In my last newsletter I opened with a list of why crude oil prices are likely to move higher into year-end. The items I listed are all keys to a tightening of supply & demand, which is the fundamental reason for any commodity to increase in price.

The sixth item on my list is that the weekly oil storage reports need to become less bearish. Since last November we’ve watched U.S. crude oil inventories move way over the 5-year average levels for this time of year. The day after the last newsletter was published the Department of Energy reported the first decline in crude oil inventories in over five months. Better yet, the next two week’s reports also reported declines. In total, U.S. crude oil inventories have now declined more than 9 million barrels from the peak in late April and I am expecting the steady decline to continue through the summer.

The simple reason for the recent decline in inventory is that U.S. refiners need to draw more crude oil feedstock from storage to produce transportation fuels. Americans and
Europeans, to a lesser extent, hit the road each summer for vacations. Recreational vehicles, boats and SUVs burn up a lot of gasoline on long holiday weekends.

Refiners ramp up production of gasoline and diesel fuel each year in May in anticipation of increasing demand. Also, summer gasoline blends cannot contain as much butane (by law). Therefore, more crude oil is needed to produce each gallon of gasoline. Since refiners cannot blend in as much cheaper natural gas liquids (“NGL”), gasoline prices at the pump go up 10-15 cents per gallon around Memorial Day. Most people think the retailers are just using the higher demand period of summer to gouge them with higher prices, but that is not the case. By the way, most convenience stores make more money selling fountain drinks and cigarettes than they do selling gasoline.

The second fundamental reason we’re going to see a tightening supply of oil is the sharp drop in the active rig count in North America’s top four oil plays. North American oil production has peaked and is likely already on decline. We won’t know for sure how steep the decline is until actual data is accumulated from the state reports. Actual U.S. production volumes are only available through February. Here are the last six months of actual U.S. crude oil production from the EIA website:

<table>
<thead>
<tr>
<th>Month</th>
<th>Bbls per day</th>
</tr>
</thead>
<tbody>
<tr>
<td>September 14</td>
<td>8,909,100</td>
</tr>
<tr>
<td>October 14</td>
<td>9,063,161</td>
</tr>
<tr>
<td>November 14</td>
<td>9,028,933</td>
</tr>
<tr>
<td>December 14</td>
<td>9,227,645</td>
</tr>
<tr>
<td>January 15</td>
<td>9,214,419</td>
</tr>
<tr>
<td>February 15</td>
<td>9,237,928</td>
</tr>
</tbody>
</table>

The number of rigs drilling for oil in the U.S. peaked in early October at 1,609. The active rig count started to decline slowly and then dropped off a cliff in the first quarter. The number of rigs drilling for oil today in the U.S. is 659.

The U.S. consumes over 16.5 million barrels of crude oil each day, so we are a net importer of oil and (sad to say) we probably always will be. We simply lack the leadership in Washington to become energy independent.

It is not the drilling of wells that adds production. It is the completing of those wells to a gathering system that adds production. From the time the drilling rig moves off location, it takes several months to complete a new high rate horizontal well to a sales line. Therefore, it takes several months before we can expect to see a decline in production as a result of declining drilling activity. My expectation is that U.S. crude oil production peaked in March or April and by the 3rd quarter we will see monthly declines of more than 100,000 barrels of oil per day. My “guess” is that U.S. crude oil production will be close to 8.5 million barrels per day by year-end.

One reason it takes much longer to complete a well than to drill it, is because more companies have moved to pad development drilling. Multiple wells are drilled from a

**EPG Coming Events**

Our luncheons in Houston and Dallas give EPG members and their guests an opportunity to meet the top management of some of the most promising small and mid-cap energy companies that we track. Members and guests need to register on our website.

Our luncheons are free for EPG members and just $40 for non-members that register through our website or $50 at the door.

**Wednesday, June 10:** Resource Royalty, LLC a private company that packages mineral interests throughout all major oil & gas basins, is hosting a luncheon at The Hess Club, 5430 Westheimer Rd., Houston, Texas

Visit energyprospectus.com to register.
single location and the wells cannot be completed until the drilling rig moves off location. Companies like Continental Resources (CLR) and EOG Resources (EOG) are now drilling up to 16 wells per pad in the Bakken / Three Forks play in North Dakota.

A not so obvious reason for the decline in U.S. crude oil inventories is that the NYMEX futures curve has flattened. In the first quarter the difference between the front month contract for West Texas Intermediate (WTI) and the NYMEX contract for delivery a year later was over $10/bbl. A gap that wide made it profitable for speculators to take physical delivery of the oil, pay storage fees of $0.40 to $0.50 per barrel per month and “pre-sell” the oil by shorting a NYMEX contract over a year out. Those days are over (for now) and speculators are no longer taking physical delivery of crude oil at Cushing, Oklahoma.

Saudi Arabia could push oil prices back over $100/bbl quickly, if they so desired.

On June 5th the Organization of Petroleum Exporting Counties (“OPEC”) will meet in Vienna, Austria. At the very least, I am expecting Saudi Arabia to say that the fundamentals are improving and that they see the forces of supply & demand bringing stability to the price of oil. Since many OPEC nations are suffering as a result of today’s oil price, Saudi Arabia is sure to be under pressure to do something to shore up prices. There is a chance we get a statement from OPEC that they have a target price in mind for Brent at $80/bbl.

The energy markets are driven by speculators whose trading dominates the commodity exchanges. Speculators will be “working the markets” in the days leading up to and after the OPEC meeting. For an interesting article on the OPEC WEBSITE on how they feel about speculative trading.

**Sweet 16 Growth Portfolio**

The Sweet 16 has pulled back a bit since my last newsletter, but it is still up 18.2% year-to-date, compared to the S&P 500 Index that is up just 3.3% YTD.

One reason for the pullback is that there seemed to be a lot more articles published recently speculating that oil prices had gotten “ahead of themselves” and were due for a bit of a pullback. Wall Street traders move oil prices in the short-run and they seem to believe their own press.

As you can see in the chart on the next page, WTI has been trading sideways in a tight channel that has a base around $57.50/bbl and strong resistance at $60.00/bbl for more than two weeks. My expectation is that WTI breaks higher on continued weekly draws from U.S. crude oil storage (discussed above) and confirmation of declining U.S. production. Commentary from OPEC will impact oil prices as well.

If we get several closes above $60/bbl, that price level should turn into a support level. Because oil prices fell so fast, there are few technical
resistance levels other than the psychological resistance at $60, $70 and $80 per barrel. If the “ducks line up just right,” we could see a rather quick move toward $70 for WTI.

Laredo Petroleum (LPI) has been promoted to the Sweet 16 from our Small-Cap Growth Portfolio. It replaces Whiting Petroleum (WLL).

The Sweet 16 is a “Growth Portfolio” and Whiting’s production is now on decline. Based on value, WLL is trading at a deep discount to my valuation of $42.50. I will continue to track Whiting closely and there is a good chance it moves back into the Sweet 16 when oil prices are higher and their production guidance improves.

Laredo Petroleum is based in my old stomping grounds of Tulsa, Oklahoma and all of their oil & gas assets are in the Permian Basin. The company has impressed me by focusing heavily on systematic development of their leasehold to reduce capital costs and operating expenses per barrel of production. It certainly helps that their acreage sits in an area of the Permian that has at least three stacked pays that can be produced with horizontal wells.

The economics in the Permian Basin are still quite good thanks to stacked pays, plenty of infrastructure and drilling & completion service companies that have lowered their costs by 20% to 30%.

Laredo’s leasehold is in large blocks which they have divided up into “Production Corridor’s”. As illustrated in the diagram on this page, by drilling stacked laterals from drilling pads placed in a row, surface facilities and gathering lines can be arranged to minimize the surface “footprint” and lower costs. At Laredo’s Reagan North Corridor they are moving forward on a plan to drill 448 stacked laterals. This large area will take several years to fully develop and Laredo expects each well pad grouping to payout in less than a year with the full project generating a 12 to 1 return on investment, even at today’s oil & gas prices.

Laredo maintains an active hedging program. As of March 31, 2015 they have approximately 100% of this year’s oil production hedged at a weighted-average floor price of $80.99/bbl, which gives me a high level of confidence in my forecast model. They have approximately 60% of this year’s natural gas production hedged with floors at $3.00/mmbtu. If oil or natural gas prices do spike higher than the floors above, the company will get the higher prices (up to the ceilings on the collars).

The Sweet 16 is all about production and proven reserve growth: Laredo’s production has increased steadily from 27,041 barrels of oil equivalent (“boe”) in the first quarter of 2014 to 47,130 boepd in the first quarter of 2015. The mid-point of the company’s production guidance for 2015 is for a 38% year-over-year increase in production.

We will publish a detailed profile on Laredo Petroleum later this week. I urge you all to read it carefully.
If you’ve been checking your e-mails, you know we are in the process of updating all of the Sweet 16 company profiles for first quarter actuals. All of my forecast models have been updated, so the valuations in the table are accurate. You can view the forecast spreadsheets on the website and download them to Excel if you want to adjust production and / or commodity prices.

**Bonanza Creek (BCEI)** is down 9.2% since I added it to the Sweet 16 on April 1, 2015, but the outlook is fine. The company has a strong track record of growing production and proven reserves. They are on-track for more than 20% production growth this year and with 60% of their oil hedged at good prices, cash flow from operations will cover a large percentage of this year’s capital expenditure budget. The only negative I see for BCEI is that they produce over 4,500 bbls per day of NGLs. NGL prices have been hammered in the DJ Basin this year. Total production should be 30,000 boepd by year-end (61% crude oil, 16% NGLs and 23% natural gas).

For those of you that are short-term traders, I have noticed that BCEI and Matador Resources (MTDR) make fairly significant moves from week-to-week.

Several members have sent me e-mails asking how I picked the “Elite Eight”, which are highlighted on the first page of the Sweet 16 spreadsheet. You can view the S-16 spreadsheet and download it from the EPG website. It is updated each weekend.

The Elite Eight (CXO, XEC, CLR, DVN, EOG, NFX, RRC and SM) are the larger companies in the Sweet 16. I have been tracking them all for many years and I have a very high level of confidence in my forecast models for each company. Size does matter in this business and so does the quality of management and technical teams. A wise petroleum engineer once told me to “bet on the jockey, not the horse” in this business. Management of these large independents have proven track records. They know how to survive periods of low commodity prices. Their size allows them to access lower cost capital and negotiate better prices from oilfield services firms.

The Elite Eight are all what I call “Core Holding Quality” stocks. That
does not mean they will generate the highest capital gains. In fact, during periods where oil & gas prices are rising (where I hope we are today), it is the small-caps that have generated the big gains. For example, SM Energy (SM) is the smallest company in the Elite Eight and I believe it offers the most potential upside for us.

We will be sending out updated profiles on CRZO, CXO, DVN, GPOR and LPI this week. The best place to ask questions about the Sweet 16 or any of the companies mentioned in this newsletter is the EPG Forum.

Disclosure: I have long positions in ALV.TO, BBEP, BTE, CLR, CRK, DDP, DVN, GST, HCLP, LINE, LNCO, LSTMF, MEMP, MTDR, MWE, NFX, OAS, PBB.TO, PWE, RRC, SN, TOG.TO and TXP.TO. I do not intend on buying or selling any securities mentioned in this newsletter within 72 hours of the publication date on page one. I am not receiving compensation from any of the companies mentioned in this newsletter. See the DISCLAIMER on the last page of this newsletter for more details.

**Small-Cap Portfolio**

Small-caps have more risk than the mid-caps in our Sweet 16, but they also have more potential. Companies with lower production have more exposure to a prolonged period of low commodity prices. I believe by staying focused on the fundamentals we can increase our chances of making profitable investments in this space because it has less analysts’ coverage.

I have decided to add RSP Permian, Inc. (RSPP) to the portfolio. It is a smaller version of Diamondback Energy (FANG) which has been a big winner for us in the Sweet 16. It is a pure play on the Permian Basin and heavily weighted to oil. It has a strong balance sheet with more than enough cash flow from operations and liquidity to fund the company’s capital expenditure budget this year.

In 2014, RSPP increased production by 153%. This year they are on-track for more than 50% additional production growth, even on a reduced drilling budget. RSPP has more than 2,000 low-risk horizontal drilling locations; most of them have stacked pay potential.

Since RSPP is a fairly new company, I am starting out with a rather conservative valuation on the common stock. Do not let that keep you from taking a hard look at this one. As they ramp up production, the valuation should go higher. First Call’s price target is $32.76. Global Hunter and Wunderlich (two firms that cover a lot of small-cap E&P companies) recently rated it a BUY.

We published an updated profile on Sanchez Energy (SN) last week. In my opinion, this stock is now grossly oversold and this is shaping up to be an example of how leverage works both ways. If you believe oil & gas prices are going to stay low for several years, then you should avoid situations like this. Frankly, if you believe we are in for a long period of low commodity prices you are probably totally out of this sector anyway.

Sanchez has slashed their capital expenditures, cutting their budget in half from last year. The company has more than enough cash in the bank

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**Small-Cap Growth Portfolio**

<table>
<thead>
<tr>
<th>Company Name</th>
<th>Primary Product</th>
<th>Stock Symbol</th>
<th>Share Price</th>
<th>EPG Fair Value Estimate</th>
<th>Percent Undervalued</th>
</tr>
</thead>
<tbody>
<tr>
<td>ABRAXAS PETROLEUM</td>
<td>OIL</td>
<td>AXAS</td>
<td>$2.96</td>
<td>$5.00</td>
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<td>CPE</td>
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<td>$10.40</td>
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<td>PETROQUEST ENERGY</td>
<td>GAS</td>
<td>PQ</td>
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<td>RSPP</td>
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<tr>
<td>SANCHEZ ENERGY</td>
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<td>SN</td>
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<td>$19.35</td>
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<tr>
<td>TRIANGLE PETROLEUM</td>
<td>OIL</td>
<td>TPLM</td>
<td>$5.25</td>
<td>$9.35</td>
<td>78.10%</td>
</tr>
</tbody>
</table>

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**RSP Permian Overview**

- Large, contiguous, core acreage blocks in the Midland Basin
- 188,000 net “effective horizontal acres” (13) and 47,000 net surface acres (55%, >95% rights to all depths)
- More than 2,000 horizontal and 1,200 vertical drilling locations
- Low-risk, oil-rich base with rapid growth potential
- Leader in Northern Midland Basin horizontal development
- Drilled wells in five different horizontal benches
- Proven reserves and production exceed reserves replacement ratio
- Type curves and production increase result in good industry results
- Track record of production and asset growth
- Since IPO in January 2014, RSP has doubled proved reserves and production and increased total Net Focus Area locations and acreage by more than 50%
- Expecting robust 2015 growth despite challenging commodity price environment

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**Sanchez Energy (SN)**

In my opinion, this stock is now grossly oversold and this is shaping up to be an example of how leverage works both ways. If you believe oil & gas prices are going to stay low for several years, then you should avoid situations like this. Frankly, if you believe we are in for a long period of low commodity prices you are probably totally out of this sector anyway.

Sanchez has slashed their capital expenditures, cutting their budget in half from last year. The company has more than enough cash in the bank...
and cash flow from operations to fund this year’s reduced spending level. They are focused on the high rate of return projects in their large inventory and should be able to hold production steady at approximately 45,000 boe per day (first quarter production was 45,217 boepd).

If WTI bounce back to over $70/bbl by year-end, my valuation for SN could be too conservative. The stock is currently trading at approximately 3X my cash flow from operations forecast for 2015. That is a very low multiple for any decent upstream company.

I have updated all of the other small-cap forecast models on the website since they reported first quarter results. All of them are tracking close to my forecast models. Triangle Petroleum (TPLM) is on a fiscal year that ends in January, so they will not report results for their quarter that ended April 30th until June 8th.

In June we will publish updated profiles on all of the companies in the Small-Cap Growth Portfolio.

## High Yield Income Portfolio

Our Income Portfolio is focused on finding energy sector stocks and MLP units that offer high yield with a reasonable level of risk.

Several members have expressed their concerns to me via e-mail and on the EPG Forum that Memorial Production Partners LP (MEMP) may have to cut their cash distributions to unitholders in order to preserve capital. Based on my forecast model, they will not be forced to cut distributions, but that does not mean they won’t. They do have a high percentage of their production hedged at good prices (see table at bottom of my forecast model) and they have more than enough cash flow from operations and liquidity to fund their capital program. In fact, I expect them to make at least one accretive acquisition later this year.

Plains All American Pipeline LP (PAA) dipped about $3/unit last week when one of their California pipelines leaked about 2,500 barrels of crude oil onto a local beach. Dozens of articles appeared on the web about the incident, which made the spill sound worse than it really is. Plains has clean-up crews on-site and the beach should be back to normal in a few weeks. “Stuff” happens in the energy sector, but this one does not look like a significant issue for PAA.

Emerge Energy Services LP (EMES) was upgraded to a BUY by Goldman Sach last week and Robert W. Baird also upgraded it from Underperform to Neutral. In my opinion, EMES and Hi-Crush Partners LP (HCLP) are now both over-sold. The upstream companies are using more and more

<table>
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<tr>
<th>Company Name</th>
<th>Primary Product</th>
<th>Stock Symbol</th>
<th>Share Price</th>
<th>Estimated Annual Yield</th>
<th>Annual Dividend</th>
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<td>CPE-PA</td>
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<td>EPM-PA</td>
<td>$26.80</td>
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<td>GASTAR EXPLORATION - Pfd Series A</td>
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<td>GASTAR EXPLORATION - Pfd Series B</td>
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<td>$5.76</td>
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<td>LINN ENERGY (Upstream)</td>
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<td>LINE</td>
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<td>MEMORIAL PRODUCTION PARTNERS</td>
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<td>VANGUARD NAT RES (Upstream)</td>
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<td>VNR</td>
<td>$16.60</td>
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<td>EMERGE ENERGY SERVICES LP</td>
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<td>HI CRUSH PARTNERS LP</td>
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<td>PLAINS ALL AMERICAN PIPELINE</td>
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<td>SOUTHCROSS ENERGY PARTNERS</td>
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<td>SXE</td>
<td>$14.47</td>
<td>11.1%</td>
<td>$1.60</td>
</tr>
</tbody>
</table>
sand to complete high-rate horizontal wells. These two high quality frac sand companies will not only survive the dip in the oil price cycle; they will come out with more market share.

Midstream MLPs have much lower exposure to commodity prices than the upstream companies. On May 7th, Southcross Energy Partners, LP (SXE), the smallest midstream MLP in the portfolio, completed the acquisition of gathering, treating, compression, and transportation assets from Southcross Holdings, LP (Holdings). The acquired assets consist of the Valley Wells sour gas gathering and treating system, compression assets that are part of the Valley Wells and Lancaster gathering and treating systems and NGL pipelines. Total consideration for the assets consists of 4.5 million new common units issued to Holdings and $15 million in cash, equating to total consideration of approximately $78 million. Southcross expects to spend approximately $26 million in remaining capital expenditures towards the completion of the NGL pipelines. Once the NGL pipelines are placed into service, which is anticipated in July 2015, the assets are expected to generate annualized EBITDA of approximately $18 million through largely fixed fee contract arrangements.

SXE reported EBITDA of $17.0 million in the first quarter of 2015, so you can see how significant this transaction is for the company. We will publish an updated profile on this small-cap midstream company in June.

New Profiles

The following reports were posted to the website since our last newsletter:

- Updated Net Income and Cash Flow Forecasts for several of our Sweet 16 and other portfolio companies
- A table of our Fair Value estimates for each Sweet 16 company compared to First Call’s 12-month price targets

Company Profiles

- Baytex Energy (BTE)
- Bonanza Creek (BCEI)
- Cimarex Energy (XEC)
- Continental Resources (CLR)
- Diamondback Energy (FANG)
- EOG Resources (EOG)
- Matador Resources (MTDR)
- Newfield Exploration (NFX)
- Sanchez Energy (SN)
- SM Energy (SM)
- Whiting Petroleum (WLL)

Final Thoughts

Susan and I will be celebrating our 40th wedding anniversary on May 30th. All I can say is that “time flies when you are having fun”. We’ve had a great life together and raised two sons that are both married to wonderful girls. They are both self-supporting, which I consider a major accomplishment these days. We have two beautiful blond granddaughters who live in Iceland. We don’t see the kids as much as we’d like, but the wonders of Skype make on-line visits fun. The fact that Skype is free still amazes me.

Making money is great, but I think how you spend it is more important. We love travelling and the annual EPG Cruise is a highlight for us. If you are a new member and need some information on the next week long EPG Cruise that departs from Ft. Lauderdale, Florida on January 31, 2016 just send Susan a note at sportysmom@aol.com and she will get the details to you. As of today we have 48 people signed up for the next cruise.

Last week I had the pleasure of being on Jim Puplava’s Financial Sense News hour show as part of an Energy Roundtable with Jim, Robert Rapier
We live in a great country and we have a lot of people to thank for our freedom. Just think where this world would be without America.

Our goal is not to tell you what to invest in, but to give you a lot of good choices. Not all of the stocks we discuss in this newsletter or on the website are going to go up, but the majority of them have since 2001 when I launched EPG. If you stay focused on owning companies that have strong fundamentals and growth locked in, I believe you will have an edge in the market.

Thank you for your support.

Keep an eye on the macro-environment, but look closely at the details before you invest in anything and good luck!

Dan Steffens, President
Energy Prospectus Group