



Oil and Gas Industry Idea

October 10, 2011

China Buys More Oil and Gas in Canada Sinopec Bids for Daylight Energy

Summary and Recommendation

One of China's two largest oil companies, Sinopec, offers C\$10.08 a share for Canadian oil and gas producer Daylight Energy Ltd. (DAY – Toronto) for a total consideration we estimate to be US\$3.2 billion. On the basis of a tentative estimate made after we learned of the deal, the McDep Ratio of the transaction would be near 1.0. The buyer, a credible industry participant apparently ratifies indirectly our analysis of value in buy-rated Canadian producers (see *Meter Reader and Income and Small Cap Weekly*). Daylight reports 174 million barrels of proven and probable reserves producing on an adjusted life index of 8.9 years (see table Natural Gas and Oil Reserves on page 2). In our framework those reserves may have present value of about US\$10 a share taking account of projected cash flow (see tables Functional Cash Flow and Present Value on page 2 and Next Twelve Months Operating and Financial Results on page 3). Contrarian-buy **Birchcliff Energy, Ltd. (BIREF)** compares most closely in size and areas of operation. Coincidentally, Birchcliff chief executive Jeff Tonken is a director of Daylight. Birchcliff has engaged investment bankers to seek buyers (see *ISCW* October 7, 2011).

Kurt H. Wulff, CFA

<i>Symbol</i>	DAY	<i>Ebitda Next Twelve Months ending 9/30/12 (US\$mm)</i>	291
<i>Rating</i>		<i>North American Natural Gas/Ebitda (%)</i>	35
<i>Price (US\$/sh)</i>	9.71	<i>Natural Gas and Oil Production/Ebitda (%)</i>	100
<i>Pricing Date</i>		<i>Adjusted Reserves/Production NTM</i>	8.9
<i>Shares (mm)</i>	239	<i>EV/Ebitda</i>	10.8
<i>Market Capitalization (US\$mm)</i>	2,320	<i>PV/Ebitda</i>	11.1
<i>Debt (US\$mm)</i>	840	<i>Probable Reserves (%)</i>	45
<i>Enterprise Value (EV) (US\$mm)</i>	3,160	<i>Natural Gas and Oil Ebitda (US\$/mcf)</i>	17.31
<i>Present Value (PV) (US\$mm)</i>	3,230	<i>Present Value Proven and Probable Reserves(US\$/boe)</i>	23.23
<i>Net Present Value (US\$/share)</i>	10	<i>Oil and Gas Ebitda Margin (%)</i>	66
<i>Debt/Present Value</i>	0.26	<i>Earnings Next Twelve Months (US\$/sh)</i>	0.38
<i>McDep Ratio - EV/PV</i>	0.98	<i>Price/Earnings Next Twelve Months</i>	26
<i>Dividend Yield (%/year)</i>	6.0	<i>Indicated Annual Dividend (US\$/sh)</i>	0.58
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\$100 a barrel and natural gas, \$8 a million btu.			
For historical analysis of Birchcliff see www.mcdep.com/5bir.htm			



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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)	725	53	1043	174
Proven (P1)	385	32	577	96
Probable (P2)	340	21	466	78
<i>Production, Next Twelve Months</i>				
	51	4.9	81	13
<i>Reserve Life Index (years)</i>				
R/P (P1+P2)	14.1	10.8	12.9	12.9
R/P (P1)	7.5	6.5	7.1	7.1
R/P (P2)	6.6	4.3	5.8	5.8
R/P (P1+.3P2)	9.5	7.8	8.9	8.9

Daylight 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	102	9.5	12.7	1,300	40%
Oil	189	7.8	10.2	1,930	60%
	291	8.9	11.1	3,230	100%
Debt					840
Net Present Value (US\$mm)					2,390
Shares					239
Net Present Value - Standard Estimate (US\$/sh)					10
NPV Approximation by Cash Flow Multiple Depending on Reserve Life (US\$/sh)					10



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Daylight Energy Ltd.							
Next Twelve Months Operating and Financial Estimates							
(Canadian Dollars)							
							<i>Next Twelve Months</i>
	<i>Q2</i>	<i>Q3E</i>	<i>Q4E</i>	<i>Q1E</i>	<i>Q2E</i>	<i>Q3E</i>	<i>9/30/12</i>
	<i>6/30/11</i>	<i>9/30/11</i>	<i>12/31/11</i>	<i>3/31/12</i>	<i>6/30/12</i>	<i>9/30/12</i>	<i>9/30/12</i>
Volume (before royalty)							
Natural Gas (mmcf)	141	141	141	141	141	141	141
Oil (mbd)	13.4	13.4	13.4	13.4	13.4	13.4	13.4
Total (mboed)	36.8	36.8	36.8	36.8	36.8	36.8	36.8
Price							
Henry Hub (US\$/mmbtu)	4.32	4.19	3.77	4.09	4.10	4.19	4.04
Currency (US\$/C\$)	1.03	1.02	0.96	0.96	0.96	0.96	0.96
Henry Hub (C\$/mmbtu)	4.18	4.11	3.91	4.25	4.25	4.35	4.19
Differential (C\$/mmbtu)	0.27	0.26	0.25	0.27	0.27	0.28	0.27
Company (C\$/mcf)	3.91	3.85	3.66	3.97	3.98	4.07	3.92
WTI Cushing (US\$/bbl)	102.55	89.76	77.64	77.91	78.81	79.83	78.55
WTI Cushing (C\$/bbl)	99.21	87.94	80.59	80.87	81.81	82.86	81.53
Differential (C\$/bbl)	6.75	5.99	5.49	5.50	5.57	5.64	5.55
Company (C\$/bbl)	92.46	81.96	75.10	75.37	76.24	77.22	75.98
Total (\$/bbl)	48.54	44.48	41.28	42.57	42.91	43.63	42.60
Revenue (\$mm)							
Natural Gas	50	50	47	51	51	53	202
Oil	113	101	92	92	93	95	372
Royalties	(34)	(32)	(30)	(28)	(28)	(29)	(115)
Total	128	119	110	114	115	119	459
Expense	42	40	38	39	39	40	156
Ebitda (\$mm)	86	78	73	75	76	78	303
Deprec., Deplet., & Amort.	64	64	64	64	64	64	256
Other non-cash	(30)	(30)	(30)	(30)	(30)	(30)	(121)
Interest	11	11	11	11	11	11	44
Ebt	41	34	28	31	31	33	123
Income tax	10	8	7	7	8	8	30
Net Income (\$mm)	31	26	21	23	24	25	94
Per share (\$)	0.13	0.11	0.09	0.10	0.10	0.11	0.39
Shares (millions)	239	239	239	239	239	239	239
Ebitda margin (after royalty)	67%	66%	66%	66%	66%	66%	66%
Tax rate	24%	24%	24%	24%	24%	24%	24%



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