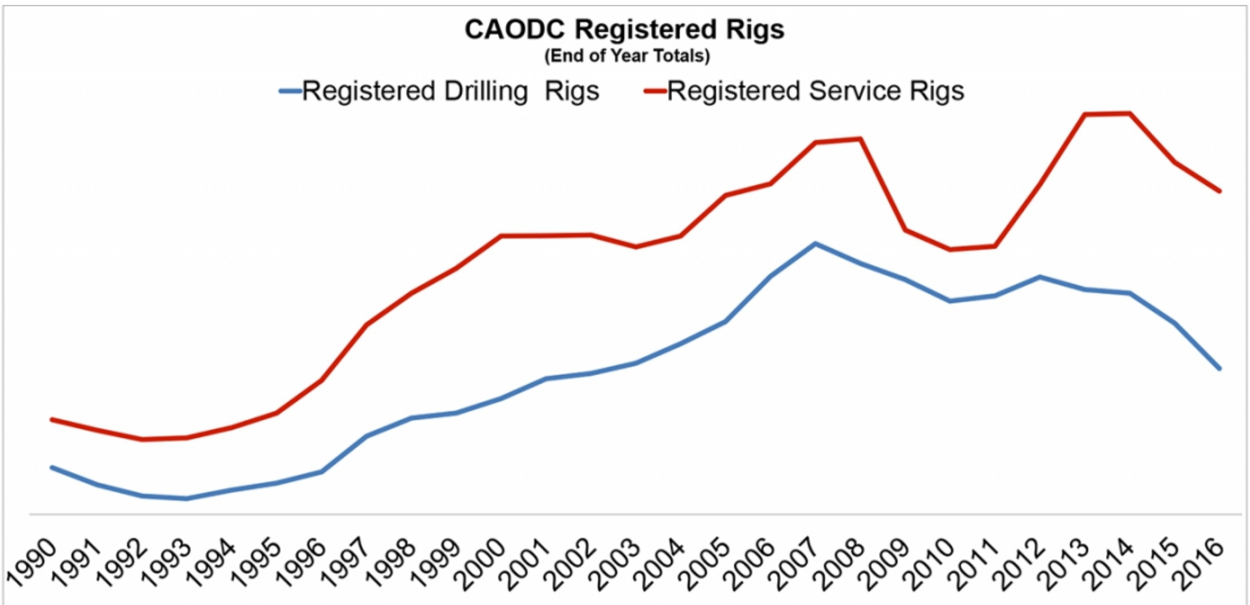
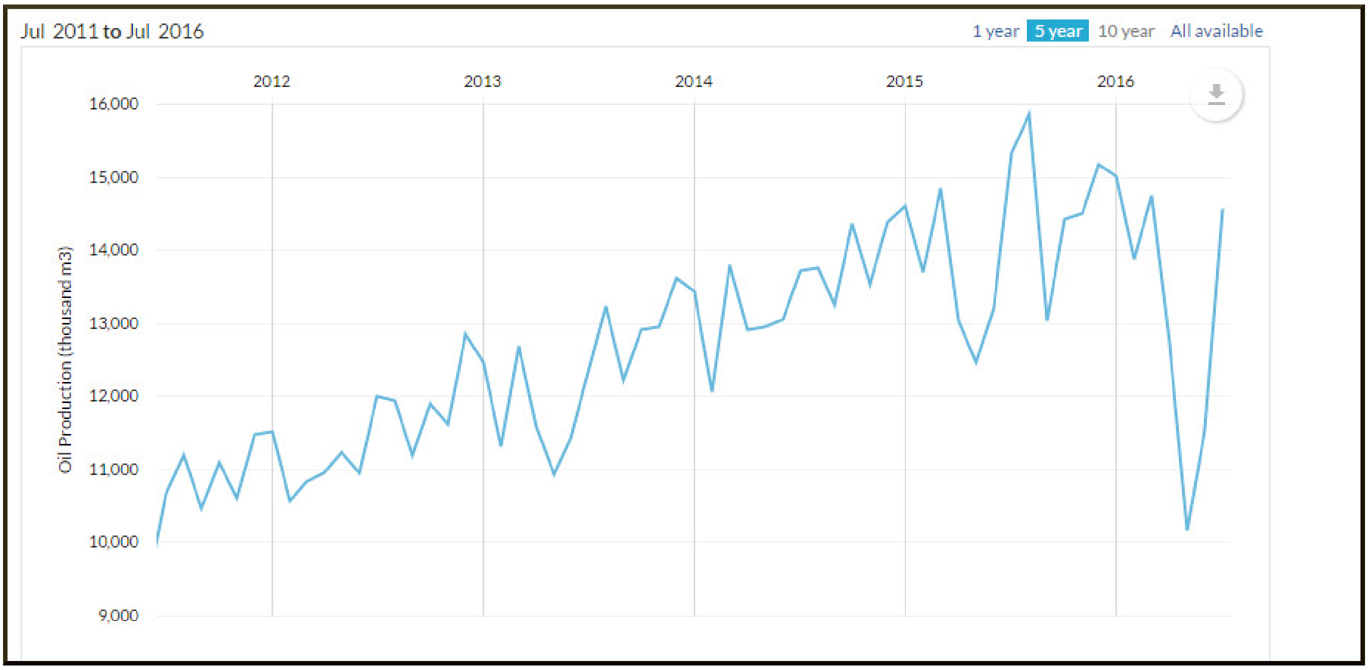
Hemisphere Energy – A “first mover” in the recovery of the oil and gas industry

Despite miners thinking that the world revolves around them and their sector, the sad truth is that in most places it does not. When commodity currencies had their Wile E. Coyote moment in 2013 and plunged it was interpreted in Canada by miners as being due to the weak metals prices. We would vouch for that being the reason behind the Australian and South African currency dives but in Canada the real reason was the weakness in the energy sector, namely oil and gas.

The difficult situation is best shown by the rig counts, which give a good reading on activity levels. These figures are only to the end of 2015 though. Surprisingly things have got worse since then despite energy prices having firmed up (and the CAD having stayed down). In August 2016 there were only 120 rigs in operation, down 552 from the fleet of 671 rigs representing a dire 18% utilisation rate.



Probably the drillers would not like us admitting this but you don’t need the drilling to have the production. You just need the drilling to have the future production. The chart shows rig counts and activity peaked in 2014 but as the chart below shows production in Alberta in 2016 is near record levels (discounting the dive for the Fort MacMurray fires). Canadian oil and gas producers are living on past exploration efforts through the lean times. And so they should and this is no different to the producers in the mining fraternity.



With production up and prices up (see chart below) it’s not exactly party like its 2012 but it is not as dire as it was either. As a result there are stirrings in the oil patch… we thought it might be useful to highlight one of the rising plays in the space that has just come onto the radar screen of InvestorIntel.

Hemisphere

One presumes it is a sign of the times that O&G juniors are starting to crawl out of the bunkers like the miners have done in the first half of 2016. The key difference is though that those in the energy space have had a brutal ride like the miners but the downturn has been much shorter than the five year drought in metals.

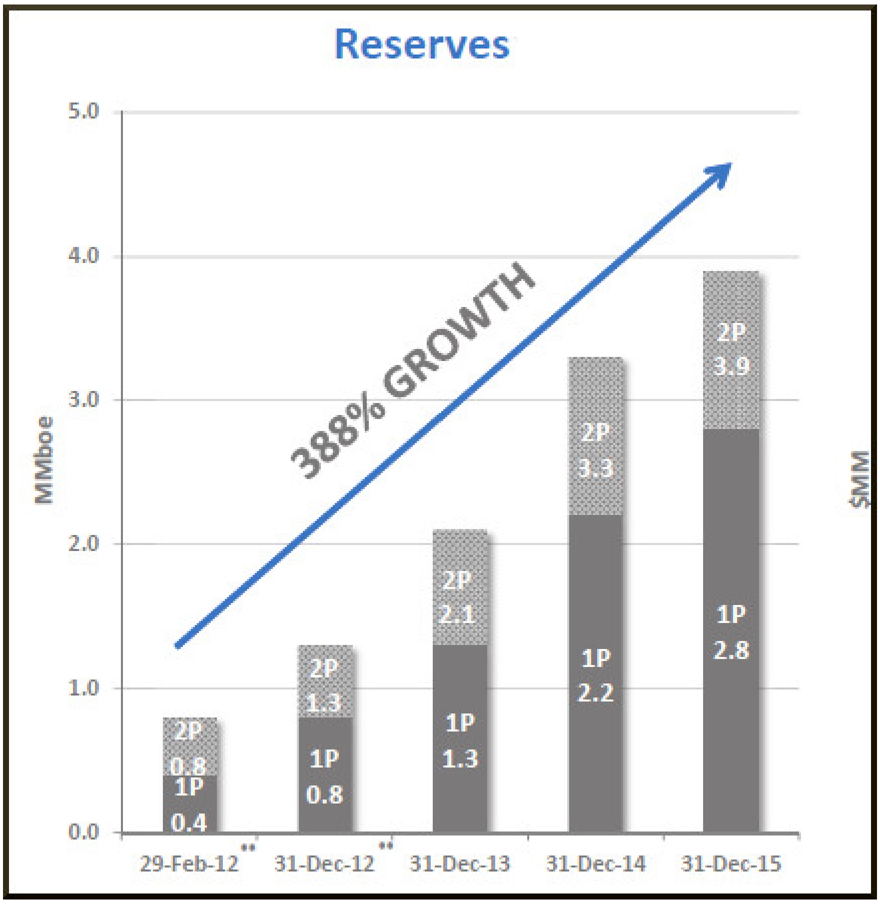
As the downturn was shorter the pain was more bearable if the juniors kept themselves in good financial health and husbanded their pennies. The one that came to my attention of late was Hemisphere Energy Corp. (TSXV:HME), a Toronto Venture-listed oil and gas company focused on oil & gas production and reserve building. Its stated principal focus is growth through strategic acquisitions and farm-ins that provide low-risk drilling opportunities. Hemisphere's core operations are in the Jenner and Atlee Buffalo areas in southeast Alberta.

The main attributes of these properties are:

- ~31,000 net acres

- ~100% Working Interest
- Mannville and Pekisko oil formations
- Depth of 900-1,000 m
- Conventional horizontal wells
- No fracking required

The reserve building strategy has put it in a strong position coming out of the slump.



Feeling Predatory & Expansionary

While many others are still reeling from the tough time they have been through, Hemisphere Energy aims to come out fighting. The strategy at the moment is based on the belief that current prices present an opportunistic entry point and is summed up as:

- Acquire known conventional oil pools with large OOIP (Original Oil in Place)
- Focus on oil pools that have low recovery factors

compared to local analogue pools
- Consolidate to achieve 100% working interest and operatorship
- Use 3D seismic and reservoir modeling to map drilling and development plan
- Apply proven horizontal drilling and completion practices for optimal oil recovery
- Implement low risk enhanced recovery waterflood programs to increase recovery factors

Conclusion

Hemisphere seems to be doing all the right things at the right time. Its stock price started the year at 4.5 cts and has been mainly around 18 cts for the last six months with a brief spike to 28 cts in mid-June. Believers in HME’s strategy have been rewarded in a way that has been quite rare in the oil and gas space in recent years.

With oil having seen its worst moments in recent times the recovery seems to be in place even if it is not soaring. Frankly, moderate recoveries are more welcome to us than “boom and bust” type moves. Hemisphere is clearly planning on being a first mover in this recovery (and certainly their share price has reflected that) but also hoping the recovery is not that robust that the bargains they want to hoover up are not made too pricey. Clearly their ambitions lie in leaving the “junior” producer label behind in an opportunistic, yet inexpensive, growth spurt.