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External Interview: The Energy Report Highlights TransAtlantic

Adam Michael: Exciting International Oil and Gas Opportunities

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Oil and gas analyst Adam Michael is excited---in some cases very excited---about a lot of things in his sector, including Turkish gas and Latin American oil plays. He even gets excited about long-term oil price fundamentals. Just don't ask him about the domestic oil and gas market. It's just so yesterday's cycle.

The Energy Report: Adam, please give us a macro view of the energy market.

Adam Michael: On a macro level, it's important to look at inventory levels, but more importantly I think it's just fundamental economics. What do the global industrial production numbers look like? Are we building business inventories? We had a huge drawdown in business inventories during the last recession and those inventories need to be replenished to feed the global expansion. As we build inventories and increase industrial production, demand for energy increases. It's really that simple.

TER: What role does credit play in the energy sector?

AM: Credit is such an important part of the world economy. Without access to credit it becomes more difficult for companies to fund working capital and inventories at the wholesale and manufacturing level; you can't have a global increase in industrial production. During this last credit crisis people lost the ability to tap the capital markets. We saw demand for oil decrease and the price of oil plunged to $40 a barrel. Now we're seeing a complete reversal and it's no coincidence the credit markets have improved incredibly. Junk spreads have narrowed from 2,000 basis points to 650 basis points over the past year. Spreads continue to tighten. The appetite for risk in the credit markets is increasing. As new issues hit the market, most of that money goes toward working capital and building inventories, which creates demand for energy.

TER: What's your view on the price for oil and natural gas?

AM: In terms of the price of oil and natural gas, we are now where we should be. I think $75 to $100 per barrel is a pretty good range as long as OPEC has spare capacity. Eventually, that capacity is going to dwindle and demand is going to take over, especially in China, where demand never really tapered off during the recession. You have the Chinese using four barrels of oil per person a day and we're using 25, so that's going to converge with time. The incremental demand for oil is going to come from China. That's positive for the energy sector, especially on the international side.

TER: Reports suggest oil-exporting nations, especially those in Latin America like Venezuela and Mexico, are not sufficiently reinvesting in their oil assets. Is this going to influence the number of barrels that they are going to be able to export?

AM: I think ultimately it's going to be bullish for the price of oil. To meet the global demand we really need all energy sources producing at their maximum capacity. When you have a country with nationalistic ideas like Venezuela what you get is a lack of investment and you drive away key talent. It's tough to attract engineers or service companies to work in Venezuela, let alone maintain the country's oil assets and grow the reserves necessary to produce oil five years from now. Ultimately, these countries produce much less than they could, which is bullish for oil.

TER: How is technology changing the oil and gas sector?

AM: This last bull market was really kind of the emergence of unconventional energy, and technology is what really what drove it---especially domestically. For example, you have huge natural gas resources that weren't commercially viable until the emergence of horizontal drilling and multi-stage fracking. Applying this technology allowed companies like Chesapeake Energy Corp. (NYSE:CHK) and Petrohawk Energy Corp. (NYSE:HK) to explore places like the Barnett and Haynesville shales and find new sources of natural gas and produce them on a massive scale.

Going forward, I think the domestic natural gas sector is really going to be a game of who's the low-cost operator. So I'm not really big into the domestic natural gas plays like I was during the last cycle. They are widely understood now and appropriately valued in the marketplace. What I'm really excited about this go around are the opportunities I'm seeing on the international side. When I say "international side," I'm talking both unconventional and conventional energy.

TER: Are you more bullish on oil or gas?

AM: I'm bullish on the oil price. Oil is more of a finite resource, whereas natural gas is different. In this last bull market, we unlocked incredible domestic natural gas resources---all the shale plays and tight gas plays. I just don't feel that there is much upside for domestic natural gas going forward.

TER: What about on the international side?

AM: On the international side, there have been so many countries that are just now opening up that have been closed off for decades. These countries haven't been drilled or explored as much as ours. Places like Colombia have had security issues with the FARC (Revolutionary Armed Forces of Colombia) for decades that prevented energy companies from safely going in and exploring and drilling wells. As Colombia has driven back the FARC, all of a sudden they are hitting incredible wells. I've seen a few 10,000 barrel-a-day wells! You just don't see that domestically. The fact that that whole frontier is now opening is an exciting opportunity. There is a massive land grab going on internationally similar to what we saw in the last cycle domestically with unconventional natural gas.

TER: Any other areas abroad that present those opportunities?

AM: I really like what I'm seeing in Turkey. Turkey imports 90% of its energy, most of it from Iran and Russia, so you have much higher natural gas prices there. Natural gas is about $8 per mcf (a unit of natural gas equal to one thousand cubic feet of gas), whereas domestically it's $4--$5. I get excited when I see an energy-dependent country that has made it attractive to invest in a largely unexplored area.

TER: Any examples?

AM: TransAtlantic Petroleum Ltd. (TSX:TNP; NYSE:TAT) is a company I'm really excited about. You have a company that at the bottom of the market put together a land package of several million acres in Turkey. They added a couple million acres in Morocco and another 700,000 or so in Romania. TransAtlantic now has a producing asset, the Selmo oil field, that gives it some good cash flow. It has also identified a couple of other areas that are very prospective for both conventional and unconventional natural gas. And it has a new gas play that just started producing in a gas field called the Thrace Basin, where the wells literally pay out in three to six months. I don't even know if they've ever fracked a well in Turkey. TransAtlantic chairman Malone Mitchell and his company have a long history of applying modern technology domestically. TransAtlantic has not only gone to Turkey and put together a great land package, but they're also taking their expertise and technology to places where they can lock up enormous acreage positions. I think it could get really exciting when you apply that technology, especially in the Thrace Basin where it looks like TransAtlantic has some tight gas opportunity. As well as in the Paleozoic trend where there are a couple of areas, especially near Arpatepe, Turkey, that look like they could be perfect for fracking or horizontal drilling. It's really that combination of strong management, applying the right technologies and then having the real estate in the right areas. We're still at the very early innings of what TransAtlantic is doing there.

TER: What about some other areas or other companies?

AM: I'll head back to Colombia just because they've done everything right. Colombia is really three or four years ahead of other regions in the world that are trying to attract foreign capital and expertise to increase energy production. When countries revamp their hydrocarbon laws, they usually look at what Colombia did. You've seen incredible amounts of foreign investment flow into Colombia during the last few years. Everybody knows that Venezuela has had incredible reserves and energy assets that may be misused right now. The heavy oil and the natural gas assets don't stop at the border of Colombia--- they run right through it and into Colombia. Now that the FARC's been pushed back you're seeing companies develop them.

TER: Any examples?

AM: One that I'm excited about is a company called Pacific Rubiales Energy Corp. (TSX:PRE;BVC:PREC). It has identified a heavy oil trend around the Rubiales Field. When Pacific went in a few years ago, it might have had a couple of billion barrels of oil in play that it was hoping to get a 15% recovery rate on. Essentially it has done step-out drilling around the known heavy oil deposit. I love companies that drill where known oil exists! Pacific Rubiales has an 80% exploration success rate and that's because the assets are that great. It just keeps stepping out and showing you that these heavy oil deposits are a lot bigger than we originally thought. The latest number is five billion barrels.

TER: Could that amount climb higher?

AM: As Pacific keeps stepping out and drilling more, you'll see that number increase, probably to 10 billion barrels. The whole process of proving up an asset is very similar to what unconventional natural gas companies did domestically in the last cycle, and is why companies like Ultra Petroleum Corp. (NYSE:UPL) and Southwestern Energy Co. (NYSE:SWN) were among the top-performing stocks in the last cycle. We are seeing the same thing again, only internationally this time. I like the risk/reward of companies like Pacific Rubiales where you have a very rapid increase in production. They've been doubling production the last couple of years. They'll do it again this year. The also have another 10 million acres between Peru and Colombia that are leased and that they plan to explore. That's the kind of stuff I look for on the international side that makes it exciting.

TER: Any similar companies come to mind?

AM: If we go down to Peru, there's a company called BPZ Energy Inc. (NYSE:BPZ) that operates in the northern part of the country. The chairman of BPZ Energy used to run Peru's state-owned oil company in the 1980s before it was nationalized. For a couple of decades, there wasn't a whole lot of exploration activity in Peru. In the mid-2000s, Peru opened back up to foreign investment and offered some pretty attractive fiscal terms to attract capital. The guys from BPZ, who knew where the good assets were, leased four very large blocks in northern Peru. They have hit a couple of really big oil wells offshore. It's exciting stuff. You're drilling conventional oil wells and hitting 2,000 barrel a day producers. You don't find that here in the States. It's a big opportunity. BPZ Energy has probably 10 years' worth of exploration properties in some really good land packages that they've put together. The amount of drilling that it's going to require is going to take billions of dollars. I wouldn't be surprised to see major oil companies move in and try to get onside with BPZ or maybe lease surrounding acres because BPZ has already proven that the oil and the natural gas is there.

TER: Any other companies you're particularly excited about?

AM: TransGlobe Energy Corp. (TSX:TGL;NASDAQ:TGA) has assets in Egypt and Yemen. I think about 70% of their production comes from Egypt, which is the part I'm most excited about. In Egypt you have a couple of big opportunities where TransGlobe has identified some large prospects that it is drilling. Those could be in the 50 million barrel range. Additionally, TransGlobe is applying modern technology by using fracking and horizontal drilling to increase production, in some cases by 10x. I think you'll see TransGlobe turn into a bit of a resource play as it applies horizontal drilling and fracture stimulation to some of its properties. It is currently producing about 10,000 barrels a day. I could easily see that becoming 15,000 or 20,000 barrels in a couple of years.

TER: Any high-risk, high-reward plays out there?

AM: I like to look at some of the more speculative stuff that is at an earlier stage. There's a company called Canacol Energy Ltd. (TSX:CNE) in Colombia that has put together a nice-looking land package. It has a 10% interest in the Capella heavy oil discovery, which is a multibillion-barrel discovery that was acquired by one of the Chinese state oil companies, Sinochem. Canacol has leased a couple of very large blocks around the Capella discovery and is in the process of shooting seismic surveys. I think we'll see some wells drilled sometime in late 2010, early 2011. The amount of leverage it has to that heavy oil trend is incredible. Having that large of a footprint at an early stage is important. I'm excited about Canacol because of the heavy oil possibilities. It also has some pretty good core assets that provide steady cash flow, which is so important. It's really a combination of two. You want to find something with a little bit of cash flow, but also a great land package. I think Canacol could be something like a Pacific Rubiales in five years. Like I said, it's still at a very early stage.

TER: Most of your recommendations are oil versus gas plays. Is that the trend?

AM: That's where I see the most opportunities---on the oil side. Unless you have a specific circumstance like in Turkey, where you have $8 natural gas prices and wells that pay out in three months, but that's the exception.

TER: With Obama possibly opening up some of the offshore drilling in the U.S., do you see an opportunity in the future for substantial finds? Although with the crisis in the Gulf, who knows if more offshore drilling will open up.

TER: That's a good question. I don't. Here's why. I think domestically we're probably going to see the tax breaks for energy companies repealed next year. That's going to cost our domestic energy industry about $40 billion. The Independent Petroleum Association of America (IPAA) thinks that if you take away $40 billion in tax breaks, production costs will go up. The IPAA thinks it could actually reduce production by 20% on the oil side and about 12% on the natural gas side. The offshore stuff takes time to explore---to shoot seismic surveys and identify prospects. Now we have the BP oil leak to contend with and there will no doubt be more regulation and higher costs associated with offshore drilling domestically. Longer term, it might help us out, but I don't think it will make this cycle.

TER: What about the deep sea drilling off of Brazil that we have been hearing so much about?

AM: I tend to shy away from Brazil. Petrobras (NYSE:PBR) has obviously been an enormous winner, but it just seems it has really got a lock on the deep sub-salt projects in Brazil. I'm really not that excited about what I've seen onshore in Brazil. There are a lot of eyes on Petrobras and I look for opportunity in places where others are not looking. Brazil is just not something I get really excited about.

Adam R. Michael, 35, founded Platform Advisors, LLC, a California registered investment advisor that manages the Platform Energy Fund. Mr. Michael has over 10 years of experience in the energy industry in various capacities. With the majority of his career based in Houston, Texas, he is able to use his energy background and industry contacts alongside his investment experience to identify energy investment opportunities in geopolitically stable countries with attractive geological prospects and fiscal regimes.

Mr. Michael has a bachelor's degree in Industrial Distribution from Texas A&M University (1997) and a MBA from Rice University (2004).