

Executive Summary - Q4/11 Quarterly Preview; “Oil Aboard!”

Unless otherwise denoted, all figures in C\$
We are utilizing a US\$0.95 exchange rate

Compelling Valuations:

Oilfield service valuations, currently trading at 4.0x our 2012 estimates, are near historical lows. Given our outlook for continued strength in the industry, as well as pricing gains consistent with cost inflation, we believe valuations are compelling, particularly for the pressure pumpers, which are trading at 3.1x our 2012 estimates.

Activity Level Forecast:

We have slightly reduced our well count forecast for 2012 to 13,000 from 13,250; however, we are expecting utilization rates similar to 2011 (which were the highest recorded since 2006). As the shift to horizontal drilling takes hold, the time taken to drill a well has risen, leading to increased operating days and utilization (despite the well count decline).

Drilling And Completion Spending:

E&P budgets are expected to rise only slightly in 2012; however, we expect a greater proportion of these budgets will be directed toward drilling and completion (D&C) services. The shift to horizontal drilling has had a profound effect, with average cost per well nearly doubling since 2005.

Recommendations:

Our top ideas for the sector based on current valuations and growth potential are Calfrac Well Services (CFW-TSX), ♦Canyon Services Group (FRC-TSX) and Trican Well Service (TCW-T) in the pressure pumping space and ♦Western Energy Services (WRG-TSX) in the drilling space.

For more information, please see our full report entitled ‘Q4/11 Quarterly Preview; “Oil Aboard!”’, dated January 26, 2012.

♦During the past twenty-four months, Cormark Securities Inc., either on its own or as a syndicate member, participated in the underwriting of securities and/or provided financial advice regarding the stock market insight and analysis regarding potential transactions for these companies.

Revised Recommendations And Target Prices: As we enter the new year with a relatively strong finish to 2011, we expect the momentum which has built up will continue, resulting in Q1/12 activity, which has not been experienced since 2006. Looking ahead, into the post spring break-up period, we remain a little more cautious, as weak natural gas pricing continues; however, we expect strength in oil prices will continue to support drilling activity.

With this report, we are providing an update on Q4/11 activity in the oilfield service sector, and revising our estimates for the period accordingly, as well as updating our forecast going forward.

The well count during the quarter came in below our expectations; however, operating days, which we believe is a better indicator of oilfield activity, came in slightly ahead of our forecast. The better than expected operating days, coupled with a reduction in the industry drilling rig fleet led to slightly better than expected utilization rates during the quarter.

Looking ahead, we are expecting similar utilization levels in 2012 for Western Canada, given the strength in demand from oil and liquids rich targets. On the pricing front, we do expect slight pricing gains in both the drilling and pressure pumping industries; however, we believe the gains will most likely only offset cost inflation, mostly labour. Below we highlight our revised targets.

Figure 1: Recommendation And Target Prices

Company	Symbol	Recent Price	New		Previous	
			Rating	Tgt. Price	Rating	Tgt. Price
♦ Badger	BAD-T	\$22.64	Mkt Pfm	\$23.00	Mkt Pfm	\$23.00
♦ Black Diamond	BDI-T	\$19.47	Buy	\$21.00	Buy	\$21.00
Calfrac	CFW-T	\$27.06	Top Pick	\$47.00	Top Pick	\$47.00
♦ Calmena Energy	CEZ-T	\$0.24	Buy	\$0.50 ↓	Buy	\$0.60
♦ Canadian Energy	CEU-T	\$10.97	Buy ↑	\$14.00	Mkt Pfm	\$14.00
♦ Canyon Energy	FRC-T	\$11.55	Top Pick	\$19.00	Top Pick	\$19.00
Cathedral	CET-T	\$7.07	Mkt Pfm	\$8.50	Mkt Pfm	\$8.50
Ensign	ESI-T	\$15.70	Mkt Pfm ↓	\$19.50	Buy	\$19.50
Essential	ESN-T	\$2.03	Buy	\$3.50	Buy	\$3.50
♦ GasFrac	GFS-T	\$6.85	-----Restricted-----			
Horizon	HNL-T	\$5.00	Buy	\$7.00	Buy	\$7.00
IROC	ISC-V	\$2.40	Buy	\$3.25	Buy	\$3.25
PHX Energy	PHX-T	\$10.10	Mkt Pfm	\$12.50	Mkt Pfm	\$12.50
♦ Poseidon	PSN-T	\$15.53	-----Restricted-----			
Precision	PD-T	\$10.22	Buy	\$16.50	Buy	\$16.50
Pure	PSV-T	\$8.14	Buy	\$12.00 ↑	Buy	\$11.50
♦ RMS Systems	RMS-V	\$0.45	Buy	\$1.25 ↓	Buy	\$1.50
Savanna	SVY-T	\$7.19	Mkt Pfm	\$10.00	Mkt Pfm	\$10.00
♦ Stikine	SKY-V	\$0.11	Buy (S)	\$0.60	Buy (S)	\$0.60
♦ Total	TOT-T	\$16.64	Buy	\$23.00	Buy	\$23.00
Trican	TCW-T	\$16.64	Top Pick ↑	\$28.50	Buy	\$28.50
Trinidad	TDG-T	\$6.45	Buy	\$11.00	Buy	\$11.00
♦ Western Energy	WRG-T	\$8.83	Top Pick	\$13.00	Top Pick	\$13.00
♦ Xtreme Coil	XDC-T	\$3.22	Mkt Pfm ↓	\$5.00	Buy	\$5.00

Sources: Cormark Securities Inc., Thomson One

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Our disclosure statements are located at the end of this report

Activity Assumptions: Activity in Western Canada continued to be fuelled by oil and liquids rich directed drilling. While well count of 3,723 in the quarter came in below our forecast of 4,090, operating days (which we believe to be a better indicator of activity) were slightly ahead of our forecast, as an increase in average drilling time per well was driven by the shift to horizontal drilling. Given the slightly higher than forecast operating days, coupled with a net decline in the overall rig fleet, industry utilization reached 59.2% during the quarter, a level not seen since 2006.

Looking forward into 2012, we are leaving our forecast for operating days relatively unchanged, while reducing our well count outlook to 13,000 from 13,250. The reduction is premised more so on our estimates for increased average drilling time per well. We believe that momentum which has been building to date will continue through the winter drilling season; however, we remain a little more cautious regarding the back half of the year as we believe demand may peak in Q1/12. Overall, we are forecasting 2012 utilization rates similar to 2011.

In the US, the active rig count in the quarter averaged 1,972, ahead of our 1,952 estimate driving better than expected operating days in the quarter. We are raising our average active rig expectations for 2012 to 1,900 from 1,850 given the current strength in the industry (which is averaging 1,955 to begin the year). Similar to Canada, we expect the momentum which has been building to date will continue into the first half of the year; however, moderating somewhat in H2/12. On the well count, historical revisions have reduced the well count; however, offset by an increase in well depth in drilling time. The net effect is an increase in operating days.

Figure 2: Activity Forecast

Canada	2007A	2008A	2009A	2010A	2011E			2012E		
					New	Old	Change	New	Old	Change
Well Count	18,444	16,898	8,393	12,098	12,879	13,250	(371)	13,000	13,250	(250)
Operating Days	121,948	136,290	76,398	125,478	153,852	153,675	177	156,694	156,556	138
Average Fleet Size	865	855	851	809	808	810	(1.3)	816	821	(5)
Industry Utilization	39%	44%	25%	42%	52%	52%	14 bp	52%	52%	36 bp
Producer's Cash Flow (\$BB)	\$39.8	\$53.9	\$24.8	\$29.3	\$34.7	\$33.0	\$1.7	\$34.9	\$33.3	\$1.6
Drilling Expenditures (\$BB)	\$14.0	\$15.1	\$6.8	\$11.8	\$13.5	\$13.9	-\$0.4	\$14.3	\$13.9	\$0.4
% of Producer's Cash Flow	35%	28%	27%	40%	39%	42%	-319 bp	41%	42%	-81 bp
US	2007A	2008A	2009A	2010A	2011E			2012E		
Well Count	52,218	57,756	36,182	44,805	45,954	57,234	(11,280)	50,567	64,166	(13,599)
Operating Days	618,675	662,110	381,193	550,742	672,701	669,931	2,770	695,300	676,950	18,350
Active Rigs	1,695	1,814	1,045	1,508	1,842	1,835	8	1,900	1,850	50
Commodity Assumptions										
Exchange Rate (C\$/US\$)	\$0.94	\$0.95	\$0.88	0.9708	\$1.01	\$1.00	\$0.01	\$0.95	\$0.95	\$0.00
WTI (US\$/Bbl)	\$72.38	\$99.52	\$61.89	\$79.50	\$95.04	\$90.25	\$4.79	\$95.00	\$88.00	\$7.00
Edmonton Par (C\$/Bbl)	\$77.89	\$103.05	\$66.18	\$78.05	\$94.94	\$90.08	\$4.86	\$98.00	\$90.63	\$7.37
Natural Gas (HH US\$/Mcf)	\$6.98	\$8.85	\$4.01	\$4.37	\$3.99	\$4.10	\$(0.11)	\$3.50	\$4.50	\$(1.00)
Natural Gas (AECO C\$/Mcf)	\$6.34	\$8.22	\$3.94	\$3.97	\$3.68	\$3.79	\$(0.11)	\$3.25	\$4.15	\$(0.90)

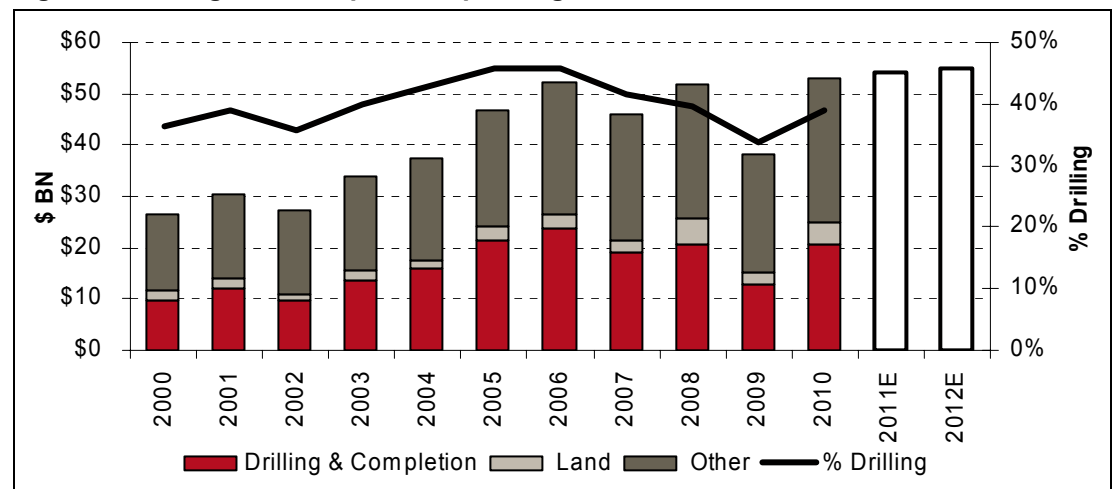
Sources: Cormark Securities Inc., Bloomberg, CAODC and Nickle's

Drilling & Completion Spending – Where Will The Money Come From? Total capital spending by E&P operators is forecast by the Canadian Association of Petroleum Producers (CAPP) to rise in 2012 to \$55 BN, marking only a 2% increase over the estimated 2011 spending. For oilfield service companies within our coverage universe, we are forecasting a 22% rise in revenue, leading to the question – Where Will The Money Come From?

As can be seen in the following exhibit, the percentage of exploration and development (E&D) costs, which are spent on drilling and completion does vary over time (historically ranging from 35% to 46%).

We expect that even if total E&D spending rises only slightly in 2012, (as forecast by CAPP) a greater proportion will be allocated to D&C and less to other areas (for instance we certainly do not expect the same level of expenditures on land in 2012 as was seen from the record levels in 2011). We estimate that every 1% change in spending allocated to D&C represents approximately \$500 MM in spending or more specifically a 4% change in D&C spending. **This supports our forecast for relatively flat producer's cash flow Y/Y (\$34.7 BN in 2011 and \$34.9 BN in 2012), but a 6% increase in expenditures on D&C (\$13.5 BN in 2011 and \$14.3 BN in 2012).**

Figure 3: Drilling And Completion Spending Versus Total E&D Costs



Sources: Cormark Securities Inc., CAPP

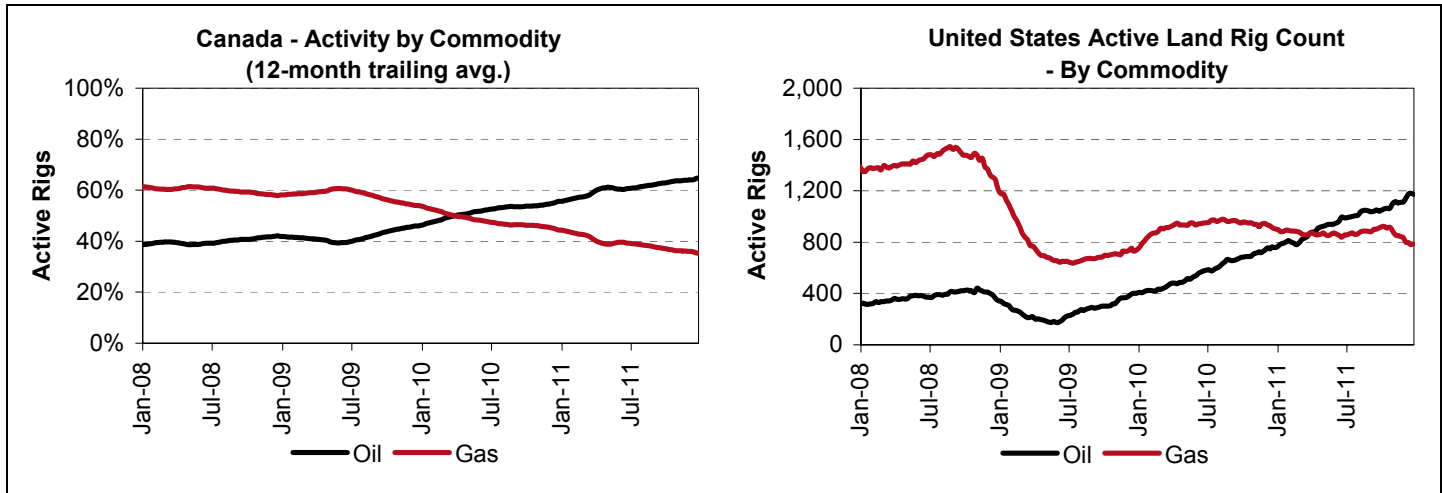
Oil And Liquids To Remain Target For Producers In 2012: The trend toward drilling for oil targets continued in Canada through Q4/11, with average active rigs targeting oil rising 33% Y/Y, while rigs targeting gas were flat. When we compare the full-year 2011 to full-year 2010, the dichotomy was a little more dramatic, with oil directed rigs rising 41% compared to a 6% decline for natural gas directed rigs.

In the US, the results were fairly similar to Canada, with oil directed rigs in the quarter rising 18% compared to a 9% decline for gas, while on an annual average, oil directed rigs rose 22% in 2011 compared to gas directed rigs which declined 6%.

We believe that with continued strength in oil pricing, we will continue to see drilling activity focus on oil as well as liquids rich targets. In regard to natural gas activity, we expect that the anticipation of the proposed west coast LNG terminal could generate interest over the long term, while near term, natural gas activity could continue to be challenged by commodity pricing.



Figure 4: Oil Directed Drilling



Sources: Cormark Securities Inc., Nickle's, Baker Hughes

With natural gas prices languishing in the sub \$3.00 level, there has been concern regarding a reduction in natural gas drilling and a resulting decline in rig utilization rates. In Figure 5, we examine how our forecasts would differ given a change in commodity pricing for both crude oil and natural gas.

Our high case employs a crude oil price of \$100/bbl, with natural gas pricing of \$2.87/Mcf. Assuming these commodity prices, our estimates for well count and operating days would decline only marginally, as we expect the uptick in oil and liquids rich drilling would mostly offset a decline in natural gas drilling.

Our low case, using a \$95/bbl crude price and \$2.50/Mcf gas price, also shows only a marginal decline, as we believe the strength in crude pricing will continue to generate rig demand, offsetting weakness in natural gas directed drilling.

Figure 5: Drilling Statistics

	2009	2010	2011E	2012E	High Case 2012E	Low Case 2012E
Average Prices						
Crude (WTI \$US/bbl)	\$61.89	\$79.50	\$95.04	\$95.00	\$100.00	\$95.00
Crude (\$C/bbl @ wellhead)	\$66.18	\$78.05	\$94.94	\$98.00	\$94.04	\$96.00
NGLs (\$C/bbl)	\$56.25	\$66.34	\$80.70	\$83.30	\$84.64	\$86.40
Natural Gas (\$C/Mcf)	\$3.94	\$3.97	\$3.68	\$3.25	\$2.87	\$2.50
Average Fleet Size						
Average Working	851	809	808	816	816	816
Utilization	209	344	422	428	423	418
	25%	42%	52%	52%	52%	51%
Wells Rig Released						
Recorded Operating Days	8,393	12,098	12,879	13,000	12,819	12,668
Days / Well	76,398	125,478	153,852	156,694	154,507	152,694
	9.1	10.4	11.9	12.1	12.1	12.1
Producer's CF (\$MM)						
	24,800	29,300	34,700	34,900	34,100	33,700

Sources: Cormark Securities Inc., Company Reports

Conclusion: Valuations for oilfield service companies within our coverage universe are approaching historical lows, trading on average at 4.0x our 2012 estimates. Looking a little deeper, we see particular value in the pressure pumping space. Given our expectations for fracturing demand to remain strong in both Canada and the US through 2012, we believe the pressure pumpers, trading at an average of 3.1x our 2012 estimates, represent particular value.

We expect activity in Canada to be on par with the activity we saw in 2011, which marked the highest since 2006. With the current active rig count of 665 surpassing that of last year, we are forecasting a strong winter drilling season in Canada. In the US, the active land rig count of 1,963 has also surpassed that of last year, which bodes well for near-term activity. Looking a little further into the year, we are a little more cautious, as the momentum which has built to date could begin to moderate. We are expecting slight pricing gains; however, likely just enough to cover cost inflation.

Capital expenditures by E&P operators are expected to rise only slightly in 2012; however, we expect a growing proportion will be used to fund drilling and completion expenses. The shift to horizontal drilling as well as increased fracturing intensity per well has led to a near doubling of the overall average well costs since 2005. However, given the increased production (and cash flow) generated from a horizontal well compared to a vertical well, we expect the technology will continue to be used, despite the increased cost.

As highlighted earlier the pressure pumpers are trading at 3.1x our 2012 EBITDA estimates and with planned capacity addition and our expectations for continued high utilization rates, we are expecting continued improvement in Y/Y financial results. We would highlight Canyon and Calfrac as two pressure pumpers in which we see particular value.

Among the drillers, we believe contractors with fleets oriented toward the deeper capacities will continue to benefit from the shift to horizontal drilling and the ensuing deeper wells. We would highlight Precision, Western, Trinidad and Total, as those with deeper capacity fleets.

Our Top Picks in the sector include Calfrac (CFW-T), Canyon (FRC-T), Trican (TCW-T) and Western (WRG-T).

We, Jeff Mochoruk and Stephen Kammermayer, hereby certify that the views expressed in this research report accurately reflect our personal views about the subject company(ies) and its (their) securities. We also certify that we have not been, and will not be receiving direct or indirect compensation in exchange for expressing the specific recommendation(s) in this report.

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Market Perform	expected to perform with its peer group
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