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Alaska oil field deal breakthrough for Wavefront

By Richard Blackwell
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Stock bounced back after small-cap company announced major deal

Wavefront Technology Solutions Inc.'s WEE-X innovative method of flushing more oil out of existing wells has caught the attention of small-cap investors.

The Edmonton company's stock leapt above the \$1 mark for the first time in almost a year last week, after it announced that "one of the world's top-five oil producers" has installed one of its units in an Alaskan oil field and will use three more.

The identity of the client was not released, although one analyst suggested it was likely either BP PLC, ConocoPhillips or Exxon Mobil.

The endorsement of a key global energy player is crucial for Wavefront, which has developed a way of extending the economic life of mature oil fields.

Its device, which attaches to the business end of conventional downhole equipment, pulses fluid into a well to loosen oil that would not otherwise be recovered.

While it is common to try to flush out oil using water pressure, pulsing the fluid is far more effective. Recent tests in the field show it can boost production from declining wells by as much as 86 per cent.

Wavefront stock traded over \$3 as recently as the summer of 2008, but it has languished under \$1 since last November, as investors wait impatiently for the company to expand its order book as proof that the industry has an appetite for the technology.

Robert McWhirter, a portfolio manager at Selective Asset Management Inc. in Toronto, said he is very enthusiastic about Wavefront's business model, which involves leasing the equipment to customers rather than outright sales.

That generates revenue month after month - a steady stream of cash that will be highly lucrative once there is a critical mass of devices in the ground, he said.

However, Mr. McWhirter is disappointed the company has not met its targets for installations, and as a result he sold off half of his fund's million-share holding in Wavefront about six months ago.

There are fewer than 50 units in the field, despite earlier promises Wavefront would have more than 100 installed by now.

With 500,000 shares still in hand, Mr. McWhirter will consider buying more if the company shows signs it is getting some large contracts from major oil patch players.

There is not "broad industry acceptance" yet, he said, and thus Wavefront "hasn't delivered as expected." Still, there are a vast number of wells in North America and beyond that could use the technology, and if the company gets a foothold the leasing model could potentially generate "Microsoft-like profit margins," he said

The new Alaskan deal is small, but a good sign, Mr. McWhirter said. "If these guys can get 100 [units] in the ground plus a visible backlog, then I think you'd become quite rightfully excited about it."

Wavefront chief financial officer Brad Paterson says a "perfect storm" of events has dented the company's plans. A drop in oil prices from the 2008 peak, a weak financing environment for oil companies, and Alberta's new royalty regime have slowed installations.

The company, which lost \$6-million on revenue of \$1.1-million in the nine months ended May 31, will break even when about 125 systems are installed, Mr. Paterson said. Each one generates about \$3,000 a month in revenue.

The company is also hopeful that it will attract business outside the oil patch. The Wavefront technology can be used to clean up underground contamination, such as scouring the underground area beneath a gas station where fuel has spilled.

The company has already sold a number of units for environmental applications, and recently completed groundwater cleanup projects in Montreal, Edmonton, New York City and Salt Lake City.

While the environmental business will be a valuable addition to Wavefront's revenue, it will likely remain secondary to the energy sector, Mr. Paterson said.

The two analysts who follow the company are both enthusiastic about its prospects, with "buy" recommendations in place and 12-month price targets of \$1.50 and \$2.00.

Jennifer Wood, an analyst at Max Capital Markets Ltd. in Toronto, said she likes the stock because "the potential for this technology to be adopted by an entire industry is huge."

The new Alaskan order is small on its own, she acknowledges, but "it is signalling that this is being validated by a huge international oil company."

Ms. Wood is projecting that Wavefront will become profitable in 2011.

Lukasz Michalowski of M Partners Inc. in Toronto said in a recent report that there are as many as 1,500 producing oil wells in Alaska, making it a potentially large market for Wavefront if the initial order leads to a broader deployment of the technology in the region.

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