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TRENDS IN EXPLORATION: IS THE
PAST THE KEY TO THE FUTURE?

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Company Profile

In the year since crude oil prices peaked at an all time high above US\$ 147 a barrel, small-cap E&P companies have been particularly hard hit by the global economic crisis. With credit markets drying up and investors turning elsewhere, most of these small independents have had to put ambitious exploration programs on hold and face up to the more mundane task of just keeping the lights on. Winstar Resources Ltd, which entered the global crisis with no debt and strong working capital, prides itself on having adjusted quickly and effectively, albeit at a cost. The company's prudence on spending meant cancelling some high-impact wells that were to be drilled in southern Tunisia in late 2008. Consequently, the company had no new production to offset declines due to mechanical difficulties, which have since been resolved, and normal declines in maturing wells. As a result, Winstar's daily production in the first quarter of 2009 fell by 15% from the 2007 peak of 2,013 boe/d to 1,712 boe/d. Even more troubling, the company's stock price hovered near the \$2 mark, which is where it was trading in 2006.

Nonetheless, company management stresses that Winstar is a much stronger company than it was three years ago, and it is now working toward resuming drilling in the fourth quarter of 2009. Furthermore, production in southern Tunisia -- which accounts for most of the company's crude output -- has improved considerably in the last few months. And, Winstar has 18 MMboe in 2P reserves, which is a 51% increase over the reserves it had booked the last time its stock was trading at \$2 per share. Probable reserves have doubled, thanks to success with the drillbit, and expansion of its facilities, including a new gas pipeline. Winstar believes it has world-class exploration prospects in its two core areas, Tunisia and Hungary, where one successful well could double or triple the production and cash flow of a company its size. In Hungary, the company is looking at potential shallow gas reserves with Tcf potential in a country eager to end its dependence on Russian gas. In Tunisia, the North African country sandwiched between Libya and Algeria that has the same geology but far more favorable terms, Winstar says companies enjoy an 80% success rate when drilling prospects in the Silurian Acacus. To pursue these ends, Winstar is beginning the search for partners in both countries as well as considering the sale of some non-core assets, in order to kick off high-impact exploration.

As president David Monachello told investors in Calgary in June 2009, "We will not wait on equity markets or commodity prices." It is a bold statement, indicative of Winstar's faith in its exploration prospects. Since then IHS sat down to discuss Winstar's forward looking plans with both Monachello and Winstar chief executive officer Charles de Mestral.

Reinventing Itself

It has been four years since Calgary-based Winstar decided to reinvent itself, focusing on international rather than Canadian opportunities. In August 2005, the company acquired Athanor BV, a Tunis-based oil and gas producer. Through the acquisition, Winstar assumed operatorship of five Tunisian concessions. Four of these the company holds 100%, Chouech Essaida, Ech Chouech, Sanrhar and Zinnia, while it operates the Sabria concession with a 45% stake. The state oil company ETAP holds the remaining 55% in Sabria per the terms negotiated by MOL when the production concession was carved out of an exploration block. In total, the five Tunisian concessions comprise about 668 sq km. In 2005, they were producing about 600 boe/d.

Monachello calls Tunisia, "a wonderful place to be an oil and gas producer," and indeed in four years Winstar has more than doubled its production in the country, which accounts for all of Winstar crude production save about 300 bo/d from its holdings in Alberta. Furthermore, in early 2009 the company began selling associated gas from its Chouech Essaida concession via an 80km pipeline it laid between the southern Tunisian concession and El Borma to the north. This is no small achievement for a company the size of Winstar, which is now selling gas to the Tunisian gas and electricity company STEG. Initial sales were about 1 MMcf/d, which were expected to increase to 2.5 MMcf/d within the first 30 days. Demand in Tunisia is strong, as the country has weathered the global financial crisis better than most. With tourism doing well and the Tunisian summer nice and hot, Winstar is able to deliver a rich gas particularly appreciated by STEG. Indeed, the pipeline is currently "delivering volumes of gas that exceed our expectations," according to de Mestral.

As the company prepares to start drilling again, it plans in the near term to focus on three concessions in Tunisia: Sabria, Chouech Essaida and Ech Chouech. At Sabria, which is on the southern shore of the large salt lake Chott el Djerid, Winstar says it has 10 to 30 potential development and/or stepout locations.

However, the big prize is believed to be at Chouech Essaida and Ech Chouech. Six wells on the licenses at last report were producing about 1,150 boe/d from the Triassic and Devonian. In 2008, Winstar acquired 400 sq km of 3D seismic over both blocks at a cost of about US\$ 10 million. Interpretation of that seismic has just been completed, identifying, as de Mestral put it, "maybe more leads and prospects than we thought, with seismic data being of higher quality than originally expected." Not only did the seismic reveal significant extensions to existing pools, but indicates there is even bigger potential in the Silurian. In fact, 24 Silurian discoveries have been made on adjacent acreage, as the Acacus play has moved toward Winstar's acreage through exploration first by Pioneer and Eni and, more recently, by OMV. These Silurian discoveries have been completed for an average initial potential of 6,000 boe/d.

Monachello says Winstar has identified 12 Silurian traps, 10 comparable to the nearby discoveries, while two are horst anomalies believed to be similar to those discovered in the Ghadames Basin of Libya. Five of these prospects have been high graded. Winstar proposes drilling wells to depths of 4,300 to 4,800m in the Ordovician. The prospects range in area from 0.8 sq km to 9 sq km, with a vertical closure of 9m to 70m. It is believed the average recoverable reserves for each field is 7.1 MMboe. Therefore, the total recoverable reserves would be 35 MMboe, which Monachello notes is the kind of potential normally reserved for companies far larger than Winstar. If all five wells are successful, initial production could be nearly 31,000 boe/d.

In hopes of moving forward on these prospects, Winstar is in the final stages of organizing a farm-out process for Ech Chouech. Offered terms will be for a partial carry, as the company wants to hold onto a piece of the concession. Meanwhile, Winstar plans to fund exploration on Chouech Essaida out of its own pockets, holding onto a 100% interest in the concession.

Dated Technology

Winstar's expansion abroad was two pronged. Concurrently with the purchase of Athanor in 2005, the company acquired El Paso Hungary Oil & Gas. This acquisition gave Winstar a 100% working interest and operatorship of about 2,600 sq km some 100km south-west of Budapest. The acreage consists of a 309 sq km production concession, the Torokkoppány Mining Plot, and the 2,300 sq km Igal II exploration permit. In 2008, Winstar drilled an exploration well in the south-eastern part of Igal II. While NAK 1 was plugged and abandoned at a total depth of 1,775m, it was successful in "identifying multiple zones with excellent reservoir quality sands and carbonates and some gas shows."

Results of the NAK 1 well convinced Winstar that their Hungarian acreage has the potential for several significant natural gas fields in Pannonian turbidites. Therefore, the company has selected a "well-recognized disposition company" to help it market Igal II, with the search for a partner to formally begin in mid-August to September 2009. Winstar is offering a farm out of up to 50% to companies willing to pay 100% of seismic and drilling costs. The company says it has identified six Pannonian turbidite anomalies, including the Turbo prospect. This stratigraphic trap is about 1,200m deep covering an area up to 53 sq km. Potential reserves are believed to be 1.75 Tcf. In a country that fears each winter the taps will be turned off in the Ukraine, there will be no problems marketing large volumes of natural gas.

Monachello says the Soviets had convinced themselves that in Hungary gas could only be trapped structurally or in reservoirs draped over highs. This presents Winstar the opportunity to use modern

technology to look for the types of structural and/or stratigraphic traps that produce in nearby fields. Noting that while a lot of wells have been drilled in the country, Monachello says "Hungary has been harvested only once, and then only under dated technology."

Hungary's favorable geology is supplemented by a political and business climate that looks kindly upon E&P companies. De Mestral says Hungary is politically and economically sophisticated. Fiscal terms are attractive, with an income tax of 18% and royalty of 12%. Most of all, the country is anxious to alleviate its dependence on energy imports, and therefore welcomes operators with open arms. Even in competitive days of early summer 2008, Winstar was able to use local service companies that were reliable and offered reasonable prices. Now it appears Hungary has weathered the worst of the global turndown, as its national bank has dropped its prime lending rate by a full percentage point to 8.5%. This move in the last week of July 2009 proved a greater reduction than markets had anticipated and is seen as an indication Hungary is well on the road to recovery.

Consequently, Winstar hopes natural gas prices will be high enough to justify the resumption of production from Torokkoppány in late 2009. Of less certainty is whether the reservoir has been able to recharge while being shut in. Eventually, Winstar plans to use Torokkoppány as a gas storage site. Since this is out of its immediate line of business, the company is looking for either a partner or buyer for the production concession.

Hungarian Spoken

In 2008, Winstar expanded into its third country -- Romania -- via a farm-in agreement with Rompetrol. Winstar has agreed to fulfill 100% of the first stage minimum exploration program by February 2012 in order to earn a 60% operated interest in the E IV-5 Satu Mare exploration permit in north-western Romania. This tract encompasses 2,949 sq km in the Bihor political province in the Pannonian Basin. It is near the Hungarian border, north-east of Petrom's XIV Marghita contract.

Satu Mare was an obvious fit for Winstar, as the geology is contiguous with Hungary and the language spoken in the area is Hungarian. In fact, the block is the same distance from Winstar's offices in Szolnok, Hungary, as Igal II. Furthermore, Romania offers a favorable tax regime, and having joined the EU on 1 January 2007, the country is moving toward a more western-type business climate.

Rompetrol and Winstar have reprocessed hundreds of kilometers of seismic, which it is now using to "put the G&G puzzle together." This process is expected to take the remainder of this year and part of the next, as the company prepares to acquire 3D seismic and drill an exploration well by 2011.

Winstar believes Romania offers opportunities similar to both Hungary and Tunisia in that it is a known producing area -- the oldest in Europe in fact -- that holds the potential for new plays waiting to be tapped by modern technology. Significant oil and gas fields have been found on the acreage surrounding Satu Mare, and certainly the geology doesn't end at the block's outline.

Full Plate

So having kept the lights on during this past tumultuous year, Winstar is looking toward the future. Having begun as a Canadian company, it now considers its Alberta properties to be non-core. The company has a full plate of opportunities and is hoping to join the ranks of the few other small cap independents that have made discoveries disproportionate to their size.