

## Pacific Energy Res. (PFE-T, \$1.69)

Recommendation: Buy

Malcolm Shaw, P.Geol. (416) 640-4949; [mshaw@wwcm.com](mailto:mshaw@wwcm.com)Kyle Hunter, MBA (416) 640-4953; [khunter@wwcm.com](mailto:khunter@wwcm.com)

March 4, 2008

All values in C\$ unless otherwise noted.

Current Price	\$1.69
Target Price (12-Month)	\$3.00
Implied Capital Gain	78%

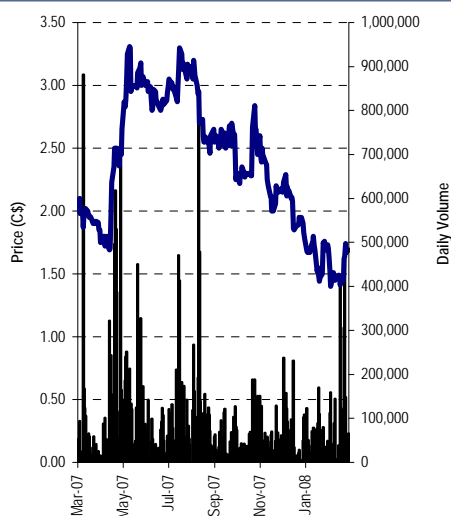
## Changes

	Old	New
Production (boe/d) '07E	11,329	10,047
CFPS FD 2008E	\$0.34	(\$0.04)
Production (boe/d) '08E	n.a.	14,862
CFPS FD 2009E	n.a.	\$0.32
Recommendation	Buy	Unch.
Target Price	\$3.00	Unch.

## Company Profile

Pacific Energy is an oil exploration and production company based out of Long Beach, California. The company has core areas in California, Alaska, and Wyoming. The company has a large, established, long-life reserve base that is currently producing ~8,000 boepd. The company plans to ramp-up production by redeveloping proven producing fields, while drilling selected high-impact exploration plays on existing lands.

## Price Chart



Source: PCQuote

## Beta Unit to Play Big Role in Pacific Energy's Production Growth Plans

- Eureka restart puts 2008 all-in exit rate of ~13,100 boepd in sight**  
 Early Eureka prod<sup>n</sup> solution could bring up to 2 kbopd back online as early as April; full 4–5 kbopd Eureka re-start on-track for Q4 2008.
- Alaska development and exploration ramping up soon**  
 Current Alaska prod<sup>n</sup> of ~4,900 boepd expected to reach ~6,200 boepd by Q4 2009; Corsair drilling targeted for mid-2009 (500 Bcf prospect).
- Pacific Energy trades at only 0.7x our risked NPV/sh estimate**  
 Alaska and Beta Unit combine to dominate ~80% of our risked NPV/sh estimate of \$2.45; low-risk development of 101.5 mmoeb in 2P reserves.
- Buy rating and \$3.00 target reiterated on 2009E outlook**  
 Risked NPV/sh of \$2.45 and 2009E CFPS of \$0.32 drive our \$3.00 price target; exploration-weighted risked EMV/sh totals \$6.37.

## Financial Summary

Shares O/S (FD, M)	234.0	52-Week Trading Range	\$1.34-\$3.75	
Market Capitalization (M)	\$395	Average Weekly Volume	524,926	
Net Debt - 2007E (M)	\$452	Market Float (M)	\$353	
Enterprise Value (M)	\$848	Risked NPV/Share	\$2.45	
<b>Forecasts</b>	<b>2006</b>	<b>2007E</b>	<b>2008E</b>	<b>2009E</b>
Production (BOE/d)	705	4,254	10,047	14,862
Weighted Avg. Realized Price (US\$/boe)	\$44.69	\$61.25	\$64.85	\$62.64
Revenues (M)	\$11.5	\$100.5	\$237.8	\$339.8
DACF (M)	(\$2.8)	\$37.6	\$66.0	\$148.9
CAPEX (M)	\$36.7	\$30.7	\$81.5	\$81.5
EPS (FD)	(\$0.17)	(\$0.16)	(\$0.22)	\$0.06
CFPS (FD)	\$0.07	\$0.04	(\$0.04)	\$0.32
<b>Valuation</b>	<b>2006</b>	<b>2007E</b>	<b>2008E</b>	<b>2009E</b>
EV/DACF		22.6x	12.9x	5.7x
EV/BOE/d (per unit production)		\$199,303	\$84,385	\$57,043
P/E		n/m	n/m	28.4x
Debt/CF		n/m	n/m	6.8x
Target EV/DACF		31.6x	17.5x	7.8x

Source: Company reports, Wellington West Capital Markets Inc.

Please see disclaimers on the last two pages of this report.

## Investment Summary and Outlook

Pacific Energy has grown rapidly in a short period of time by employing a strategy of acquiring assets with established long-life reserves and solid production growth potential, at below market prices, while also capturing considerable exploration and delineation upside. 100% of the company's assets are in the United States and are spread around three core areas in California, Alaska and Wyoming. We expect Pacific Energy's production to increase from the current level of ~8,000 boepd to ~13,100 boepd by the end of 2008 as the company restores production from the Eureka platform offshore California and carries out select recompletions and infill drilling. We calculate a risked NPV/sh of \$2.45 for the company's asset portfolio, which encompasses 101.5 mmbbls of 2P reserves. Going forward, we foresee sustainable production growth as the company focuses on developing its existing reserve base with the potential for reserves increases through exploration and step-out drilling in offshore California and Alaska.

## California Update

### *Offshore Ellen work and Eureka Restart Puts 5,900 bopd in Sight by Q4*

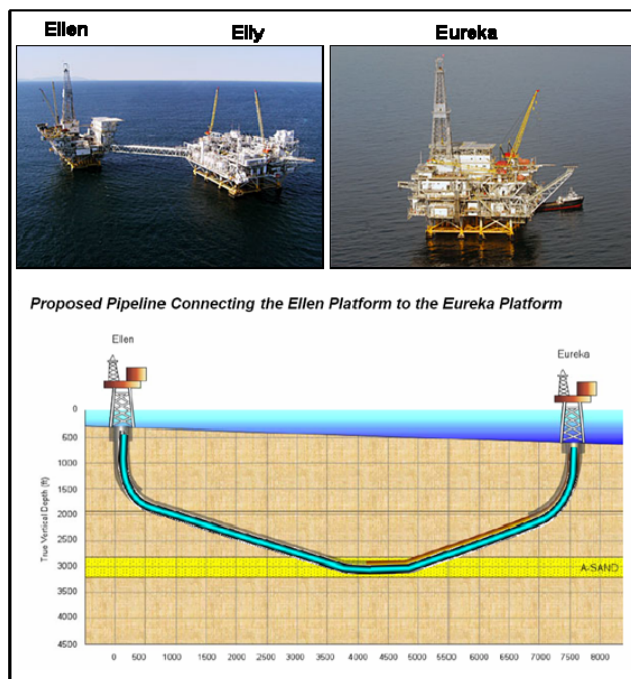
**Pacific Energy is planning to commence a development program off their Ellen platform in three to four months, which is expected to raise Ellen's production to ~3,600 bopd from the current ~2,000 bopd by Q4 2008.** Before development at their 100%-owned offshore Beta Unit can begin, the Company must complete some minor rig upgrades, which are expected to begin shortly and total US\$2M in capital expenditures. Pacific Energy plans to drill four development wells and perform nine re-drills/recompletions off their Ellen platform with the bulk of the development being carried out in Q3. Each of the four planned development wells are expected to come onstream at an initial rate of 300–400 bopd with an additional 600 bopd in combined production expected from the re-drills and recompletions. The development wells are expected to decline at a rate of 20% for the first year and level off to an 8% decline thereafter.

**An early production solution may restore as much as 2,000 bopd of Eureka production in Q2 while the company continues to work towards restoring full production (4,000–5,000 bopd) by Q4.** Production from the Eureka platform was shut-in in 1999 due to pipeline integrity issues, but the company has plans to re-fit existing waterlines to allow for crude transport as an interim workaround allowing for production restart. Pacific Energy recently confirmed the integrity of an existing 6" water line and plans to restore 1,000–2,000 bopd from the Eureka platform in April. Current plans call for a 12" water line to be sleeved by the end of Q3, which is expected to handle up to 5,000 bopd. This milestone is expected to result in the reclassification of some reserves into the proved developed producing (PDP) classification from the proved developed non-production (PDNP) group, which should ultimately improve Pacific Energy's 1<sup>st</sup> lien borrowing capability.

**Plans also remain on-track to drill two horizontal wells connecting the two platforms, Ellen and Eureka, as a longer-term solution for transporting crude from the Eureka platform.** Once the wellbores have connected, the

company plans to run a production liner along the full length of the borehole to be used as an inter-platform pipeline. The total cost of the “wellbore connect” project is expected to be ~US\$20 million. We model Beta Unit production averaging 7,000 bopd in 2009.

### Exhibit 1: Beta Unit Platforms and Wellbore Connect Schematic



Source: Company reports

### *Solid Development Growth Drives Long-reserve Life for Onshore Fields*

**Pacific Energy is preparing to drill five infill wells in their 100%-owned onshore Wilmington field and expects to have a rig available to begin drilling within the next month.** Based on results from last year’s development drilling program, we believe each of the Wilmington wells can come online at an initial rate of 50 bopd, which would put them on-track to meet our 2008 exit rate of ~1,600 bopd for onshore California. Each of the Wilmington wells are expected to cost US\$1.3M and pay back in two and a half years at ~US\$70 WTI. Wilmington’s output is included in our production profile for Pacific Energy outlined in Exhibit 2.

**Drilling of three exploration wells on the company’s San Joaquin Basin fields is expected to commence following the Wilmington development program.** The three targets are imaged on 3D seismic and per well potential ranges from one to ten million barrels. The San Joaquin acreage covers 8,792 net undeveloped acres for which we carry a risked NPV of \$0.32.

## Alaska Update

### *Alaska Development Program Planned to Ramp Up Through 2009*

**Pacific Energy's current plans call for a five-well infill/re-drill program to start at their 100%-owned Redoubt Shoal field in July 2008.** New wells are expected to produce at initial rates of 400–500 bopd and will target undeveloped reserves in undrained portions of the Redoubt Shoal field. Installation of submersible pumps in selected wells is also planned in 2008 to offset natural declines in those wells. We believe it is worth noting that Dave Hall has recently been promoted to head of Pacific Energy's Alaskan operations. Mr. Hall has worked on the company's Alaskan assets for over a decade and brings considerable operational expertise to his new role.

**We expect net exit production rates of ~5,500 boepd and ~6,200 boepd from Alaska in 2008 and 2009, respectively.** Net production from Alaska currently stands at ~4,900 boepd, which we see rising this year to ~5,500 boepd. We assume two of the five development wells planned at Redoubt Shoal produce 400–500 bopd per well (and are onstream in 2008) and that the installation of submersible pumps offsets part of the field's natural production decline.

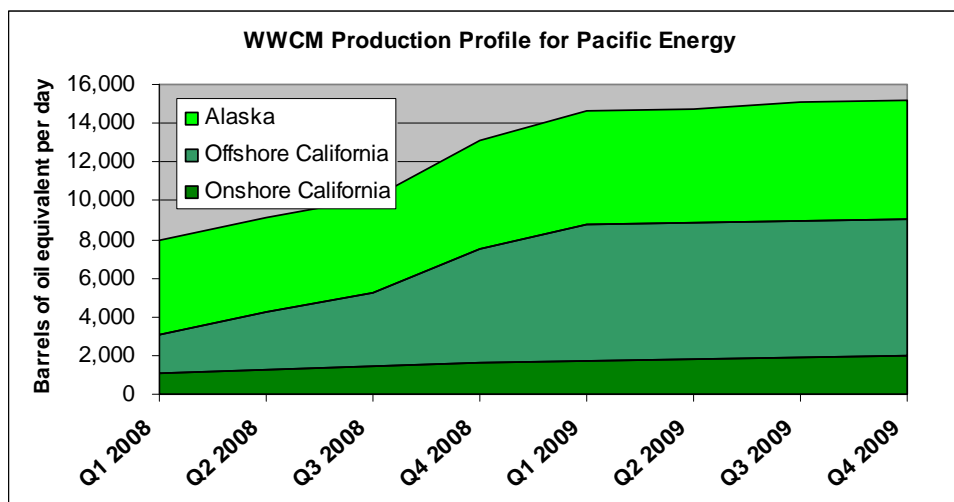
**The 100%-owned Corsair prospect remains one of the company's highest priority exploration targets and is expected to be drilled in mid-2009.** Under the terms of the amended Corsair Unit agreement, Pacific Energy has until April 2008 to show drilling capability and until June 30, 2009 to commence drilling. The prospect is in shallow water depths and requires a jack-up rig for drilling, which Pacific Energy hopes to secure by April of this year. Corsair is believed to be prospective for 500 Bcf of gas and up to 137 million barrels of oil in two deeper zones. We currently carry a 45% COS and a risked EMV/sh of \$1.88 for Corsair, which we estimate could be worth more than \$4/sh in a full success case.

## Production Outlook

### *Adding it All Up Puts ~15,200 boepd (net) in Focus as 2009 Exit Target*

**With ~7,000 bopd of net production targeted from their offshore Beta Unit, ~6,200 boepd of net production targeted from Alaska and ~2,000 bopd from the company's onshore assets, we believe Pacific Energy has the potential to be producing ~15,200 bopd by the end of 2009.** We expect our 2009 production estimate would drive cash flow pre share of ~\$0.32 at ~US\$70 WTI on a pretax basis. Pacific Energy could become taxable in 2009 depending on the ramp in production from the Beta Unit and the final capital expenditure figure from this year's program, but we currently model PFE as being tax-free through 2009.

## Exhibit 2: Production Projections Driving WWCN CFPS Estimates



Source: Company reports, Wellington West Capital Markets Inc.

## Corporate Debt Summary

### *Non-core Divestitures Key to Restructuring Leveraged Balance Sheet*

**Pacific Energy's balance sheet remains highly leveraged with long-term debt of ~US\$480M (Debt/2009E cash flow of ~6.8x) following their acquisition of Forest Alaska Operating LLC for US\$457.5M.** The acquisition was successfully orchestrated by Pacific Energy by taking on two separate term loans from Goldman Sachs that totaled US\$425M. The two term loans, term loan A and term loan B, carried values of US\$108M (@ 7.75% interest) and US\$317M (@ 19.5% interest), respectively. In our model, we assume Pacific Energy paid down US\$40M of term loan B in November through a private placement for US\$65M.

**We model Pacific Energy generating an average loss of ~US\$2.1M in free cashflow per quarter in 2008 after covering their quarterly interest payments, which we estimate to be US\$18.7M.** The bulk of the company's quarterly interest payments come from term loan A (~US\$2.1M), term loan B (~US\$13.5M) and the senior credit facility (~US\$2.2M).

**Near-term opportunities to reduce the debt load and/or provide working capital include: 1) the potential disposition of onshore producing oil properties and 2) the potential for the release of approximately ½ of the ~\$100 million reclamation bond currently posted for the Beta Unit when the Eureka platform comes online.** Disposition of the company's 50% interest in the Cook Inlet Pipeline Company appears unlikely at this stage as recent regulatory changes designed to encourage exploration activity in the Cook Inlet have negatively impact the potential revenue stream for a third-party (MLP-type) purchaser. We believe divestiture of Pacific Energy's non-core onshore California assets remains a viable option. Based on our 2008 target exit rate estimate of 1,635 bopd, we believe Pacific Energy's onshore California portfolio could garner upwards of US\$100M (@ US\$60,000 per flowing barrel) given the long reserve life (>25 years) of the fields.

**If Pacific Energy were to execute on the two debt reduction options we lay out, we expect the company could free-up US\$150M in cash in 2008 that could help pay down a portion of the ~US\$480M in outstanding long-term debt and/or fund this year's capital expenditure program.** We estimate the current outstanding balance of the company's term loan B to be ~US\$277M and we would expect Pacific Energy to use a portion of any additional proceeds received this year to pay down the second tranche (B2) of this loan, which is currently US\$85M and comes due in Q1 2009. In this scenario, Term loan B would be reduced to ~US\$192M (implied Debt/2009E cash flow falls to ~5.9x and PFE would have an additional US\$65M in cash), leaving Pacific Energy with the option to pay down additional debt and/or direct funds towards this year's ~US\$82M capital expenditure program. We have outlined Pacific Energy's interest bearing long-term debt in Exhibit 3.

### **Exhibit 3: Pacific Energy's Interest Bearing Long-term Debt**

<b>Debt Facility</b>	<b>Principal</b>
<b>Senior Credit Facility</b>	\$65,000,000
<b>Term Loan A</b>	\$108,000,000
<b>Term Loan B</b>	\$277,000,000
<b>Seller Note (Forest Oil)</b>	\$29,250,000
<b>Total</b>	<b>\$479,250,000</b>

Source: Company reports, Wellington West Capital Markets Inc.

## Valuation and Summary Recommendation

**We are maintaining our \$3.00 target and Buy recommendation on Pacific Energy as we update our production outlook and roll-out our 2009 estimates.** We remain bullish on Pacific Energy and believe the company is well-positioned to meet our production growth estimates and improve the corporate balance sheet.

**We expect the company to ramp up production from current levels of ~8,000 boepd to ~13,100 boepd (~96% oil) by the end of 2008 and ~15,200 by the end of 2009 (Exhibit 2).** The three main drivers of our production estimates over the next 12 months are: 1) the re-establishment of production from the Eureka platform in the Beta field, offshore California (shut in at 4,400 boepd in 1999), 2) the drilling of four successful development wells off Beta Unit's Ellen platform, and 3) successful implementation of the Redoubt Shoal development/optimization plan in Alaska. With the increase in production planned through 2009, we expect operating costs to fall to US\$20/bbl in Q4 2009 from our current estimate of US\$35/bbl.

**Our 2009E projected CFPS of \$0.32/sh and risked NPV/sh estimate of \$2.45 drive our \$3.00 target and are weighted equally at 35% in our blended valuation outlined in Exhibit 6.** The downward revisions in our 2008E EPS and CFPS estimates (EPS of \$0.09/sh drops to loss of \$0.22/sh and CFPS drops from \$0.34/sh to loss of \$0.04/sh) reflect: a) operating costs and interest expenses materially higher than our initial estimates, and b) slightly lower production estimates. These metrics are expected to see strong improvements in 2009E as per unit production costs drop (with rising production) and as interest expenses decrease in the face of reduced debt and/or debt restructuring. Our EMV/sh estimate of \$6.37 (20% weighting) and acquisition value of \$1.95 (10% weighting – based on risked resource potential) rounds out the remaining components of our \$3.00 target price for Pacific Energy. Components of our risked NPV/sh estimates are outlined in Exhibits 4 & 5.

### Exhibit 4: WWCM Risked NPV/sh Valuation Breakdown

Prospect/Field	Risked NPV	Risked NPV/sh	WWCM Net Risked resource estimate (mmbbls)
Alaska	\$404,645,884	\$1.73	46.3
Beta Unit	\$434,611,240	\$1.86	48.8
Wilmington	\$119,480,139	\$0.51	13.5
San Joaquin Basin	\$52,112,957	\$0.22	3.1
Long Beach	\$5,867,598	\$0.03	0.3
Rosecrans	\$8,378,718	\$0.04	0.6
Net Debt	\$452,417,936	(\$1.93)	
<b>TOTAL</b>	<b>\$572,678,600</b>	<b>\$2.45</b>	<b>112.6</b>

Source: Company reports, Wellington West Capital Markets Inc.

**Exhibit 5: WWCM EMV Valuation Breakdown**

Prospect/Field	Net Interest	Chance of Success	WWCM Gross Unrisked resource estimate (mmboe)	WWCM Net Risked resource estimate (mmboe)	Net Risked EMV	Net Risked EMV/sh	Net Unrisked EMV/sh
Alaska (net producing)	100%	80%	60.6	48.5	\$423,900,274	\$1.81	\$2.26
Beta Unit	100%	60%	100.0	60.0	\$526,471,903	\$2.25	\$3.75
Long Beach	100%	100%	0.4	0.4	\$6,803,810	\$0.03	\$0.03
Rosecrans	50%	70%	2.0	0.7	\$10,495,137	\$0.04	\$0.06
San Joaquin Basin	100%	70%	5.0	3.5	\$58,576,008	\$0.25	\$0.36
Wilmington	100%	70%	20.0	14.0	\$122,099,548	\$0.52	\$0.75
Wyoming	26%	20%	500.0	26.0	\$253,920,000	\$1.09	\$5.43
Corsair	100%	45%	100.0	45.0	\$439,000,000	\$1.88	\$4.17
Alaska Upside	100%	5%	200.0	10.0	\$102,500,000	\$0.44	\$8.76
				Net Debt	\$452,417,936	(\$1.93)	(\$1.93)
				<b>TOTAL</b>	<b>\$1,491,348,744</b>	<b>\$6.37</b>	<b>\$23.64</b>

Source: Company reports, Wellington West Capital Markets Inc.

**Our work suggests that Pacific Energy is trading at ~0.7x our risked NPV estimate, which leads us to propose that Pacific Energy is an attractive “value play” at current price levels.** We believe Pacific Energy gives investors exposure to a large, long-life resource base with significant development, step-out and exploration upside. In our view the asset portfolio is well-balanced between development work and high-impact exploration potential in Alaska. Exploration aside, we believe the company can reach ~15,200 boepd in production by the end of 2009 on the existing 2P reserve base if current development plans are executed as planned.

**Exhibit 6: Summary Valuation Table (all numbers net of debt)**

Valuation Matrix	Forecast	Target Multiple		Value	Weighting	Weighted Value
Risked NPV/share	\$	2.45	1.0	\$ 2.45	35%	\$ 0.86
2009E CFPS	\$	0.32	5.0	\$ 1.59	35%	\$ 0.56
Asset EMV/share	\$	6.37	1.0	\$ 6.37	20%	\$ 1.27
Acquisition Value	\$	1.95	1.0	\$ 1.95	10%	\$ 0.20
				12 month target price		<b>\$ 2.88</b>

Source: Wellington West Capital Markets Inc.

## Disclaimers

The particulars contained herein were obtained from sources that we believe to be reliable, but are not guaranteed by us and may be incomplete or inaccurate. The opinions expressed are based upon our analysis and interpretation of these particulars and are not to be construed as a solicitation of offer to buy or sell the securities mentioned herein. Wellington West Capital Markets Inc. (“WWCM”) may act as financial advisor, fiscal agent or underwriter for certain of the companies mentioned herein, and may receive remuneration for its services. WWCM and/or its principals, officers, directors, representatives, and associates may have a position in the securities mentioned herein and may make purchases and/or sales of these securities from time to time in the open market or otherwise. This report may not be reproduced in whole or in part, or further distributed or published or referred to in any manner whatsoever nor may the information, opinions or conclusions contained herein be referred to without in each case the prior written consent of WWCM.

U.S. Institutions may conduct business through our affiliate Wellington West Capital Markets (USA) Inc. Wellington West Capital Markets (USA) Inc. accepts the contents of this research report, however, the company that prepared this report may not be subject to U.S. rules regarding the preparation of research reports and the independence of research analysts.

This report will be forwarded to our affiliate Wellington West Capital Inc. (“WWCI”). Subject to WWCI management review and approval, this report may be distributed to clients of WWCI. WWCI and WWCM are members of the Canadian Investor Protection Fund (“CIPF”).

### *Wellington West Capital Markets Stock Rating System*

The rating system is based on the stock’s expected absolute total return over the next 12 months. Generally, Strong Buy rating is expected to produce a total return of 25% or more, Buy a total return of 10% to 25%, Market Perform a total return of 0% to 10% and Underperform a negative total return. Speculative Buy rating is expected to produce a total return of 25% or more, but is based on factors and forecasts that have high degrees of uncertainty. The distribution of the recommendations for the last three-month period and their relationship with investment banking business are available on request by emailing to [compliance@wwcm.com](mailto:compliance@wwcm.com).

### *Analyst Compensation*

Research analysts receive compensation based on a number of factors as determined by WWCM’s management. Compensation is affected by all of the firm’s business activities, including revenue generated from capital markets and investment banking. No part of the compensation of the analyst who authored this report is based on the specific recommendation or views expressed in this report.

### *Analyst Trading*

WWCM permits analysts to own and trade in the securities and/or derivatives of those companies under their coverage, subject to the following restrictions: no trades can be executed in anticipation of the initiation of coverage; no trades can be executed for five days after dissemination of launching coverage or a material change in recommendation; and no trades can be executed against an analyst's recommendation. Exceptions require prior approval of the Head of Research and can only be executed for a reason unrelated to the outlook of the stock.

### *Dissemination of Research*

WWCM endeavors to make all reasonable efforts to provide research, simultaneously and electronically to all eligible clients and potential clients.

Company Name	Ticker Symbol	Applicable Disclosure
Pacific Energy Resources Ltd.	PFE-T	2, 3, 11

### *Applicable Disclosure Details*

- 1) In the last 12 months, WWCM, or its affiliates, have managed or co-managed an offering of securities by the subject issuer.
- 2) In the last 12 months, WWCM, or its affiliates, have received compensation for investment banking and related services from the subject issuer.
- 3) The research analyst or a member of the research analyst's household, or any associate or individual preparing the report, has a long position in the shares and/or the options of the subject issuer.
- 4) The research analyst or a member of the research's household, or any associate or individual preparing the report, has a short position in the shares and/or the options of the subject issuer.
- 5) WWCM or its affiliates is a market maker, or is associated with the specialist that makes a market in the securities of the subject issuer.
- 6) WWCM or its affiliates own more than 1% of any class of common equity of the subject issuer.
- 7) WWCM has a conflict of interest with the subject issuer.
- 8) The research analyst(s) has a conflict of interest with the subject issuer.
- 9) Over the last 12 months, the research analyst has received compensation based on a specific investment banking transaction relative to the subject issuer.
- 10) The research analyst or a member of the research analyst's household serves as a Director or Officer or Advisory Board Member of the subject issuer.
- 11) The research analyst(s) has viewed the material operations of the issuer\*.  
 (\*toured Alaskan office and facilities in October 2007)
- 12) A portion of the travel expenses of the analyst were paid or reimbursed by the issuer.

### *Analyst Certification*

Each analyst of WWCM whose name appears in this research report hereby certifies that (i) the recommendations and opinions expressed in the research report accurately reflect the research analyst's personal views about any and all of the securities or issuers discussed herein that are within the analyst's coverage universe and (ii) no part of the research analyst's compensation was, is, or will be, directly or indirectly related to the provision of specific recommendations or views expressed by the research analyst in the research report.