Outlook for 2016 – Energy

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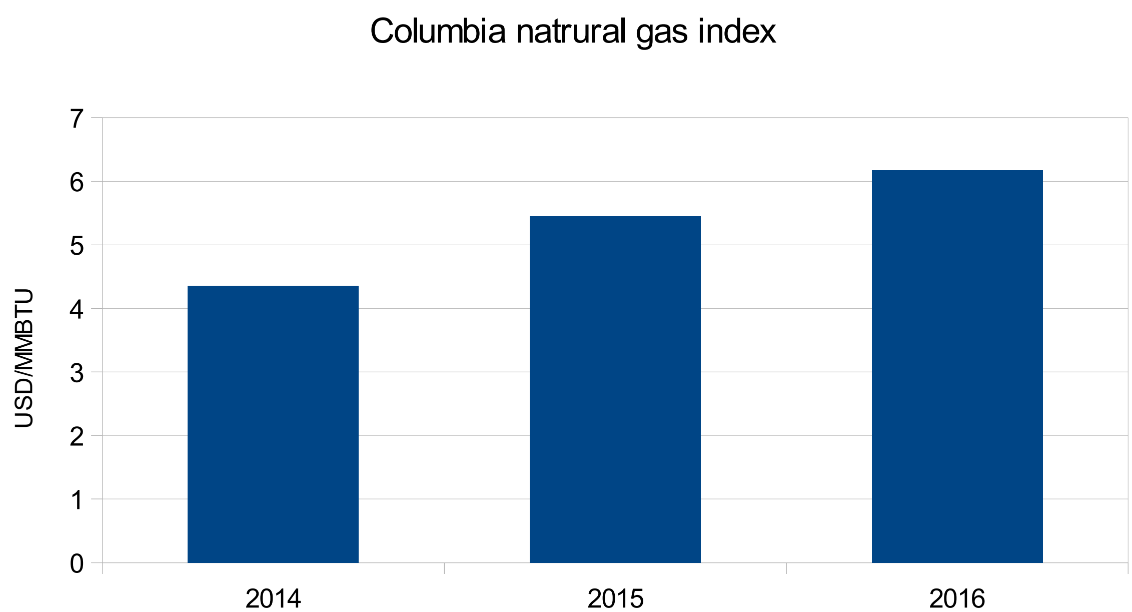
We had a very tough year of 2015. Fortunately I sold off most of the leveraged energy position as soon as oil started to tank in September 2014. During 2015, my key energy positions are ones of the few best performing energy juniors while many other energy companies are facing bankruptcy. I believe 2016 could be the potential breakout year for them. If you are interested in investing in energy for the long run, you should take a closer look.

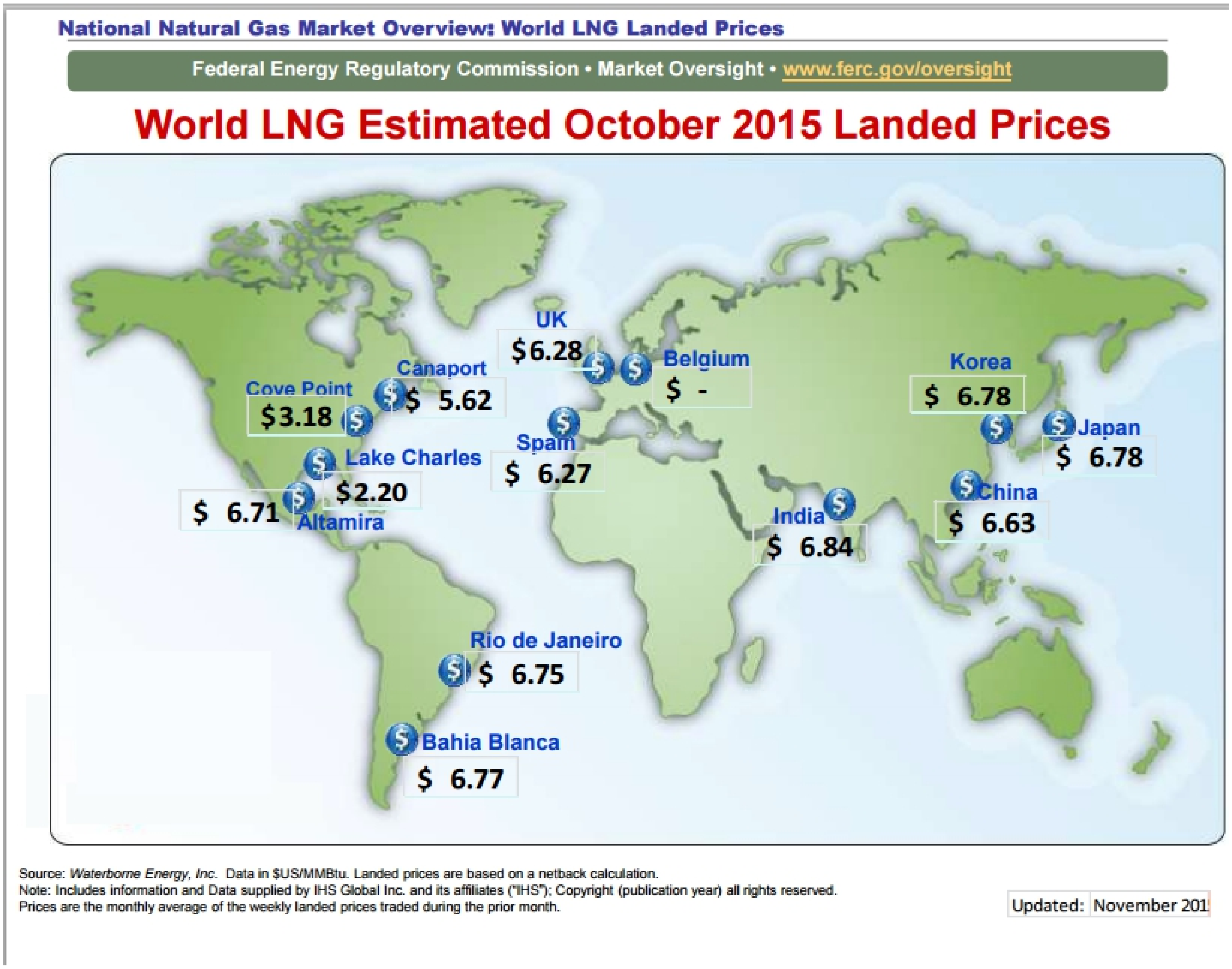
I see the most exciting opportunities in 2016 energy trade are in natural gas. Attached is the chart of natural gas price index in Columbia, set by the government agency. It shows a robust demand but a supply shortage in this country. Imagine if you were a natural gas supplier of the country, it would be booming just like the oil crash of 2014-15 never happened!



The reason why the natural gas price could rise in Columbia while the oil prcie crashed is a little counter-intuitive. Ngas price is influenced by local supply demand, LNG import/export and potential diesel replacement of ngas (if the price is too high).

First let's take a look at diesel replacement. Oil and gas has the energy ratio of 6:1. Basically 1 MMBTU has about the energy of 6 barrels of oil. If you add the refining cost, I believe six dollars ngas is competitive to thirty dollars oil. Then there is the factor of clean energy to consider. Ngas burns much cleaner than diesel. I believe we have to have oil in the **twenty dollars area for extended period** of time in order for the switch to happen.

The main threat seems to be LNG. Below is the most recent LNG price around the world. You can see although LNG prices dropped significantly from $20/MMBTU after Japanese nuclear disaster to close to 7 now, it is still higher than my 6 dollar target. The reason is that LNG is quite expensive to ship. It is estimated to be about 4/MMBTU to ship it around world. There are talks that LNG may drop below 6 in 2016, but I doubt it will be sustainable. Plus it will be likely for the long term customers who sign up 20-30 years contracts index to Brent or WTI. Therefore the bottom line is that it is very difficult for LNG to compete with 6 dollar natural gas.



My conclusion is that the current market environment supports **$5-6/MMBTU ngas in certain area in the world**.(You don't want to invest in gas producers in the US and Canada for the obvious reason) **It will be a stock-picker's market.** You need to know the market well and avoid those markets which are in oversupply, like North America. You should look for the niche that can sustain high ngas for at least a few years so ngas producers can make good money and ride out the downturn. They may even pick up assets on the cheap as well.

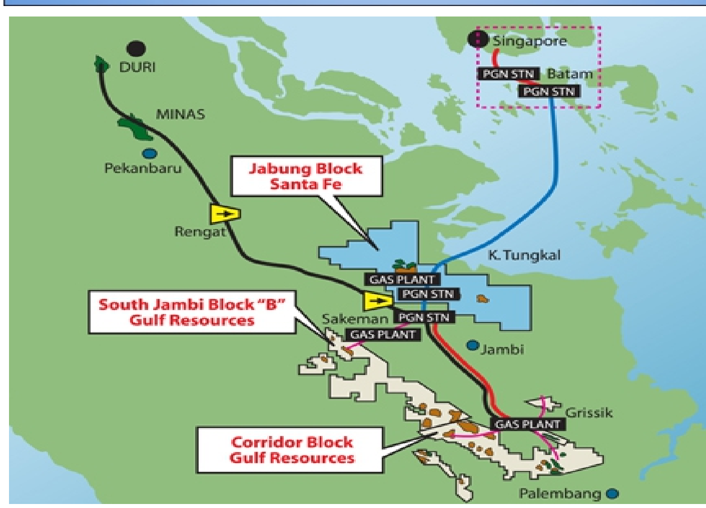
These are the areas with sustainable high natural gas price that I like.

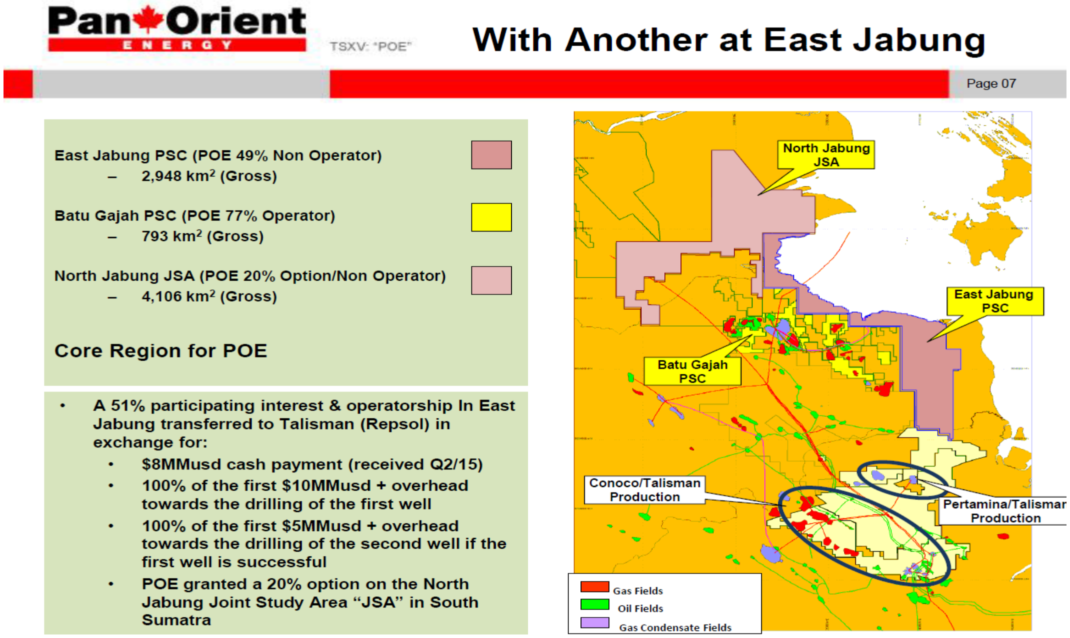
Asia

Most parts of Asia should have high ngas price for the foreseeable future. In particular, I like Sumatra, Indonesia. It is located next to Singapore and has a undersea pipeline that supplies ngas to Singapore. Ngas in Singapore commands very high premium and it is one of the most profitable ngas producing areas in the world.

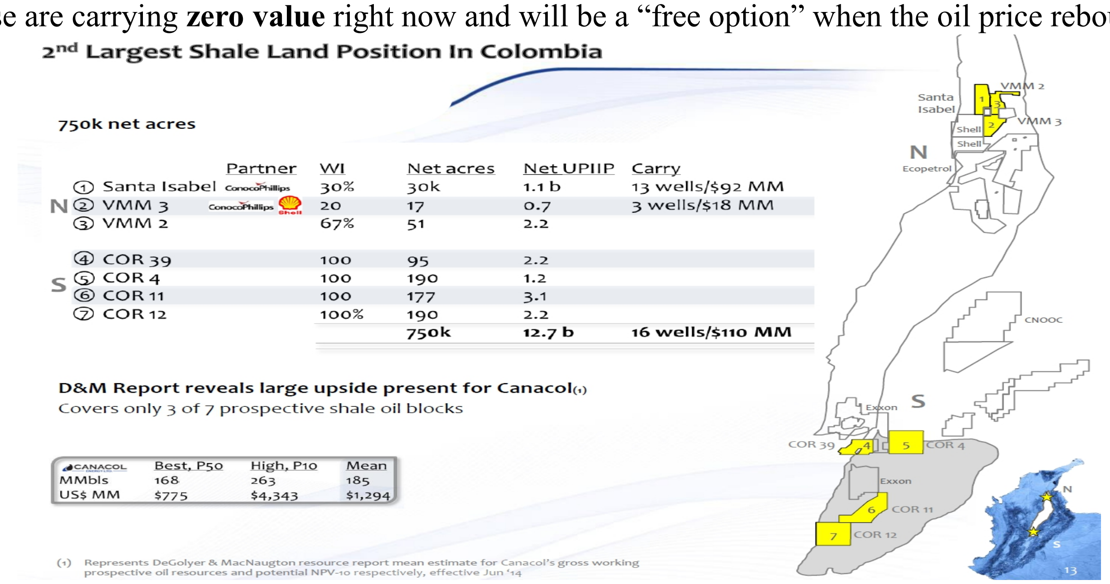
My top energy holding **Pan Orient(POE.v, POEFF)** is operating in this area. POE is in such a unique situation that I haven't been able to observe elsewhere for a long time. It is trading at significantly below cash(1.2CAD vs estimated 1.5 CAD cash). It has a low cost producing oil field in Thailand that is generating free cash flow that covers much of the corporate G&A. Most importantly the management have been selling off assets and returning cash to shareholders. They returned 75c CAD to shareholders not long ago, with another 40c CAD coming in February of 2016. If I can make an educated guess, I think we will have a good chance that Batu Gajah and Canadian assets will be sold by the end of 2016 and the company can be in the position to return 2 CAD or more to their shareholders, much higher than the current share price.

The most exciting part of POE is the planned East Jabung drilling by Talisman(part of Repsol now) in 2016. The target is 250 million BOE and the high estimate is 850 million BOE(gross). Recently Devon bought high cost fracking plays in the US at 4 dollar/barrel in resource. I expect the discovery can worth at least $10/barrel because it is conventional low cost discovery and it is in high energy price region. We are talking about billion of dollars worth of discovery versus the pitiful 50 millions USD of POE market cap! That's why POE is my largest energy position.





Another key energy holding of mine is **Canacol Energy(CNE.to, CNNEF.pk)**. Its story is very simple. They are about to turn on the valves of its Colombian natural gas production. I already showed you that the gas price is escalating there, like few other regions in the world. Its gas output should be more than quadruple by the end of February of 2016. Since their gas field has very low operating costs, I expect they should generate over 100 millions USD in free cash flow in 2016. I welcome you to compare this to other zombie companies that are heading to bankruptcy. It has manageable debt of ~200 millions. CNE also has extensive portfolio of oil assets and will likely pick up more during the downturn. All these are carrying **zero value** right now and will be a "free option" when the oil price rebounds.



I am also very bullish on natural gas in EU, where Russia is the key supplier. I own a small position in Ukraine gas producer CUB energy(KUB.v). I am still waiting for the government to act and reduce the royalty as they promised. They have been very slow moving in that front. I am also watching a few other stocks in that area.

In conclusion, I don't know whether oil will bottom in 2016 or later. I don't know where it will bottom. However, if we invest in a few very selective natural gas companies that can generate great income during the difficult period, we will have winners in our hands. While the other energy companies are struggling, our companies can generate cash flow, consolidate the area and even return cash to shareholders. While the Wall Street experts are debating when and where the oil price will bottom, I feel I have a very nice niche that can do very well in this market and I am quite excited about their prospects in 2016. If you want to invest in energy at all during 2016, these companies should be your top choices.

Finally, let me give you a piece of advice. 2016 is looking like another tough year for investing. If you don't feel comfortable investing in energy, you don't have to. Unless you are fund manager, you can put your own money anywhere you wish. I always have a philosophy to **ride commodity boom on the way up, not on the way down!** Remember, gold miners? When I saw the trouble back in 2012, I under-weighted them. When I saw oil in trouble in September 2014, I sold most of my leveraged positions. However, remember all these multi-baggers I had in the boom time? I was able to keep most of my profits! We have a rough oil market. I don't know when we will get over it. I will be watching it carefully and updating you as soon as I see something. I will also update you my opinions on other commodities, like gold, as well as my other favorite stocks. But I really want to warn everyone about buying the trash in the oil market, even if it dropped 99%, it still has another 100% downside to go!