

Oil prices plus Canadian dollar equals opportunity

After passing through a dark place in the first quarter of last year (on the revenue, oil price and stock price fronts), it has been all uphill (in a good way) for Hemisphere Energy Corporation (TSXV: HME) since the recent nadir in oil prices. The latest results for the third quarter of 2016 show that financial healing is moving along at a swift pace.

The oil price turn has been key to the transformation (though close behind has been the changes in the company itself). As the chart below shows in the last weeks of the year now finished, the oil price in Canadian dollar terms was up over 40% from its lows in the third quarter. This augurs even better results from Hemisphere Energy in the quarter just ended.



The September Results

Below can be shown out P&L table for Hemisphere Energy over the last few quarters and the preceding years.

Hemisphere Energy									
CAD mns									
	3Q16	2Q16	1Q16	FY15	4Q15	3Q15	FY14	FY13	FY12
Total Revenue	1.41	1.34	0.83	8.97	1.33	1.89	13.63	8.67	6.5
Cost of Revenue, Total	0.63	0.76	0.7	3.64	0.87	0.79	4.35	3.07	1.85
Gross Profit	0.78	0.58	0.13	5.34	0.46	1.09	9.28	5.61	4.66
Selling/General/Admin. Expenses	0.3	0.29	0.34	1.88	0.45	0.23	2.65	1.88	1.53
Research & Development	0.01	0.01	0.01	0.06	0.05	0	0.19	0.12	0.12
Depreciation/Amortisation	0.71	0.69	0.69	5.12	0.8	1.23	5.36	3.09	2.24
Interest Expense (Income)	-	-	-	-	-	-	-	-	-
Unusual Expense (Income)	0	-	-	4.37	1.35	3.01	2.7	5.64	0.18
Other Operating Expenses, Total	0	0	-	-	0	-	-	-	-
Total Operating Expense	1.65	1.75	1.73	15.07	3.52	5.27	15.26	13.79	5.92
Operating Income	-0.24	-0.41	-0.91	-6.1	-2.19	-3.38	-1.63	-5.12	0.58
Gain (Loss) on Sale of Assets	-	-	-	-	-	0	0	0	-
Other, Net	-0.04	-0.04	-0.04	-0.12	-0.03	-0.03	0.29	-0.01	-0.02
Income Before Tax	-0.41	-0.58	-1.07	-6.67	-2.33	-3.52	-1.54	-5.31	0.54
Tax	0	0	0	1.64	0	1.24	0.13	-1.48	0.48
Income After Tax	-0.41	-0.58	-1.07	-8.31	-2.33	-4.76	-1.67	-3.83	0.06
Diluted Weighted Average Shares	85.08	75.95	75.8	75.76	75.8	75.8	70.08	54.48	52.31
Diluted EPS	0.00	-0.01	-0.01	-0.11	-0.03	-0.06	-0.02	-0.07	0.00

As can be noted, topline revenues are up 75% from the first quarter's levels while gross profits rose six-fold. Meanwhile the company has been shrinking its GS&A (down by 33% year-to-date versus the same period of 2015). Operating losses declined by two thirds, and bottom line losses more than halved. Aggregate funds flow from operations in the third quarter was \$345,007, a 116% increase over the second quarter. It achieved an operating netback of \$16.36/boe, a 26% increase over the second quarter.

We would venture that if this trend continues the company will be showing a bottom line in the black for the fourth quarter and almost definitely by 1Q17.

Financing

The improving prices in oil and gas coincided in the third quarter with an improved financing scene generally across the resources space. To take advantage of this, Hemisphere Energy closed the final tranche of a private placement of a combination of common shares and CDE flow-through common shares. Total gross proceeds from the financing were \$1.9mn. It's worth noting that all the required expenditures for the flow-through funds were made in the third quarter.

Production

In the third quarter daily production averaged 518 boe (of which 87% was oil), a 5% increase over the second quarter. Part of this was due to the company having drilled its first horizontal development well into the Atlee Buffalo Upper Mannville G pool at the end of July 2016. This well was put on production in August and has averaged just over 60 boe/d (100% oil) over its first three months online and has produced almost 70 boe/d (100% oil) during the first half of November. Total costs to drill, complete, equip and tie-in the well was \$685,000 which was 10% under budget and 45% less than the average cost of the 10 Atlee Buffalo wells drilled by Hemisphere Energy in 2014.

The new well continues to show stable production rates, and management expects it to be capable of greater production in the future once a planned multi-well battery is constructed in conjunction with further development of the pool. All oil production is currently being trucked directly to sales, eliminating the need for any third party processing.

In September, a water separation and reinjection facility was completed for production from the Atlee Buffalo Upper Mannville F pool, which has enabled water rates at the injectors to be increased and has eliminated all water trucking for third party disposal, with attendant cost-savings. The management stated that they continue to see successful results from Hemisphere Energy's three active waterflood pilots in the pool.

Hemisphere Energy's daily corporate production is currently at approximately 640 boe (thus 20% above the Q3 average). In the last quarter of 2016, Hemisphere Energy has been optimizing its Atlee waterfloods and production while minimizing operating and transportation costs. Planning is underway for further development in both the Atlee F and G pools for 2017 provided the pricing environment continues to improve.

This latest production number for Q4 resulted in a nice spike in the stock price in trading in the new year.



Conclusion

With the oil and gas prices much enhanced from their darkest hour and the Canadian dollar still at a major discount to the US (and no sign of a gap-closing imminent) the advantage is still there for players north of the border to recoup lost territory and position themselves for a normalization of the energy markets.

With the Trump administration heavy in ex- or pro- energy industry execs the direction is likely to be more towards policies favoring extraction and transportation. However, with mixed signals being the order of the day, one never can tell. Anyway Hemisphere Energy is more of a stealth operator than one that will come to the attention of anyone wishing ill to the Canadian industry.

With the company's latest strategy focusing on higher quality

assets and getting the financial house in order there is the distinct possibility that the company will make more money at its bottom line in 2017 than it made in 2012 when oil and gas prices (average WTI at US\$111.67) were a quantum higher, thus if prices continue to appreciate then that will just be more icing and cherries on Hemisphere Energy's "cake".