



Independent Stock Idea

May 13, 2010

rating: buy
s&p 500: 1170

Birchcliff Energy Ltd. (BIR.TO) New Buy for Small Cap Natural Gas Growth

<i>Symbol</i>	BIREF	<i>Ebitda Next Twelve Months ending 3/31/11 (US\$mm)</i>	127
<i>Rating</i>	Buy	<i>North American Natural Gas/Ebitda (%)</i>	48
<i>Price (US\$/sh)</i>	9.32	<i>Natural Gas and Oil Production/Ebitda (%)</i>	100
<i>Pricing Date</i>	5/12/10	<i>Adjusted Reserves/Production NTM</i>	23.6
<i>Shares (mm)</i>	127	<i>EV/Ebitda</i>	11.3
<i>Market Capitalization (US\$mm)</i>	1,180	<i>PV/Ebitda</i>	16.0
<i>Debt (US\$mm)</i>	250	<i>Undeveloped Reserves (%)</i>	43
<i>Enterprise Value (EV) (US\$mm)</i>	1,430	<i>Natural Gas and Oil Ebitda (US\$/mcf)</i>	3.23
<i>Present Value (PV) (US\$mm)</i>	2,030	<i>Present Value Proven Reserves(US\$/boe)</i>	16.14
<i>Net Present Value (US\$/share)</i>	14	<i>Oil and Gas Ebitda Margin (%)</i>	67
<i>Debt/Present Value</i>	0.12	<i>Earnings Next Twelve Months (US\$/sh)</i>	0.22
<i>McDep Ratio - EV/PV</i>	0.71	<i>Price/Earnings Next Twelve Months</i>	43
<i>Dividend Yield (%/year)</i>	0.0	<i>Indicated Annual Dividend (US\$/sh)</i>	0.00
Note: Estimated cash flow and earnings tied to one-year futures prices for oil and natural gas.			
Reported results may vary widely from estimates. Estimated present value per share revised only infrequently.			
Estimated present value presumes a long-term price for oil of US\$75 a barrel and natural gas, \$8 a million btu.			
For historical analysis of Birchcliff see www.mcdep.com/5bir.htm			

Summary and Recommendation

We initiate a buy recommendation of Canadian small cap producer **Birchcliff Energy Ltd. (BIR.TO)** for rapidly growing natural gas production in the Montney/Doig unconventional shale gas/tight gas formation in northwest Alberta. Anticipating production from probable reserves in addition to proven quantities, we see unlevered appreciation potential of 41% in Birchcliff stock to a McDep Ratio of 1.0 where stock price would equal Net Present Value (NPV) of US\$14 a share, up from US\$11. Seeing a month of successful operation in the first phase of expansion of a processing plant completed at the end of the first quarter, we estimate unlevered cash flow for the next twelve months of US\$127 million (C\$129 million), up 25% from three months ago (see table [Next Twelve Months Operating and Financial Estimates](#)). The estimate includes a further 24% volume gain in the first quarter of 2011 from a second phase of processing expansion. At the same time, we change our estimate of adjusted reserve life index to include probable reserves as estimated by an independent engineer (see table [Natural Gas and Oil Reserves](#)). Higher initial cash flow and longer life with its required additional investment support NPV (see table [Functional Cash Flow and Present Value](#)). Strategic advantages include high working interests, operating control and contiguous lands in a concentrated geographic area (see map from annual report). Volatility in stock price warns of higher risk in Birchcliff stock. Yet, we are attracted to the opportunity as we see new investor interest in small cap oil and gas stocks. Contributing factors may include higher spill risk in deep water oil, a possible turn in natural gas pricing ahead, the decline of the euro and weakening confidence in currency-denominated savings.

Kurt H. Wulff, CFA



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Birchcliff Energy Ltd.									
Next Twelve Months Operating and Financial Estimates									
(Canadian Dollars)									
									<i>Next</i>
	<i>Q1</i>	<i>Q4</i>	<i>Q1</i>	<i>Q2E</i>	<i>Q3E</i>	<i>Q4E</i>	<i>Year</i>	<i>Q1E</i>	<i>Months</i>
	<i>3/31/09</i>	<i>12/31/09</i>	<i>3/31/10</i>	<i>6/30/10</i>	<i>9/30/10</i>	<i>12/31/10</i>	<i>2010E</i>	<i>3/31/11</i>	<i>3/31/11</i>
Volume (before royalty)									
Natural Gas (mmcf)	54	43	43	58	58	58	54	73	62
Days	90	92	90	91	92	92	365	90	365
Oil (mbd)	3.5	3.3	3.3	3.9	3.9	3.9	3.8	4.5	4.0
Total (bcf)	6.8	5.8	5.6	7.4	7.5	7.5	28	9.0	31
Total (mmcf)	75	63	62	81	81	81	77	100	86
Price						13.6			
Henry Hub (US\$/mmbtu)	4.90	4.16	5.32	4.09	4.35	4.99	4.69	5.42	4.72
Currency (US\$/C\$)	0.80	0.95	0.96	0.98	0.98	0.98	0.98	0.98	0.98
Henry Hub (C\$/mmbtu)	6.09	4.40	5.53	4.17	4.44	5.09	4.81	5.53	4.81
Differential (C\$/mmbtu)	0.82	(0.41)	0.19	0.15	0.15	0.18	0.22	0.19	0.13
Company (C\$/mcf)	5.27	4.81	5.34	4.03	4.28	4.92	4.59	5.34	4.68
WTI Cushing (US\$/bbl)	42.96	76.09	78.67	79.57	82.07	84.56	81.22	85.06	82.82
WTI Cushing (C\$/bbl)	53.43	80.35	81.82	81.16	83.70	86.24	83.30	86.75	84.46
Differential (C\$/bbl)	4.35	5.93	2.48	8.30	8.56	8.82	7.24	8.88	8.57
Company (C\$/bbl)	49.08	74.43	79.34	72.85	75.14	77.41	76.06	77.88	75.89
Total (\$/bbl)	36.48	43.24	47.12	38.17	39.92	43.27	41.80	44.40	41.59
Revenue (\$mm)									
Natural Gas	26	19	20	21	23	26	91	35	105
Oil	15	23	24	26	27	28	104	32	112
Royalties	(9)	(5)	(5)	(5)	(6)	(6)	(22)	(8)	(25)
Total	32	37	39	42	44	48	173	59	193
Expense	16	13	13	14	15	16	57	19	64
Ebitda (\$mm)	16	24	26	28	30	32	116	40	129
Deprec., Deplet., & Amort.	25	15	16	16	16	16	64	16	64
Other non-cash	3	15	3	3	3	3	10	3	10
Interest	2	1	3	3	3	3	12	3	12
Ebt	(14)	(8)	5	6	8	11	30	18	43
Income tax	(3)	(9)	2	2	3	4	11	6	15
Net Income (\$mm)	(11)	1	3	4	5	7	19	12	28
Per share (\$)	(0.09)	0.01	0.02	0.03	0.04	0.05	0.15	0.09	0.22
Shares (millions)	122	126	127	127	127	127	127	127	127
Ebitda margin (after royalty)	51%	64%	67%	67%	67%	67%	67%	67%	67%
Tax rate	19%	116%	44%	35%	35%	35%	36%	35%	35%

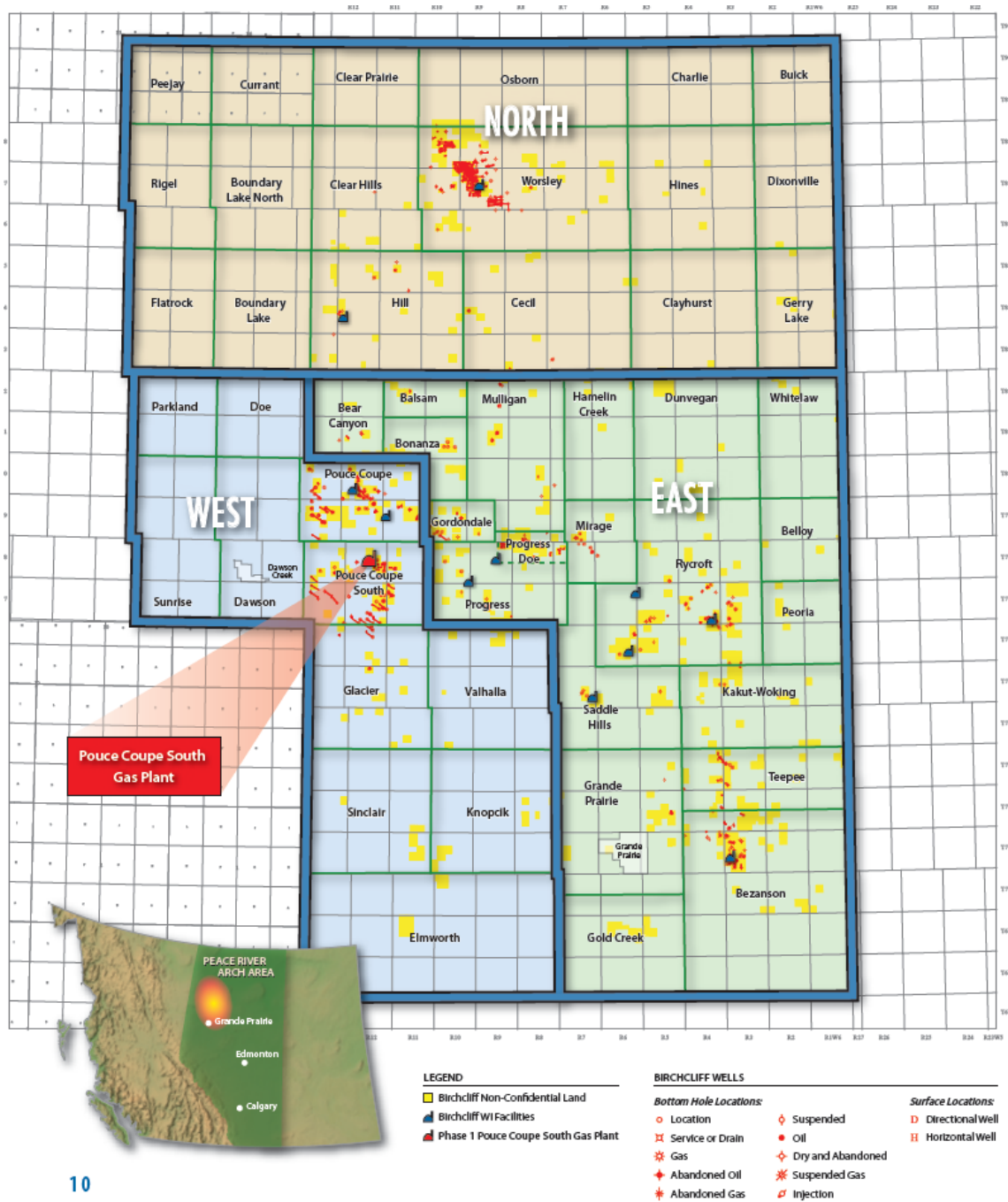


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Birchcliff Energy Ltd.				
Natural Gas and Oil Reserves				
	<i>Natural Gas</i>	<i>Oil</i>	<i>Total</i>	
	<i>(bcf)</i>	<i>(mmb)</i>	<i>(bcf)</i>	<i>(mmb)</i>
<i>Reserves (bcf or mmb)</i>				
Proven and Probable (P1+P2)	748	33	943.6	157
Proven (P1)	411	22	541	90
Probable (P2)	337	11	403	67
<i>Production, Next Twelve Months</i>				
	23	1.5	31	5
<i>Reserve Life Index (years)</i>				
R/P (P1+P2)	33.2	22.1	30.1	30.1
R/P (P1)	18.3	14.6	17.2	17.2
R/P (P2)	15.0	7.4	12.8	12.8
R/P (P1+.5P2)	25.7	18.3	23.6	23.6

Birchcliff Energy Ltd.					
Functional Cash Flow and Present Value					
	<i>NTM</i>	<i>Adjusted</i>	<i>PV/</i>	<i>Present</i>	
	<i>Ebitda</i>	<i>R/P</i>	<i>Ebitda</i>	<i>Value</i>	
North American Natural Gas	62	25.7	21.5	1,330	66%
Oil	65	18.3	10.8	700	34%
	127	23.6	16.0	2,030	100%
Debt					250
Net Present Value (US\$mm)					1,780
Shares					127
Net Present Value - Standard Estimate (US\$/sh)					14
NPV Approximation by Cash Flow Multiple Depending on Reserve Life (US\$/sh)					14





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