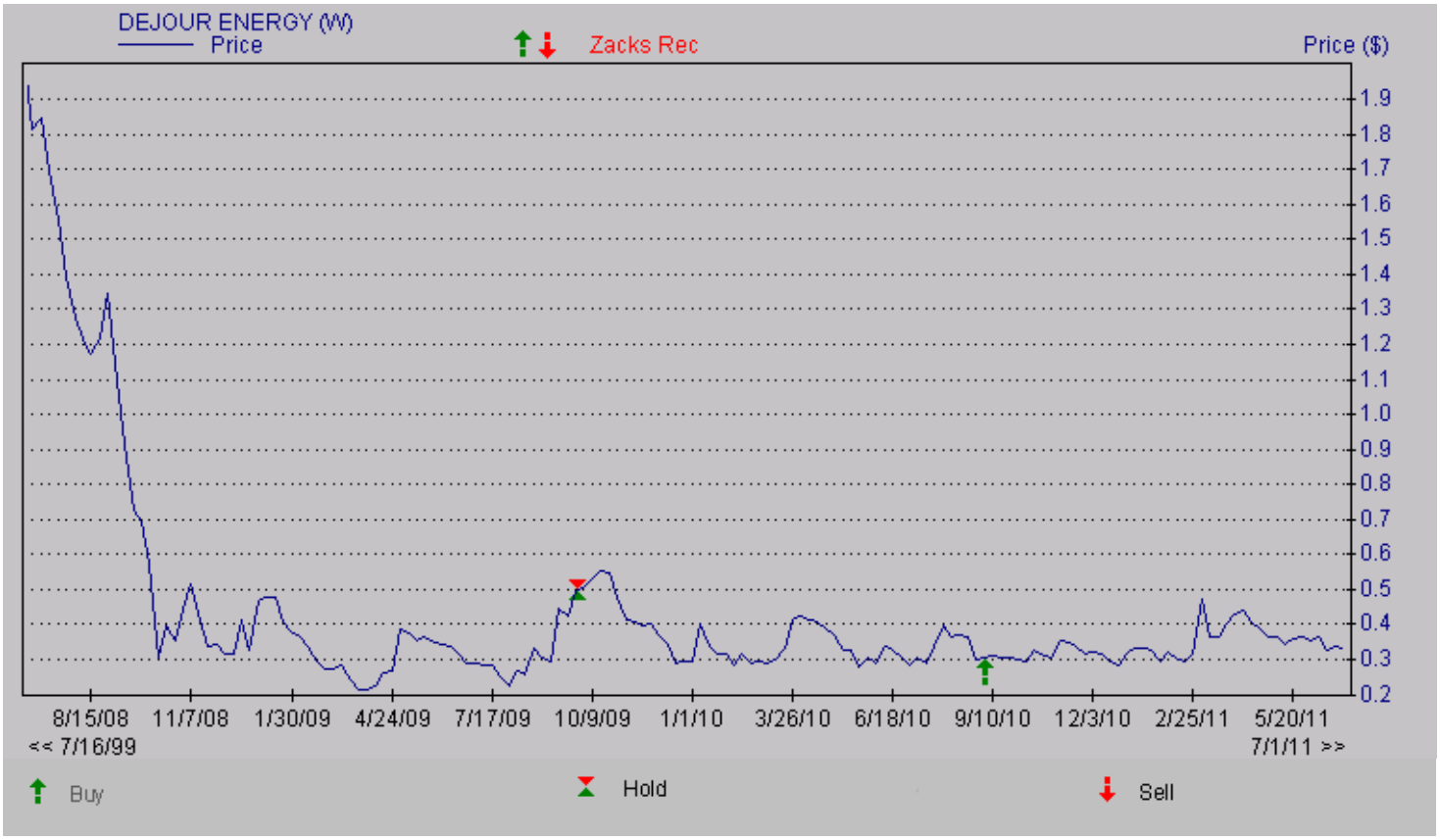
PROJECTED FINANCIAL STATEMENT (INCOME STATEMENT)

Dejour Energy Inc. Earnings Model

FISCAL YRS ENDING 12/31	Q1	Q2	Q3	Q4	2010	Q1	Q2 E	Q3 E	Q4 E	2011 E	2012 E	2013 E
PROVED RESERVES (net)												
Natural gas (MMCF)					**62,939**					**72,380**	**83,237**	**95,722**
Crude oil (MBO)					**626**					**689**	**930**	**1,116**
Natural gas liquids (MBO)					**4**					**4**	**5**	**6**
Total (MMCFE)					**62,963**					**72,404**	**83,267**	**95,758**
Total (MBOE)					**11,120**					**12,756**	**14,807**	**17,075**
PRODUCTION VOLUMES (net)												
Natural gas (MMCF)	96.6	136.5	167.3	148.5	**548.9**	146.7	177.5	177.5	177.5	**679.0**	**750.0**	**750.0**
Crude oil (MBO)	11.8	31.8	28.2	13.7	**85.5**	12.3	27.3	47.8	51.1	**138.4**	**200.0**	**200.0**
Natural gas liquids (BBLS)	0.6											
Total (MMCFE)	100.3	136.5	167.3	148.5	**1,061.9**	146.7	177.5	177.5	177.5	**1,509.5**	**1,950.0**	**1,950.0**
Total (MBOE)	28.5	54.5	56.1	38.4	**177.0**	36.7	56.9	77.4	80.6	**251.6**	**325.0**	**325.0**
OIL PRICE REALIZATIONS / GAS HUB PRICES												
Natural gas (CAD/MCF)	5.04	4.29	3.81	3.73	**16.87**	3.89	3.90	3.90	3.90	**3.90**	**3.90**	**4.05**
Oil (CAD/BBL)	71.60	65.79	66.77	71.17	**275.33**	82.51	83.00	83.00	83.00	**82.88**	**91.00**	**92.00**
Natural gas liquids (CAD/BBL)	23.58											
INCOME STATEMENT (CAD 000 except EPS)												
Natural gas revenues	487	586	638	554	**2,264**	571	692	692	692	**2,647**	**2,925**	**3,038**
Crude oil revenues	846	2,089	1,885	975	**5,795**	1,013	2,266	3,965	4,238	**11,482**	**18,200**	**18,400**
Natural gas liquids revenues	15		11		**26**							
Total oil and gas revenues	1,347	2,676	2,534	1,529	**8,085**	1,583	2,958	4,657	4,930	**14,129**	**21,125**	**21,438**
Royalties	221	551	362	178	**1,311**	237	621	978	1,035	**2,967**	**4,436**	**4,502**
Total oil and gas revenues (net)	1,127	2,125	2,173	1,351	**6,774**	1,347	2,337	3,679	3,895	**11,162**	**16,689**	**16,936**
Other operating revenues	9	93	10	7	**68**	8	0	0	0	**8**	**0**	**0**
TOTAL REVENUES	1,135	2,218	2,183	1,358	**6,841**	1,355	2,337	3,679	3,895	**11,170**	**16,689**	**16,936**
Operating expenses												
Operating and transportation	845	660	543	559	**2,605**	507	525	550	575	**2,157**	**2,308**	**2,470**
General and administrative	987	769	670	997	**3,423**	960	800	690	1,000	**3,450**	**3,500**	**4,200**
Amortization, depletion & acc.	1,109	1,351	1,393	1,357	**5,250**	718	1,606	2,810	3,003	**8,137**	**11,619**	**11,791**
Change in fair value of warranty liability	499					874						
Stock based compensation	237	150	150	156	**621**	189	170	175	175	**709**	**750**	**800**
Total operating expenses	3,677	2,930	2,756	3,069	**11,899**	3,247	3,101	4,225	4,753	**14,453**	**18,177**	**19,260**
OPERATING INCOME	(2,541)	(713)	(574)	(1,711)	**(5,057)**	(1,892)	(764)	(546)	(859)	**(3,283)**	**(1,488)**	**(2,325)**
Interest expense	(256)	(275)	309	(239)	**(458)**	(243)	(250)	(200)	(150)	**(843)**	**(500)**	**(250)**
Interest income		8	9	11	**37**					**0**	**0**	**0**
Gain (loss) on investments	(42)				**0**	(47)				**(47)**	**0**	**0**
Equity income (loss)					**0**					**0**	**0**	**0**
Impairments			(10)		**(10)**					**0**	**0**	**0**
Foreign exchange gain (loss)	(16)	13	(9)	(16)	**(28)**	(84)	0	0	0	**(84)**	**0**	**0**
Pretax income	(2,855)	(968)	(275)	(1,955)	**(5,517)**	(2,266)	(1,014)	(746)	(1,009)	**(4,257)**	**(1,988)**	**(2,575)**
Inc. tax recovery (expense)	271	0	464	504	**968**	187	0	0	0	**0**	**0**	**0**
Foreign currency translation adjustment	(430)					(287)	0	0	0	**0**	**0**	**0**
Net Income before non-reoccuring items	(3,014)	(968)	189	(1,451)	**(4,549)**	(2,366)	(1,014)	(746)	(1,009)	**(4,257)**	**(1,988)**	**(2,575)**
Less: non-recurring items	0	0	0	0	**0**	0	0	0	0	**0**	**0**	**0**
REPORTED NET INCOME	(3,014)	(968)	189	(1,451)	**(4,549)**	(2,366)	(1,014)	(746)	(1,009)	**(4,257)**	**(1,988)**	**(2,575)**
Weighted Avg. Shares Out.	97,727	98,698	99,198	100,698	**99,789**	116,652	118,000	120,000	125,000	**119,913**	**130,000**	**140,000**
EPS before NRI	(0.03)	(0.01)	0.00	(0.01)	**(0.05)**	(0.02)	(0.01)	(0.01)	(0.01)	**(0.04)**	**(0.02)**	**(0.02)**
REPORTED NET INCOME	(0.03)	(0.01)	0.00	(0.01)	**(0.05)**	(0.02)	(0.01)	(0.01)	(0.01)	**(0.04)**	**(0.02)**	**(0.02)**

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

HISTORICAL ZACKS RECOMMENDATIONS



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