

**CANADA**

**SOG CN** Outperform

Price 20 Aug 10 C\$0.84

Volatility index Very High

12-month target C\$ 2.00

12-month TSR % +138.1

Valuation C\$ 2.00

- 1.0x P/RENAV

**GICS sector** Energy

Market cap C\$m 90

30-day avg turnover C\$m 0.1

Market cap US\$m 51

Number shares on issue m 107.1

**Investment fundamentals**

Year end 31 Dec		2009A	2010E	2011E	2012E
Sales revenue	m	2.8	9.1	27.7	45.9
EBITDA	m	-1.5	1.5	12.3	23.1
Recurring profit	m	-3.9	-2.3	2.2	7.4
Reported profit	m	-3.9	-2.3	2.2	7.4
Gross cashflow	m	-1.7	1.4	12.3	23.0
CFPS	C\$	-0.04	0.02	0.11	0.21
CFPS growth	%	nmf	nmf	746.7	87.2
PGCFPS	x	-21.8	62.1	7.3	3.9
EPS rec	C\$	-0.09	-0.02	0.02	0.07
EPS rec growth	%	nmf	75.0	nmf	238.0
PER rec	x	nmf	nmf	41.1	12.2
EV/EBITDA	x	-47.3	50.6	7.2	3.8
Net debt/equity	%	-7.4	-39.1	5.5	8.5
P/BV	x	3.6	2.0	2.1	1.8

**SOG CN vs TSX, & rec history**



Note: Recommendation timeline - if not a continuous line, then there was no Macquarie coverage at the time or there was an embargo period.

Source: FactSet, Macquarie Research, August 2010  
(all figures in CAD unless noted)

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# Strategic Oil & Gas

## 2Q10 results; gearing up to reach 750boe/d by year-end

### Event

- Strategic reported 2Q10 production of 266boe/d and CFPS of (C\$0.00), which was slightly below our C\$0.01 mainly as a result of higher operating and G&A costs. Strategic ended 2Q10 with a net cash position of C\$1.3m and a C\$5.0m unutilized credit facility.
- At Conrad in early July, Strategic drilled a multi-leg Sawtooth horizontal well. Initial indications from the well affirm it could add 50–100bbl/d when tied in. The company holds ten additional drill locations at Conrad.
- In late July, Strategic and its partner drilled two wells at Taber targeting the Glauconite and Lower Mannville zones. The wells have been equipped and will be brought on production early next month. Initial indications after logging the well are positive, though no production rates were given. Strategic is currently evaluating potential future locations.

### Impact

- Slightly positive.** Operationally, we are encouraged by the results at Conrad, which are in line with our type curve, and optimistic of the potential rates that will result from the wells drilled at Taber. Together the three Taber and Conrad wells could add in excess of 150bbl/d (net) over the next month.

### Earnings and target price revision

- We have reduced our 2010 and 2011 production to 394boe/d and 987boe/d, respectively. Our CFPS estimates are now C\$0.02 in 2010 and C\$0.11 in 2011.

### Price catalyst

- 12-month price target: C\$2.00 based on a 1.0x P/RENAV methodology.
- Catalyst: Maxhamish development, Taber well results.

### Action and recommendation

- We continue to believe that Strategic is one of the few junior producers to have access to >500mmbbl of gross OOIP in a contiguous light oil pool. While work still needs to be done to expand the infrastructure in the area, we believe the company is on the right development track. In the near term, we expect strong production adds from Taber, and further clarity on the planned development scheme at Maxhamish as the key catalysts to move the stock higher. We maintain our Outperform rating and C\$2.00 target price, which is based on 1.0x our RENAV.

## Strategic Oil &amp; Gas (SOG CN, Outperform, Target price: C\$2.00)

Price Assumption		2009	2010E	2011E	2012E	Quarterly Forecast					
						1Q10	2Q10E	3Q10E	4Q10E		
Oil-WTI	US\$/b	61.85	80.97	87.50	98.00	Oil-WTI	US\$/b	78.80	78.09	82.00	85.00
Oil-Edmonton Par	\$/b	66.35	80.84	90.03	96.02	Gas-Henry Hub	US\$/mmbtu	5.38	4.32	4.10	4.30
Oil-Lloyd Heavy Blend	\$/b	58.40	69.91	75.97	78.84	US\$/C\$	\$	0.96	0.97	0.97	0.97
Gas-Henry Hub	US\$/mmbtu	3.95	4.50	5.10	5.55	Liquids Realization	\$/b	70.75	64.80	79.79	82.79
Gas-AECO	\$/mcf	4.05	4.15	4.90	4.85	Gas Realization	\$/mcf	5.12	4.41	3.83	3.99
US\$/C\$	\$	0.88	0.97	0.95	1.00	Oil & Liquids	kb/d	0.2	0.2	0.3	0.5
<b>Income Statement</b>		<b>2009</b>	<b>2010E</b>	<b>2011E</b>	<b>2012E</b>	Natural Gas	mcm/d	0.5	0.5	0.7	0.8
Oil & Liquids	kb/d	0.1	0.3	0.8	1.3	Total Production	kb/d (@ 6:1)	0.3	0.3	0.4	0.6
Natural Gas	mcm/d	0.6	0.6	1.1	1.6	Gas Production Ratio	%	28.3	30.3	30.7	22.7
Total Production	kb/d (@ 6:1)	0.2	0.4	1.0	1.5	Revenue (net of hedging & transp.)	m	1.6	1.2	1.9	3.5
Gas Production Ratio	%	47.9	27.0	18.8	17.1	EBITDA	m	0.1	-0.5	0.3	1.5
Production per Share Growth YoY	%	nmf	12.6	83.1	54.5	Net Income	m	(0.7)	(1.1)	(0.5)	0.0
Revenue (net of hedging & transp.)	m	2.8	8.3	25.2	42.0	EPS (basic)	(0.01)	(0.02)	(0.01)	0.00	
Royalties	m	(0.5)	(0.9)	(4.4)	(7.8)	EPS (diluted)	(0.01)	(0.01)	(0.00)	0.00	
Operating Costs	m	(1.2)	(3.2)	(6.1)	(8.4)	Adjusted EPS (diluted)	(0.01)	(0.01)	(0.00)	0.00	
G&A Costs	m	(2.6)	(2.8)	(2.4)	(2.8)	Cash Flow from Operations	m	0.1	-0.5	0.2	1.5
EBITDA	m	-1.5	1.5	12.3	23.1	CFPS	0.00	(0.00)	0.00	0.02	
Interest Costs	m	(0.1)	(0.1)	0.0	(0.1)	Production per Share Growth YoY	%	-40.1	-39.3	0.4	31.4
DD&A, Others Costs, & Tax	m	(2.3)	(3.7)	(10.1)	(15.6)	Production per Share Growth QoQ	%	-42.2	-14.3	43.3	85.1
Net Income	m	(3.9)	(2.3)	2.2	7.4	CFPS Growth YoY	%	-112.4	-28.7	-143.3	-181.4
EPS (basic)	(0.10)	(0.03)	0.02	0.07	CFPS Growth QoQ	%	-103.1	-832.3	-149.3	633.7	
EPS (diluted)	(0.09)	(0.03)	0.02	0.07	Revenue/boe	\$/boe	57.46	51.51	55.33	62.49	
Adjusted EPS (diluted)	(0.09)	(0.03)	0.02	0.07	Royalties/boe	\$/boe	(7.48)	(5.08)	(5.46)	(6.16)	
Dividend Per Share	NA	NA	NA	NA	Operating costs/boe	\$/boe	(21.67)	(32.57)	(20.00)	(20.00)	
Revenue per Share Growth YoY	%	nmf	66.1	121.4	66.6	Operating Netback/boe	\$/boe	28.32	13.86	29.88	36.33
EBITDA per Share Growth YoY	%	nmf	-153.1	515.3	88.0	G&A/boe	\$/boe	(24.35)	(32.63)	(22.63)	(8.87)
Basic WA Shares OS	m	38.7	73.7	103.5	103.5	Interest/boe	\$/boe	(1.39)	(1.03)	(0.31)	0.00
Diluted WA Shares OS	m	43.7	78.3	107.1	107.1	Cash Netback/boe	\$/boe	2.58	(19.79)	6.93	27.46
<b>Balance Sheet</b>		<b>2009</b>	<b>2010E</b>	<b>2011E</b>	<b>2012E</b>	<b>Cashflow Analysis</b>					
Cash	m	3.0	15.7	0.0	0.0	Cash Flow from Operations	m	(1.6)	1.4	12.3	23.0
Debt	m	1.5	0.0	2.3	4.4	Chgs in Working Cap	m	0.5	(0.3)	0.0	0.0
Net Debt	m	-4.6	-17.5	0.5	2.5	Net Cash Flow from Operations	m	(1.2)	1.0	12.3	23.0
Bank Lines	m	5.0	5.0	5.0	5.0	Cash Flow from Investing	m	(10.1)	(7.9)	(30.0)	(25.0)
Net Debt as % of Bank Lines	%	nmf	nmf	10.1	50.4	Cash Flow from Financing	m	13.3	19.5	2.1	2.0
Total Assets	m	26	45	51	65	Increase in Cash	m	1.9	12.6	(15.7)	0.0
Total Liabilities	m	5	5	8	14	Free Cash Flow <sup>1</sup>	m	(8.1)	(8.1)	(17.7)	(2.0)
Total S/H Equity	m	21	39	43	51	Debt Adjusted Cash Flow (DACF)	m	(1.6)	1.4	12.3	23.1
<b>Ratios Analysis</b>		<b>2009</b>	<b>2010E</b>	<b>2011E</b>	<b>2012E</b>	CFPS	-0.04	0.02	0.11	0.21	
ROA	%	nmf	nmf	6.6	18.5	Development Capital Expenditures	m	6.4	9.5	30.0	25.0
ROCE	%	nmf	nmf	5.2	14.8	Total Capex (incl. Acq'n/Disp'n)	m	6.4	9.5	30.0	25.0
ROE	%	nmf	nmf	5.3	15.7	Capex/Cash Flow	x	-3.9	6.9	2.4	1.1
Net Debt/Equity	%	-22.0	-44.4	1.2	4.9	<b>Per Boe Statistics</b>		<b>2009</b>	<b>2010E</b>	<b>2011E</b>	<b>2012E</b>
Net Debt/CF	x	nmf	-12.8	0.0	0.1	Revenue/boe	\$/boe	39.26	57.91	70.05	75.52
Price/Book	x	2.8	2.2	2.0	1.7	Royalties/boe	\$/boe	(7.37)	(6.07)	(12.32)	(14.03)
Book Value	0.3	0.4	0.4	0.5	Operating costs/boe	\$/boe	(16.39)	(22.44)	(17.00)	(15.00)	
<b>Valuation</b>		<b>2009</b>	<b>2010E</b>	<b>2011E</b>	<b>2012E</b>	Operating Netback/boe	\$/boe	15.50	29.40	40.74	46.49
P/E	x	nmf	nmf	41.1	12.2	G&A/boe	\$/boe	(37.00)	(19.26)	(6.66)	(5.03)
P/CF	x	nmf	48.1	7.3	3.9	Interest/boe	\$/boe	(1.32)	(0.52)	0.00	(0.18)
Enterprise Value	m	63	71	89	91	Capital Tax/boe	\$/boe	0.00	0.00	0.00	0.00
EV/DACF	x	-40.3	49.1	7.2	3.9	Cash Netback/boe	\$/boe	(22.82)	9.61	34.07	41.28
EV/Reserves <sup>4</sup>	\$/boe	53.78				Depletion and Depreciation/boe	\$/boe	(27.19)	(27.17)	(22.00)	(20.00)
EV/Production <sup>4</sup>	\$/boe/d	308.8	174.5	87.9	58.2	Stock based compensation/boe	\$/boe	(6.76)	(5.20)	(3.33)	(2.16)
Reserve/Production (2P)	years	15.0				Other Non-cash/boe	\$/boe	(0.07)	0.00	0.00	0.00
Dividend Yield	%	0.0	0.0	0.0	0.00	Cash Taxes/boe	\$/boe	0.00	0.00	0.00	0.00
Core Net Asset Value (PV10AT) <sup>5</sup>		0.38				Deferred Taxes/boe	\$/boe	2.38	6.71	(2.67)	(5.83)
P/NAV	x	2.2				Earnings Netback/boe	\$/boe	(54.46)	(16.05)	6.08	13.29
Core NAV + Risked Resource Upside (PV10AT) <sup>5</sup>		2.01				<b>Capital Efficiencies</b>		<b>2009</b>	<b>3-Year</b>		
P/(NAV+Risked Upside)	x	0.4				F&D (Proven)	\$/boe	nmf	na		
<b>Sensitivities (Adjusted Cash Flow)</b>		<b>2009</b>	<b>2010E</b>	<b>2011E</b>	<b>2012E</b>	FD&A (2P) <sup>6</sup>	\$/boe	nmf	na		
Oil WTI +/- US\$1.00/b	%	nmf	7.1	2.1	1.7	Recycle Ratio - (2P) <sup>6</sup>	x	nmf	na		
Gas +/- C\$0.25/mcf	%	nmf	3.9	0.7	0.5						
Oil +/- 100 b/d	%	nmf	125.4	16.9	9.9						
Gas +/- 1.0 mcm/d	%	nmf	2.8	4.1	2.5						

All figures CAD unless noted and production and reserve figures are gross of royalties

1) Cash flow from Operations (before chg in WC) Less Capex and Dividends; 2) Excludes Revisions; 3) Includes changes in Future Development Capital; 4) Excludes non-producing assets; 5) Strip pricing; 6) Annual per share figures are calculated using a weighted average share count for the period

Source: Company data, Macquarie Research, August 2010

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<p><b>Recommendation proportions – For quarter ending 30 June 2010</b></p>						
<p>Outperform Neutral Underperform</p>	<p>50.55% 35.16% 14.29%</p>	<p>64.29% 17.15% 18.56%</p>	<p>54.41% 38.24% 7.35%</p>	<p>45.63% 47.91% 6.46%</p>	<p>65.08% 30.69% 4.23%</p>	<p>50.26% (for US coverage by MCUSA, 4.58% of stocks covered are investment banking clients)            35.16% (for US coverage by MCUSA, 5.56% of stocks covered are investment banking clients)            14.58% (for US coverage by MCUSA, 0.00% of stocks covered are investment banking clients)</p>

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