

STIKINE ENERGY CORP.

SKY-TSXV: C\$0.33

OUTPERFORM

Target Price: \$0.75

A Frac-ing Good Buy — Initiating Coverage

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Stikine Energy Corp. (SKY-TSXV, \$0.33)

Outperform, Target: \$0.75 — Initiating Coverage

SKY-TSXV	\$0.33
Rating	Outperform
Risk	Speculative
Target Price	\$0.75
Projected Total Return	127.3%

What's Changed?	Prior	New
Rating		OUTPERFORM
Target Price	-	\$0.75
NAV	-	\$0.75

Market Data	
52-Week Trading Range	\$0.18-\$0.58
Shares Outstanding, Basic (mm)	87.8
Shares Outstanding, FD (mm)	90.0
Market Capitalization (mm)	\$29.0
Net debt (mm)	-\$5.5
Enterprise value (mm)	\$23.5

Forecasts			
FYE: February	2011E	2012E	2013E
Financial Aggregates (mm)			
Revenue	\$0.0	\$0.0	\$0.0
EBITDA	(\$0.4)	(\$0.5)	(\$0.5)
Net income	(\$0.4)	(\$0.5)	(\$5.8)
Per Share (\$)			
EPS	(\$0.01)	(\$0.00)	(\$0.02)
CFPS	(\$0.00)	(\$0.00)	(\$0.02)
NAVPS		\$0.75	

Current Valuation	
P/NAV	0.44x

Target Valuation
 1.0 times our NAV of \$0.75/sh
Source: Capital IQ, company reports, Stonecap Securities Inc.

A Frac-ing Good Buy; Initiating Coverage

- We are initiating coverage on Stikine Energy (Stikine) with an Outperform recommendation and \$0.75 target price. Our target price is based on 1.0x our NAV estimate and implies a 127% return from the current price.
- Stikine is currently focused on the exploration and development of the Nonda and Angus frac sand projects in northeast British Columbia.
- Stikine is targeting two principal markets for its frac sand: the Horn River Basin and the Montney Basin, both of which are over-pressured shale formations and ideal candidates for fracturing.
- Both projects are located within 200km of their respective target basins and due to this distinct transportation advantage, we expect Stikine to be amongst the lowest cost suppliers of frac sand.
- The Nonda and Angus projects have extremely large resource potential and could produce sufficient amounts of frac sand to supply the entire life-cycle of each basin.

Valuation

Our net asset value estimate for Stikine is \$0.75 per share. Our mine net present values assume a conservative long-term frac sand price of \$250/tonne and a 15% discount rate. Our target price is based on 1.0x our NAV and has significant leverage to the frac sand price. A 10% increase to our frac sand estimate results in a 40% increase in our NAV.

Conclusion

As upwards of 80% of the current delivered cost of frac sand to Horn River and Montney results from shipping and handling, Stikine could be the low-cost supplier to each of the target basins. We believe that positive results from process optimization and the upcoming PEA/scoping study for Nonda/Angus (expected summer 2011) will be the primary catalysts for upward revisions to our NAV and target price. We initiate coverage with an Outperform recommendation and \$0.75 target price.

Please see disclosures at the end of this document.

Executive Summary

We are initiating coverage on Stikine Energy with an Outperform recommendation and \$0.75 target price. Our target price is based on 1.0x our NAV estimate and implies a 127% return from the current price.

Our recommendation is based on positive fundamentals in the Horn River Basin and Montney Basin, along with the competitive advantage offered by the mines' locations.

Positive fundamentals in the Horn River and Montney Basins

Stikine is targeting two principal markets for its frac sand: the Horn River Basin (HRB) and the Montney Basin, both of which are over-pressured shale formations and ideal candidates for hydraulic fracturing.

The HRB is thought to be one of Canada's largest sources of shale gas. The basin encompasses an area of approximately 1.1 million hectares and contains over 500 trillion cubic feet of natural gas (third largest in North America), according to the BC Oil and Gas Commission and Encana Corp. (ECA-TSX; not rated). The Montney Basin is a large formation of siltstone and shale in the Western Canadian Sedimentary Basin. According to BC's Ministry of Energy, Mines, and Petroleum Resources, estimates of natural gas in the Montney range from 80 to 700 trillion cubic feet of gas in place. From 2005 to 2009, production of natural gas from horizontal shale gas wells drilled in the Montney rose from zero to 376 million cubic feet per day and is expected to continue rising.

According to the BC Oil and Gas Commission, the number of well approvals targeting shale has increased to 140 in 2009/10 from 3 in 2005/06 in the HRB and in the Montney, more than 390 wells were drilled in 2010, up from 30 in 2005. In Q1/2011 alone, 213 wells were approved in the Montney Basin. Based on data from drillers in the area, we estimate that each well drilled in the HRB requires an average of 12 to 24 fracturing stages, using approximately 200-300 tonnes of frac sand per stage. In the Montney Basin, we estimate that each well requires an average of 8 to 14 fracturing stages, using approximately 100-200 tonnes of frac sand per stage. We expect that for every 100 wells drilled in the HRB, 450,000 tonnes of frac sand is required and for every 100 wells drilled in the Montney, 165,000 tonnes of frac sand is required. **Both of Stikine's projects have the potential to host extremely large resources and could produce sufficient amounts of frac sand to supply the entire life cycle of each basin.**

Figure 1: Frac sand demand outlook

Basin	Frac Stages per Well	Frac Sand per Stage	Frac Sand Required Per 100 Wells
Horn River	12-24	200t-300t	450,000t
Montney	8-14	100t-200t	165,000t

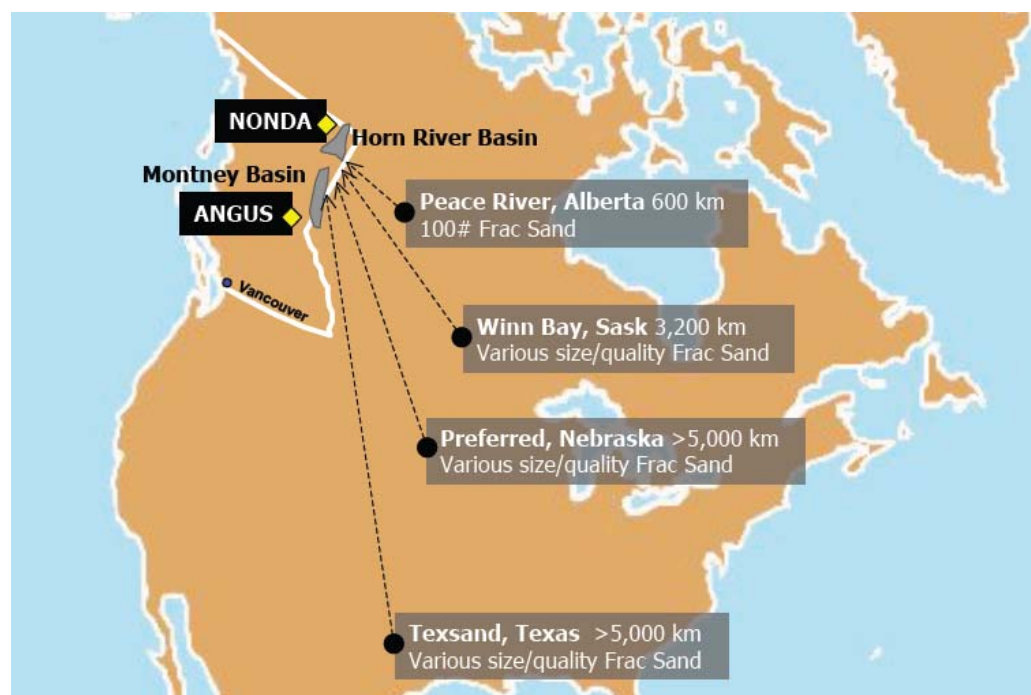
Source: Trican Well Service Ltd., CalFrac Well Services, Stonecap Securities Inc.

Mine proximities yield massive competitive advantage

In the U.S., the largest suppliers of frac sand are principally concentrated in Illinois, Wisconsin, and Texas. In Canada, there are currently two competing suppliers of frac sand located in Peace River, Alberta and Hanson Lake, Saskatchewan, respectively.

While frac sand is not in short supply in the U.S., the nearest supplier (Preferred Sands) is over 5,000km by rail from northeast British Columbia. In Canada, Canadian Silica is currently the closest supplier of frac sand to the basins, but is still located 600km away and has the capacity to produce only 500,000 tonnes per year.

Figure 2: Mine locations



Source: Company reports

Both of Stikine’s projects are located within 200km of their respective target basins and as such, the company should benefit from a distinct transportation advantage. **As upwards of 80% of the current delivered cost of frac sand results from shipping and handling, Stikine would likely be the low-cost supplier to each of the basins.**

Valuation

Our net asset value (NAV) estimate for Stikine is C\$0.75 per share (Figure 3). Our mine net present values (NPVs) assume a long-term frac sand price of \$250/tonne and a 15% discount rate (see details below). We include the in-the-money warrants and options and the net cash and working capital amounts are proforma to account for the December 2010 equity raise. We estimate 428 million shares outstanding once fully financed, based on a 50/50% debt/equity split.

Figure 3: Stikine net asset value

		C\$ million	% of NAV
Nonda (100%), British Columbia	NPV at 15%	\$133.4	43.0%
Angus (100%), British Columbia	NPV at 15%	\$165.6	53.3%
Cash	Proforma	\$5.5	1.8%
Non-cash working capital	as at Nov 30, 2010	\$0.1	0.0%
Long term debt	as at Nov 30, 2010	\$0.0	0.0%
ITM option/warrant proceeds	in-the-money at C\$0.25 - C\$0.50	\$5.9	1.9%
Total NAV		\$310.6	
Shares o/s (millions)	Proforma	87.8	
Fully financed shares (millions)	50/50 debt/equity	427.6	
Total NAVPS (\$)		\$0.75	

Source: Stonecap Securities Inc.

Our 15% discount rate is higher than the 12% we traditionally use for early stage mining projects. This is a result of the current frac sand demand in the HRB and Montney being lower than our production forecast at Nonda and Angus. Our discount rate will decline going forward, as fracing activity in the target basins increases.

Nonda and Angus

Our valuations for Nonda and Angus assume mine lives of 25 years based on the lifecycle of the basins, however we expect the resource at each site could support a much longer operation. We estimate that each mine operates at 5,000 tonnes/day with 50% yields, producing close to 900,000 tonnes of frac sand each year. We assume that mining, processing and transportation costs at each operation are \$135/tonne, slightly above the company's guidance of \$105-\$125/tonne. We expect capital expenditures at Nonda (\$300 million) to be higher than Angus (\$175 million) due to additional infrastructure requirements (power, road upgrades, etc.). Detailed modeling assumptions are provided in Figure 4 below.

Figure 4: Modeling assumptions

	Nonda	Angus
Mine Life	25 years	25 years
Frac Sand Price	\$250/mt	\$250/mt
Mining Rate	5,000 tpd	5,000 tpd
Mining Cost	\$20.00/mt	\$20.00/mt
Processing Cost	\$30.00/mt	\$30.00/mt
G&A Cost	\$10.00/mt	\$10.00/mt
Transportation Cost	\$75.00/mt	\$75.00/mt
Depreciation	\$10.00/mt	\$10.00/mt
Debt/Equity Split	50%/50%	50%/50%
Income Taxes	30%	30%
Capital Expenditures	\$300.0mm	\$175.0mm

Source: Stonecap Securities Inc.

Our 12-month target price for Stikine is \$0.75 per share, based on 1.0 times our NAVPS. While this target provides an attractive potential rate of return of 127% to the current share price, we believe that positive results from process optimization and the upcoming preliminary economic assessment (PEA)/scoping study for Nonda/Angus (expected summer 2011) will be the primary catalysts for upward revisions to our NAV and target price.

The Stikine NAV has significant leverage to the frac sand price, as illustrated in Figure 5. We believe that our \$250/tonne estimate is very conservative, based on an estimated current delivered cost of sand to the basins ranging from \$225-325/tonne. **A 10% increase to our \$250/tonne estimate results in a 40% increase in our NAV.**

Figure 5: NAV sensitivity

		Long Term Frac Sand Price (\$/mt)								
		150	175	200	225	250	275	300	325	350
Discount Rate	7.5%	-0.60	0.05	0.75	1.40	2.10	2.75	3.40	4.10	4.75
	10.0%	-0.60	-0.10	0.45	0.95	1.45	2.00	2.50	3.00	3.50
	12.5%	-0.60	-0.20	0.20	0.65	1.05	1.45	1.85	2.25	2.65
	15.0%	-0.55	-0.25	0.10	0.40	0.75	1.05	1.35	1.70	2.00
	17.5%	-0.55	-0.30	0.00	0.25	0.50	0.75	1.05	1.30	1.55
	20.0%	-0.50	-0.30	-0.10	0.15	0.35	0.55	0.80	1.00	1.20

Source: Stonecap Securities Inc.

Company Overview

Stikine Energy Corp. was incorporated on July 10, 2000, as Withit Capital Corp., changed its name to Stikine Gold Corporation on June 18, 2002, and changed its name to Stikine Energy Corp. on August 3, 2010. The company is engaged in the acquisition, exploration and development of resource properties in Canada. Stikine is currently focused on the development of the Nonda and Angus frac sand projects. The company's objective is to become a leading low-cost supplier of high-quality frac sand to the HRB and Montney Basin in Western Canada. Stikine owns a 100% interest in both the Nonda and Angus quartz-pure sandstone projects, which the company staked in 2009.

Stikine has completed two equity raises in the last year. In December 2010, the company completed its most recent private placement, raising \$5.9 million through the sale of 19.5 million units at a price of \$0.30. Each unit consisted of one common share of Stikine and one-half of one common share purchase warrant. Each warrant entitles the holder thereof to acquire one common share of the company at an exercise price of \$0.40 until December 30, 2011, and at an exercise price of \$0.50 until December 30, 2012. The majority of the net proceeds from the private placement are anticipated to be used to define a resource and complete a PEA on the Nonda project, and a scoping study for the Angus project. In June 2010, the company completed a private placement, raising \$3.1 million, consisting of 13.8 million flow-through shares and 1.7 million units at a price of \$0.20. Each unit consisted of one common share of Stikine and one-half of one warrant exercisable at a price of \$0.25 until December 17, 2011.

Figure 6: Capital structure

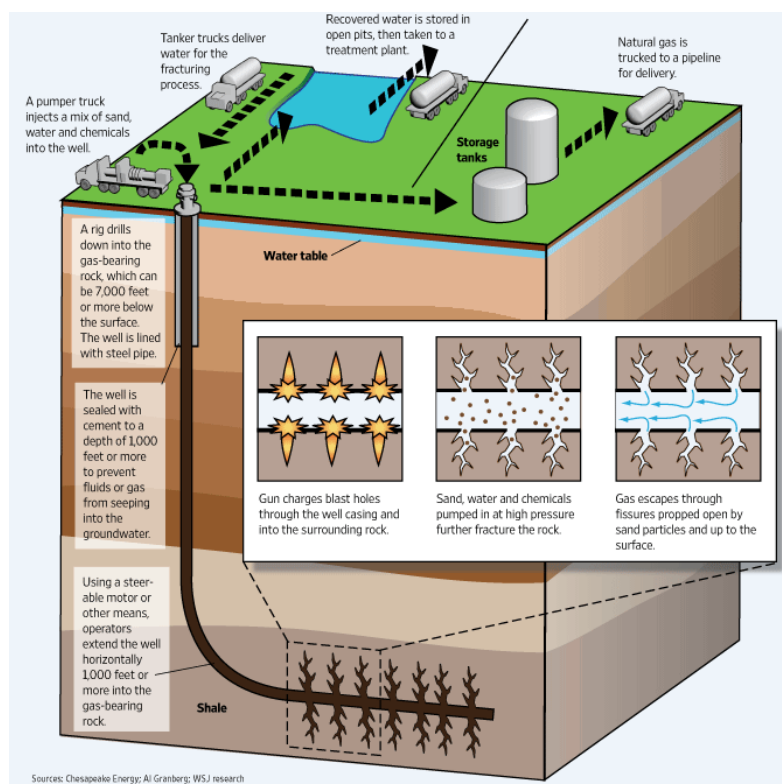
Shares Outstanding	(in mm)
Basic Shares Outstanding - November 30, 2010	68.1
Financing - December 30, 2010	19.6
Options Exercised	0.2
Total Basic Shares Outstanding - Current	87.8
Warrants	13.1
Options	8.5
Total Fully Diluted Shares Outstanding	109.4

Source: Company reports, Stonecap Securities Inc.

Introduction To Hydraulic Fracturing

Hydraulic fracturing is used to improve the permeability of a formation. A specially blended liquid is pumped down a well and into a formation under high pressure which causes the formation to crack, allowing the fracturing fluid to enter and extend the crack further into the formation. In order to keep the fracture open after the injection stops, a solid proppant, such as frac sand, is added to the fracture fluid and carried into the fissure. When the fracturing fluid is removed, the proppant remains behind and keeps the crack open, creating a conduit through which the formation fluids can flow to the well.

Figure 7: Hydraulic fracturing process



Source: Chesapeake Energy, Wall Street Journal

Two factors increase the likelihood that a formation will successfully fracture. One is the presence of hard minerals, such as silica, which break like glass. The second factor is the reservoir's internal pressure, which is generally higher when natural gas is formed in an area of low permeability. An over-pressured reservoir means that the host rock is already under significant stress and is closer to its breaking point than a normally pressured reservoir, making fracturing easier.

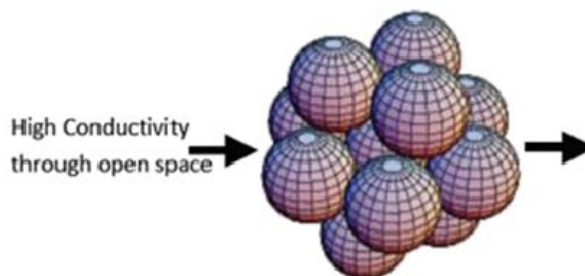
What Is Frac Sand?

Frac sand is generally comprised of washed and graded high-silica quartz sand and is available in a number of sizes, ranging from 100 mesh (0.106mm – 0.212mm) to 20/40 mesh (0.425mm – 0.85mm). In order to be effective, the frac sand must be:

- strong enough to withstand compressive forces;
- chemically inert;
- pumpable through the well head and fractures; and
- permeable to permit oil and gas flow.

In order to maximize permeability, ideal frac sand must have a high degree of both roundness and sphericity, as spheres cannot be tightly packed together (Figure 8). The open spaces allow oil and gas to flow through the fracture, which would not be possible if the frac sand was made up of rectangular prisms.

Figure 8: Ideal frac sand shape



Source: Company reports

Frac Sand Demand In Target Markets Taking Off

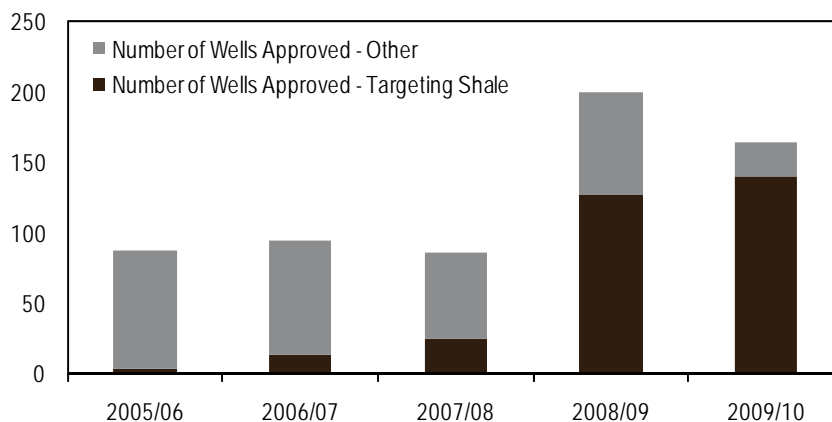
Stikine is targeting two principal markets for its frac sand: the HRB in northeastern British Columbia, and the Montney Basin, which straddles northeastern British Columbia and northwestern Alberta. Both of these basins are over-pressured shale formations, which makes them ideal candidates for fracturing.

Horn River Basin

The HRB is a large formation of siliceous shale in the Western Canadian Sedimentary Basin that is thought to be one of Canada’s largest sources of shale gas. The basin encompasses an area of approximately 1.1 million hectares in northeastern British Columbia, north of Fort Nelson and south of the Northwest Territories border. Both the BC Oil and Gas Commission and Encana have estimated the HRB contains over 500 trillion cubic feet of natural gas, which would make it the third largest formation in North America. Aside from Encana, a selection of major companies involved in the extraction of natural gas from the HRB includes: Apache Corp. (APA-NYSE; not rated), ConocoPhillips (COP-NYSE; not rated), Devon Energy Corp. (DVN-NYSE; not rated), Exxon Mobil Corp. (XOM-NYSE; not rated), Imperial Oil Ltd. (IMO-TSX; not rated), and Suncor Energy Inc. (SU-TSX; not rated).

Shale formations have low permeability, so historically commercial gas production has only occurred from shales with natural fractures. The shale gas boom in recent years has been due to modern technology in hydraulic fracturing, which has enabled the creation of extensive artificial fractures around well bores. The Horn River shales are no exception, with permeability ranging between 100 and 300 nanodarcies, which is approximately one thousand times less permeable than a conventional reservoir with permeability greater than 0.1 millidarcy. Due to high quartz content, the shales are brittle, which increases the probability of successful fracturing. According to the BC Oil and Gas Commission, the number of well approvals targeting shale has increased from three in 2005/06 to 140 in 2009/10 (Figure 9).

Figure 9: HRB well approval statistics



Source: BC Oil and Gas Commission

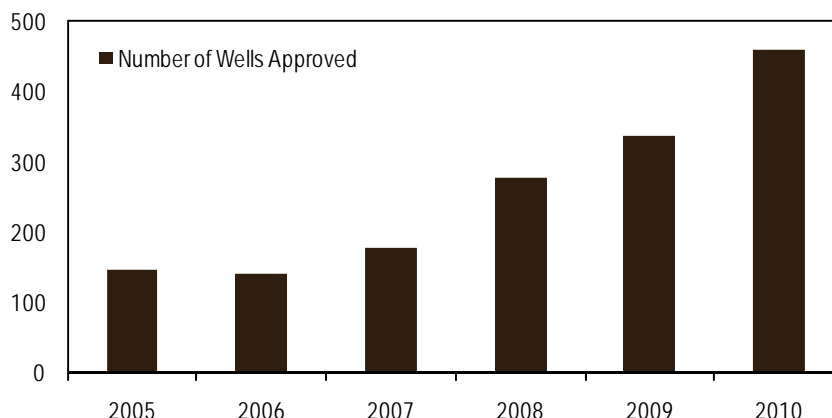
Based on data from drillers in the area such as CalFrac Well Services Ltd. (CFI-TSX; not rated) and Trican Well Service Ltd. (TCW-TSX; not rated), we estimate that each well drilled in the HRB requires an average of 12 to 24 fracturing stages, using approximately 200-300 tonnes of frac sand per stage. Recent stimulation programs in the basin support this view, as Apache averaged 17 fracturing stages over 22 wells in early 2010, while Encana averaged 23 stages over 14 wells later in the year. As a

result, we expect that for every 100 wells drilled in the basin, 450,000 tonnes of frac sand is required.

Montney Basin

The Montney Basin is a large formation of siltstone and shale in the Western Canadian Sedimentary Basin. It is located in the Dawson Creek area south of the HRB and straddles the border of British Columbia and Alberta. According to British Columbia's Ministry of Energy, Mines, and Petroleum Resources, estimates of natural gas in the Montney are highly variable, ranging from 80 to 700 trillion cubic feet of gas in place. From 2005 to 2009, production of natural gas from horizontal shale gas wells drilled in the Montney rose from zero to 376 million cubic feet per day and is expected to continue rising. According to the BC Oil and Gas Commission, more than 450 wells were approved in the Montney Basin in 2010, up from 147 in 2005 (Figure 10). A selection of major companies currently exploring for and/or producing natural gas in the Montney Basin includes: Apache, ARC Resources Ltd. (ARX-TSX; not rated), Encana, Royal Dutch Shell plc (RDS.A-NYSE; not rated), and Talisman Energy Inc. (TLM-TSX; not rated).

Figure 10: Montney Basin well approval statistics



Source: BC Oil and Gas Commission

Based on industry information, we estimate that each well drilled in the Montney Basin requires an average of 8 to 14 fracturing stages, using approximately 100-200 tonnes of frac sand per stage. These views are supported by recent reports from a number of companies working in the area. In 2010, Encana completed a total of 54 wells in the Montney Basin with an average of 13 frac stages per well. During the same year, ARC Resources completed 37 wells in the area, utilizing an average of 10 frac stages per well. As a result, we expect that for every 100 wells drilled in the basin, 165,000 tonnes of frac sand is required.

Location, Location, Location

In the United States there are more than ten suppliers of frac sand principally concentrated in Illinois, Wisconsin, and Texas. According to the U.S. Geological Survey, approximately 6.6 million tonnes of frac sand was produced in the U.S. in 2010. While there is seemingly sufficient supply in the U.S., the problem is that the nearest supplier (Preferred Sands) is 3,200km from northeast British Columbia (Figure 11).

Figure 11: North American frac sand suppliers

Company	Location	Est. Capacity (tonnes/yr)	Products (mesh)	Road Distance to NE BC
Canadian Silica	Alberta	500,000	20/40 and 100	600km
Winn Bay Sand	Saskatchewan	150,000	20/40	2,000km
Preferred Sands	Nebraska	2,500,000	6/9 to 100	3,200km
Badger Mining Company	Wisconsin	1,500,000	12/20 to 70/140	3,500km
U.S. Silica Co	Illinois	1,500,000	20/40 to 40/70	3,700km
Unimin Corp	Arkansas	250,000	40/70	4,100km
Superior Silica Sands	Texas	900,000	20/40 to 100	4,400km

Note: Capacity may include other industrial sands

Source: Company reports, Stonecap Securities Inc.

In Canada, there are currently two competing suppliers of frac sand: Canadian Silica and Winn Bay Sand Limited Partnership.

Canadian Silica operates a silica sand mining operation and processing plant near the town of Peace River, Alberta. It is currently the closest supplier of frac sand to the Horn River and Montney basins, but is still located 600km away. Canadian Silica currently has the capacity to produce 500,000 tonnes per year of 20/40 mesh and 100 mesh frac sand.

Winn Bay Sand Limited Partnership is the second closest supplier to both basins, located approximately 2,000km away in Hanson Lake, Saskatchewan. It is an open-pit mining operation with an annual capacity of 150,000 tonnes per year of 20/40 mesh frac sand and an estimated reserve of only 4.2 million tonnes.

Both of Stikine's projects are located within 200km of their respective target basins and as such, the company should benefit from a distinct transportation advantage.

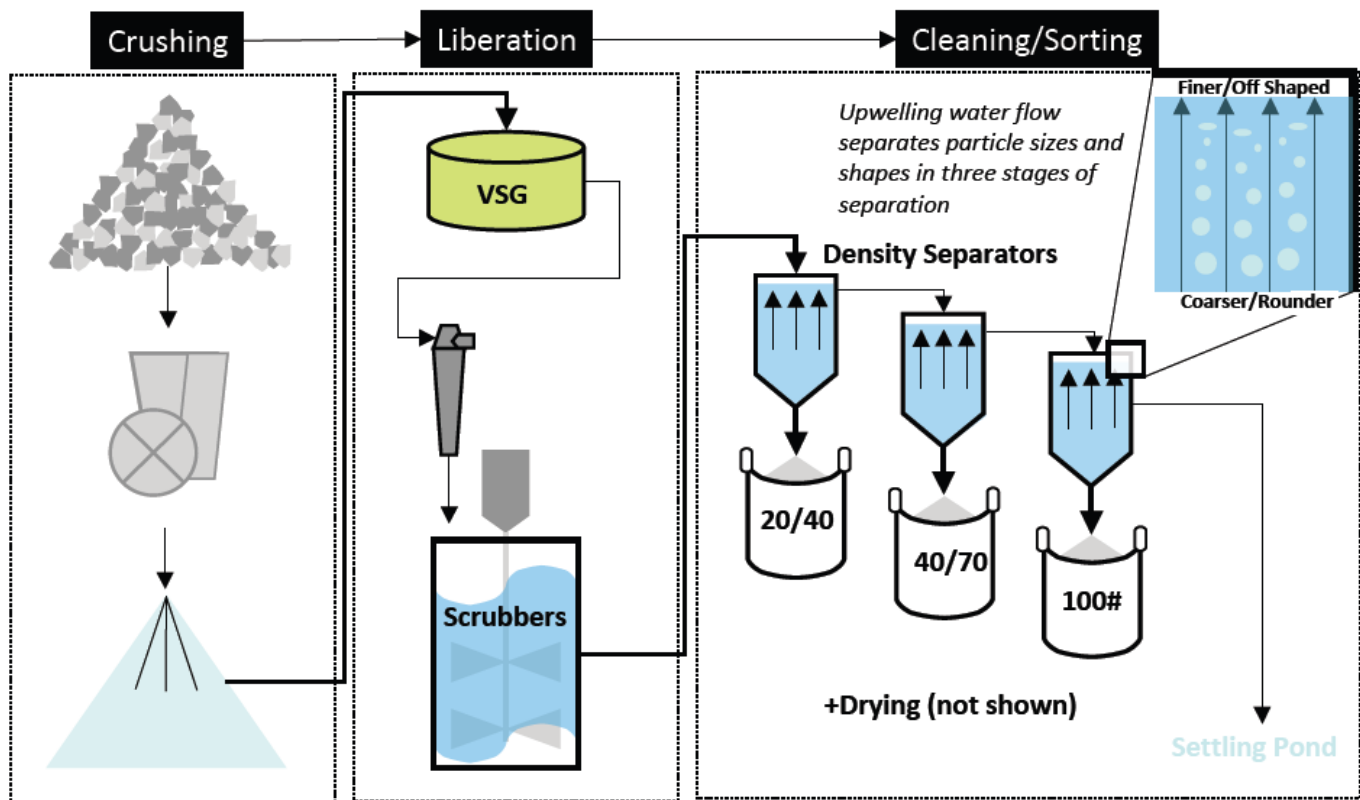
Upwards of 80% of the current delivered cost of frac sand is shipping and handling.

Simple Process Limits Scale-Up Risk

Stikine's process to convert the mined quartz-pure sandstone into frac sand involves liberating the monocrystalline sand grains within the rock. While the process is slightly different from traditional unconsolidated sand deposits, which typically remove clay, feldspars and other impurities from quartz-pure sand grains, many of the steps and required equipment are the same. Stikine's process is very simple, non-proprietary and not unique. The appropriately sized equipment required for full capacity production is readily available and as a result, we believe that scale-up risk is limited from the current 50 tonne/day pilot plant.

At the pilot plant, Stikine is currently conducting process optimization work with Nonda rock and has shipped approximately 500 tonnes of Angus samples to be processed afterwards. The company continues to make progress toward achieving API/ISO standards for proppants and results will be incorporated in the PEA (Nonda) and scoping study (Angus) by Q3/2011. The process flow diagram is shown in Figure 12 and includes three main steps, all described in detail below.

Figure 12: Process diagram



Source: Company reports

Mining

Both the Nonda and Angus deposits are large, at surface, have little to no overburden, and will be mined using conventional open pit mining methods.

Crushing

The first processing step will be to crush the ore and reduce it to a size of one-half inch. The method and equipment that will be used by Stikine for crushing is the same as that used in mining and aggregate operations around the world.

Vertical shaft grinding

In this step, the crushed ore falls into an impeller where it is spun using centrifugal force. The material hits and impacts against itself, which causes attrition and breaks it into its individual grains. After being discharged from the bottom of the machine, screening equipment is used to pass material smaller than one millimetre in diameter to the next step, while larger pieces are sent through the vertical shaft grinder again. Vertical shaft grinders are used in conventional frac sand operations and are readily available in sizes sufficient to support the full capacity assumption.

Attrition scrubbing

The material is then passed into an attrition scrubber, where two Helix propellers on each shaft force particles against each other, resulting in intense attrition and final liberation of grains. The residence time of this step is currently about 30 minutes in the pilot plant and the company is exploring a more optimal scrubber in order to speed up the process and eliminate more off-shaped particles (not spherical). This should reduce the fines content following the API/ISO crush test. Attrition scrubbers are currently used in frac sand operations and can be run in parallel to increase capacity.

Density separating

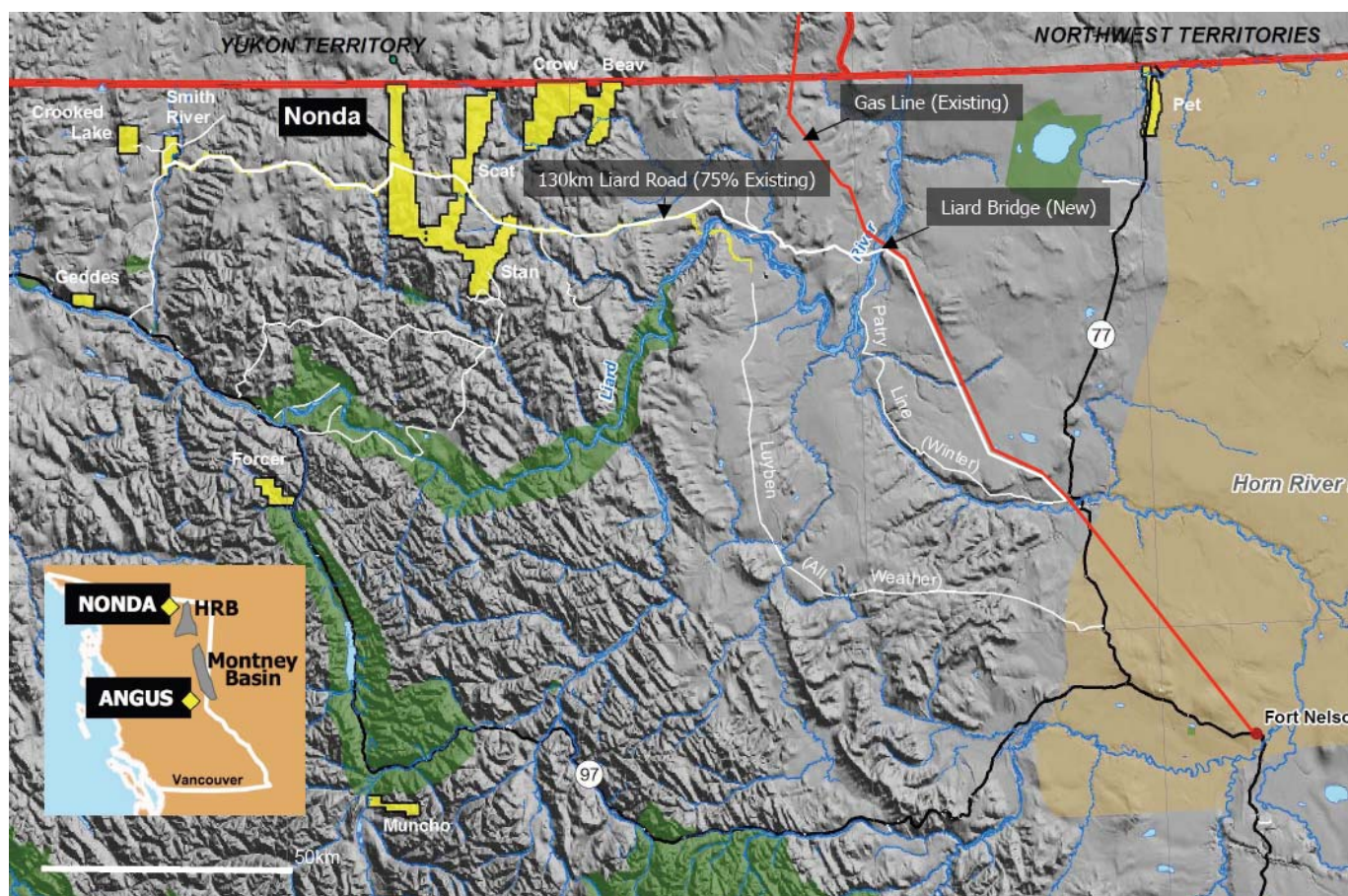
The liberated grains are then sent through a series of density separators, where they are sorted into their appropriate sizes. A rising water current is sent through the bottom of the vessel so that the coarse sand grains cluster at the bottom of the column while the progressively finer material is distributed in the upper portion. The first separator filters out the 20/40 material, the second separator captures the 40/70 material, and the third separator sorts the 100 mesh material. Density separating is common to sand operations used today at sufficient capacity to support Stikine's required output.

Nonda Project

Overview

The Nonda project is an exploration-stage deposit located approximately 150km west of the HRB in northeast British Columbia (Figure 13). The 100%-owned project comprises a massive outcrop of quartz-pure arenite (sandstone) over an area that is approximately 11.5km by 1km and at least 200m thick. The rocks are over 98% silica containing quartz grains occurring in perfect sizes for the HRB, including 20/40, 40/70 and 100 mesh. Most importantly, the rocks are exposed at surface, lending the project to open pit mining.

Figure 13: Nonda project location within British Columbia



Source: Company reports

Resource confirmation

In late 2009, Stikine completed a nine-hole drill program to confirm the continuity and quality of the quartz-pure arenite. As a result, the company believes that the Nonda project hosts a resource sufficient to supply the entire life cycle requirements of the HRB. The confirmation drilling was followed up by a bulk sample of 430 tonnes, which

was drilled and blasted in July 2010. The sample was sent to the company's pilot plant in Abbotsford, British Columbia, for crushing in September 2010. In late 2010, the company began feeding the bulk sample through the pilot plant. The sand was sorted, dewatered and bagged, then sent to Stim-Lab Inc. for proppant testing to confirm the quality of the material.

Infrastructure

The Nonda project is located in a remote area of northeast British Columbia and as a result, infrastructure in the area is quite limited. In order to access the site, Stikine would need to construct the 130km Liard Road (shown on Figure 13) which follows existing disturbances over 75% of its length, and build a bridge across the Liard River. The company has estimated the road and bridge will cost approximately \$100 million, but hopes to align with others in the area to share some of the burden. Because there is no electrical infrastructure in the surrounding area, the company anticipates tapping an existing natural gas line approximately 70km away and bringing it on-site to use for electrical generation.

Development plan

Stikine has a two-year program underway with the goal of making a production decision on the Nonda project by mid-2012. As can be seen in Figure 14 below, the company plans to complete a PEA by the end of June 2011 at an expected cost of \$1 million. Within the same timeframe, the company expects to publish an initial NI 43-101 resource estimate under the inferred classification. The bankable feasibility study is projected to be completed in early 2012, at a cost of \$4 million including progressing the environmental baseline studies. In total, the company intends to spend roughly \$7 million on the Nonda project during the development program. We estimate that the total capital expenditures to bring the project into production will be approximately \$300 million.

Figure 14: Nonda project development milestones

Development Milestones	2011				2012			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Pilot Plant Testing	█	█						
NI 43-101 Resource Estimate	█	█						
Preliminary Economic Assessment	█	█						
Feasibility Study			█	█	█	█		
Project Permitting					█	█	█	█
Environmental Baseline	█	█	█	█	█			

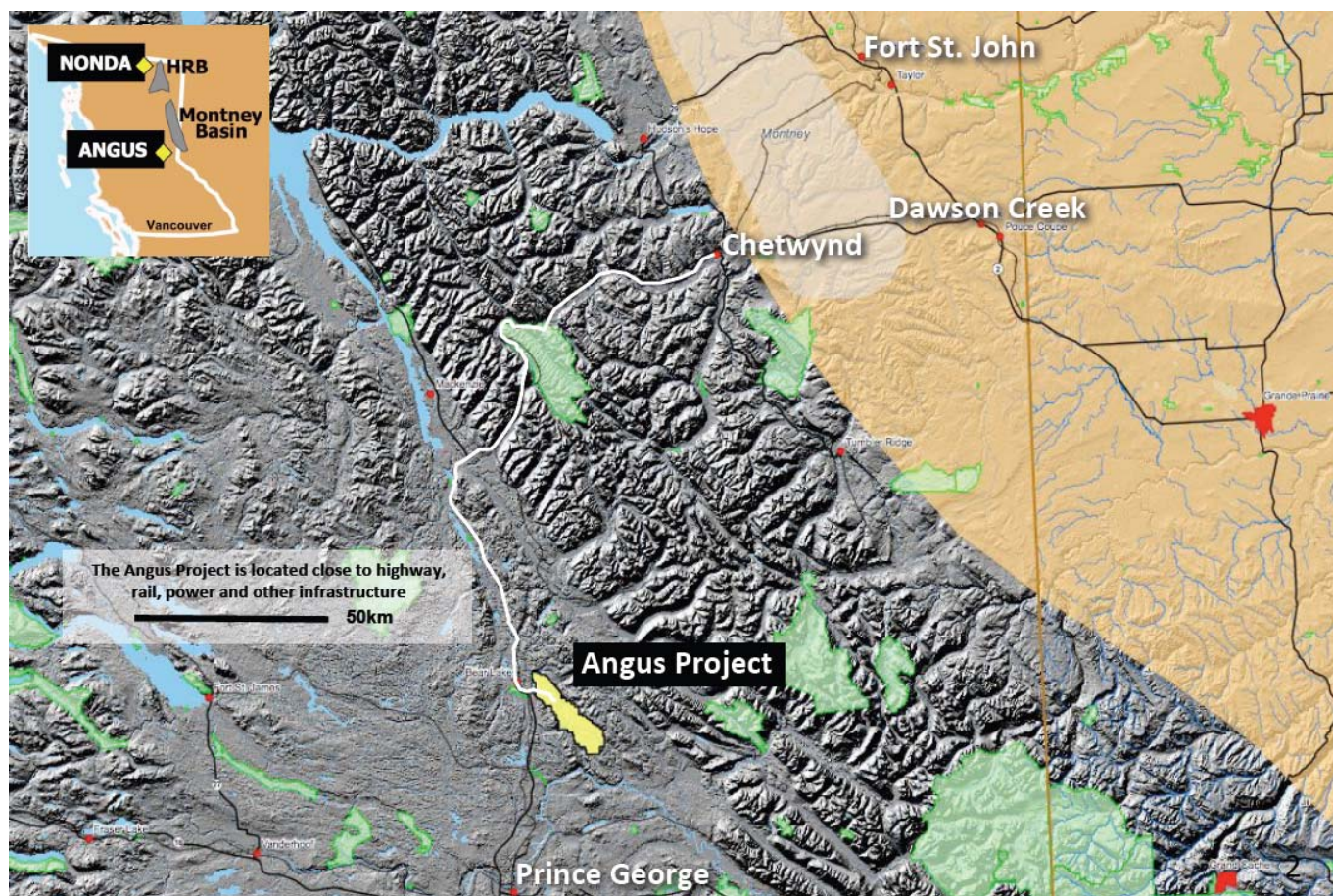
Source: Company reports, Stonecap Securities Inc.

Angus Project

Overview

The Angus project is an exploration-stage frac sand deposit located approximately 60km north of Prince George, British Columbia. The site is well positioned to serve the Montney Basin, which is 200km to the north in eastern British Columbia (Figure 15). The 100%-owned project comprises a massive outcrop of quartz-pure arenite (sandstone) over an area that is approximately 5km by 500m. The rocks are over 98% silica containing quartz grains occurring in perfect sizes for the Montney Basin, including 20/40, 30/50 and 40/70 mesh. Most importantly, the rocks are exposed at surface, lending the project to open pit mining.

Figure 15: Angus project location within British Columbia



Source: Company reports

Resource confirmation

Stikine has taken surface samples for lab scale testing, which is currently underway with positive initial results. The company then drilled and blasted approximately 500 tonnes of bulk samples from the Angus project in March 2011. These samples have been shipped to its pilot plant in Abbotsford, British Columbia, for processing and evaluation. The company believes that the Angus project's resource should be sufficient to satisfy the entire frac sand demand for the life cycle of the Montney basin.

Infrastructure

The Angus project benefits from being located near most major essential infrastructure, including power, road and rail. The site is readily accessible by existing logging roads, which run off Highway 97 less than 20km west of the project. The town of Bear Lake is also approximately 20km away and the city of Prince George is 60km to the south.

Development plan

Stikine has a two-year program underway with the goal of making a production decision on the Angus project by the end of 2012. The company plans to drill 9 to 12 holes on the property and complete a scoping study by Q3/11. We estimate that the total capital expenditures will be approximately \$175 million to bring the project into production.

Figure 16: Angus project development milestones

Development Milestones	2011				2012			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Pilot Plant Testing		■	■					
NI 43-101 Resource Estimate		■	■					
Scoping Study		■	■					
Feasibility Study				■	■	■		
Project Permitting					■	■	■	■
Environmental Baseline		■	■	■	■	■		

Source: Company reports, Stonecap Securities Inc.

Appendix A: Financial Summary

Stikine Energy Corp. (SKV-TSXV; C\$0.33)											
Rating:	Outperform	Rate of return:	127.3%	NAV:	\$0.75	EV (\$ mm)	\$23.5				
Target:	C\$0.75	Risk rating:	Speculative	P/NAV:	0.44x	Shares O/S (mm)	87.8				
Operation Summary											
Net Asset Value	Discount rate	US\$ million	Assumptions	2010A	2011E	2012E	2013E	2014E			
Nonda (100%), British Columbia	15%	\$133	Frac Sand price (US\$/tonne)	\$325	\$263	\$250	\$250	\$250			
Angus (100%), British Columbia	15%	\$166	Frac Sand price (CDN\$/tonne)	\$325	\$263	\$250	\$250	\$250			
Total mining assets		\$299	CAD/USD Exchange rate	0.88	0.98	1.00	1.00	1.00			
Cash		\$6	Frac Sand Production (000 tonnes)	2010A	2011E	2012E	2013E	2014E			
Non-cash Working Capital		\$0	Nonda (100%), British Columbia	-	-	-	-	221			
Long Term Debt		\$0	Angus (100%), British Columbia	-	-	-	-	-			
ITM FD Proceeds		\$1	Total attributable Frac Sand production	-	-	-	-	221			
Total NAV		\$306	Total Cash Costs (US\$/tonne)	2010A	2011E	2012E	2013E	2014E			
Fully Financed Shares (millions)		416.5	Nonda (100%), British Columbia	-	-	-	-	\$135			
Total NAVPS (\$)		\$0.75	Angus (100%), British Columbia	-	-	-	-	\$75			
			Total average cash cost	-	-	-	-	\$115			
Target Price	NAVPS	Target Multiple	Target Price								
Stonecap Target Price	\$0.75	1.00x	\$0.75	Capital Expenditures (US\$ million)	2010A	2011E	2012E	2013E	2014E		
				Nonda (100%), British Columbia	-	\$1	\$8	\$175	\$125		
				Angus (100%), British Columbia	-	\$1	\$7	\$100	\$75		
Frac Sand Resources (000 tonnes)		Tonnage	Grade	Total capital invested	-	\$2	\$15	\$275	\$200		
Nonda	M&I	0	0.0%								
	Inferred	0	0.0%								
Angus	M&I	0	0.0%								
	Inferred	0	0.0%								
TOTAL		0	0.0%								
Financial Summary											
Cash Flow Statement (US\$ million)	2010A	2011E	2012E	2013E	2014E	Income Statement (US\$ million)	2010A	2011E	2012E	2013E	2014E
Net earnings	\$0	(\$0)	(\$0)	(\$6)	\$8	Revenue	\$0	\$0	\$0	\$0	\$55
Non cash items	\$0	\$0	\$0	\$0	\$2	Operating costs	\$0	\$0	\$0	\$0	(\$25)
Operating cash flow	\$0	(\$0)	(\$0)	(\$6)	\$10	Gross margin	\$0	\$0	\$0	\$0	\$30
Change in non-cash working capital	\$0	(\$1)	\$0	\$0	\$0	Operating expenses	\$0	\$0	\$1	\$1	\$7
Cash from operating activities	\$0	(\$1)	(\$0)	(\$6)	\$10	Operating earnings	\$0	(\$0)	(\$1)	(\$1)	\$23
Mineral properties, PPE & other items	\$0	(\$3)	(\$15)	(\$275)	(\$200)	Other income/expenses	\$0	\$0	\$0	(\$5)	(\$16)
Cash from investing activities	\$0	(\$3)	(\$15)	(\$275)	(\$200)	Earnings (loss) before taxes and other items	\$0	(\$0)	(\$0)	(\$6)	\$8
Debt	\$0	\$0	\$0	\$138	\$100	Net earnings (loss)	\$0	(\$0)	(\$0)	(\$6)	\$8
Common shares issued	\$0	\$9	\$13	\$255	\$0	EPS	\$0.00	(\$0.01)	(\$0.00)	(\$0.02)	\$0.02
Dividends paid	\$0	\$0	\$0	\$0	\$0						
Other	\$0	(\$1)	(\$1)	(\$13)	\$0	Balance Sheet (US\$ million)	2010A	2011E	2012E	2013E	2014E
Cash in financing activities	\$0	\$9	\$12	\$380	\$100	Cash and cash equivalents	\$0	\$4	\$1	\$100	\$10
Increase (decrease) in cash	\$0	\$4	(\$4)	\$99	(\$90)	Other current assets	\$0	\$1	\$1	\$1	\$1
Cash balance @ BOY	\$0	\$0	\$4	\$1	\$100	Total assets	\$0	\$10	\$21	\$395	\$503
Cash balance @ EOY	\$0	\$4	\$1	\$100	\$10	Current liabilities	\$0	\$0	\$0	\$0	\$24
CFPS	\$0.00	(\$0.00)	(\$0.00)	(\$0.02)	\$0.02	Long-term debt & other liabilities	\$0	\$0	\$0	\$138	\$214
						Total Liabilities	\$0	\$0	\$0	\$138	\$238
						Shareholders' equity	\$0	\$9	\$21	\$257	\$265
Analyst Contact Information											
Michael Goldberg	416-342-8594	mgoldberg@stonecapsecurities.com									
Fraser Laschinger	416-342-9952	flaschinger@stonecapsecurities.com									

Source: Capital IQ, Company reports, Stonecap Securities Inc.

Appendix B: Management Profiles

Scott Broughton, P.Eng., President and Chief Executive Officer

Mr. Broughton is a Professional Engineer with over 25 years of experience in the mining industry that spans exploration, mine design, mine development and operations, consulting engineering and project management, specialist geotechnical services, business development and the formation and management of public companies. Mr. Broughton has a Bachelor of Science degree in Mining Engineering from Queens University and is a member of the Association of Professional Engineers and Geoscientists of British Columbia.

David Skerlec, CFA, Chief Financial Officer

Mr. Skerlec has over seven years experience with a Vancouver-based investment dealer, lastly as Vice President, Corporate Finance, where he specialized in exploration finance. His diverse background includes experience in the junior mining business where he supervised exploration and production at a placer gold mine. He has been a CFO of junior mining companies for 8 years.

Robert Chambers, P.Eng., Vice President – Environment and Sustainability

Mr. Chambers is a geotechnical engineer with over 25 years experience in site assessment, design and environmental aspects of tailings, mine rock and water management for mining projects. He has been responsible for site investigations, geotechnical design, construction specifications and drawings, cost estimates, contract documents, construction monitoring, instrumentation, environmental assessments and closure for mining projects. Mr. Chambers has a Bachelor of Applied Science degree in Geological Engineering and a Master of Engineering in Civil Engineering from the University of British Columbia. Mr. Chambers is a member of the Association of Professional Engineers and Geoscientists of British Columbia.

John Baker, Director

Mr. Baker is a geologist with over 38 years of experience in the minerals exploration industry including directing large exploration efforts in British Columbia during the 1970s and 80s, and at various times significant exploration programs conducted in Ireland and Alaska, in addition to work in Nevada and Mexico. He has experience with a wide variety of mineral deposit types, including volcanogenic massive sulphide, sedimentary exhalative, skarns, various porphyry types, epithermal gold/silver and mesothermal deposits. In the late 1980s and 90s, Mr. Baker was instrumental in directing and managing the growth of JT Thomas Drilling Ltd., a successful international diamond drilling company that was ultimately acquired by Major Drilling Group International Inc. in 1997.

Cleve Graham, Director

Mr. Graham has been focused on oil and gas well completions for much of his 34 years in the industry. Most recently he has concentrated on project-style development work in the HRB, located in northeast British Columbia. He has worked closely with Apache Canada and Encana Corporation on multistage shale-gas completions including hydraulic fracturing procedures, equipment and consumables such as frac sand. He helped to develop an entirely new approach to how surface operations for well completions are handled and is widely recognized as an expert in the field.

Biographies sourced from company reports.

Appendix C: Investment Risks

There are a number of risks that could negatively affect investment performance. The ability to manage these risks is an important part of the company's future success.

Environmental risks and hazards

All phases of Stikine's operations are subject to environmental regulations including: the maintenance of air and water quality, land reclamation, environmental pollution and the generation of transportable storage and disposal of hazardous waste. In recent years there has been increased apprehension over the environmental implications and health impacts rooted from hydraulic fracturing, particularly in Quebec and the United States. Specifically, there are concerns as to whether hydraulic fracturing poses a threat to unfiltered water supplies by damaging natural freshwater aquifers. Environmental legislation is evolving in a manner that will require stricter standards and enforcement, increased fines and penalties for non-compliance, more stringent environmental assessments of proposed projects and a heightened degree of responsibility for companies and their officers, directors and employees. There is no assurance that existing or future environmental regulation will not materially adversely affect the company's business, financial condition and results of operations.

Commodity prices

The profitability of Stikine's operations will be dependent upon the market price of frac sand. Mineral prices fluctuate widely and are affected by numerous factors beyond the control of the company. Future price declines could cause commercial production to be impracticable, thereby having a material adverse effect on the company's business and financial condition.

In addition to adversely affecting the company's mineral resource estimates and its financial condition, declining commodity prices can impact operations by requiring a reassessment of the feasibility of a particular project. Such a reassessment may be the result of a management decision or may be required under financing arrangements related to a particular project. Even if the project is ultimately determined to be economically viable, the need to conduct such a reassessment may cause substantial delays or may interrupt operations until the reassessment can be completed.

The profitability of Stikine's mineral properties will also be dependent on the costs of consumables used in its operations. Profitability can be impacted by the cost of fuel, energy, and steel, along with other things required to be used in future operations. In recent years, significant increases in the cost of these materials impacted anticipated profitability and further increases in the future may be detrimental to the company's financial results.

Uncertainty of additional capital

The exploration and development of Stikine's properties, the construction of mining facilities and commencement of mining operations, and the growth of the company will require substantial additional financing. Stikine has limited financial resources and has no source of operating income. Failure to obtain sufficient financing could result in a delay or indefinite postponement of exploration, development or production on any or all of the company's properties or even a loss of a property interest. An important source of funds available to the company is through the sale of equity capital, properties, royalty interests or the entering into of joint ventures. Additional financing may not be available when needed or, if available, the terms of such financing might not be favourable to the company and might involve substantial dilution to existing shareholders. Failure to raise capital when needed would have a material adverse effect on the company's business, financial condition, and ability to grow.

Price volatility

Securities of mining companies have experienced substantial volatility in the past, and especially during the previous three years, often based on factors unrelated to the financial performance or prospects of the companies involved. These factors include macroeconomic developments in North America and globally, and market perceptions of the attractiveness of particular industries. As a result of any of these factors, the market price of Stikine's stock at any given point in time may be subject to market trends and macroeconomic conditions generally, notwithstanding any potential success of the company in creating revenues, cash flows or earnings and may not accurately reflect the long-term value of the company. There can be no assurance that the continual fluctuations in price will not occur, and the value of Stikine's securities will be affected by such volatility.

Exploration stage projects

The Nonda Project and the Angus Project are both in the advanced exploration stage. There is no certainty that the expenditures made by Stikine towards the evaluation of mineral deposits on either of these properties will result in discoveries of commercial quantities of ore. Furthermore, unless the company acquires additional properties or projects, any adverse developments affecting these projects or the company's rights to develop mining concessions or other rights that are held on these properties, could materially adversely affect the company's business, financial condition and results of operations.

Government regulations and permits

The current and future operations of the company, from exploration through development activities and commercial production, if any, are and will be governed by laws and regulations governing mineral concession acquisition, prospecting, development, mining, production, exports, taxes, labour standards, occupational health, waste disposal, toxic substances, land use, environmental protection, mine safety and other matters. Companies engaged in exploration activities and in the development and operation of mines and related facilities may experience increased costs and delays in production and other schedules as a result of the need to comply with applicable laws, regulations and permits. Permits are subject to the discretion of government authorities and there can be no assurance that Stikine will be successful in obtaining all required permits. Amendments to current laws and regulations governing the operations and activities of the company or more stringent implementation thereof could have a material adverse effect on the company's business, financial condition and results of operations. Further, there can be no assurance that all permits which Stikine may require for future exploration, construction of mining facilities and conduct of mining operations, if any, will be obtainable on reasonable terms or on a timely basis, or that such laws and regulations would not have an adverse effect on any project which the company may undertake.

Competition

The mining industry is intensely competitive in all phases of exploration, development and production and Stikine competes with many companies possessing greater financial and technical resources. Competition in the mining industry is primarily for mineral rich properties that can be developed and produced economically; the technical expertise to find, develop and operate such properties; the labour to operate such properties; and the capital for the purpose of funding such properties. This competition may result in the company being unable to acquire desired properties, to recruit or retain qualified employees or to acquire the capital necessary to fund its operations and develop its properties. There is no assurance that even if commercial quantities of minerals are discovered, a ready market will exist for their sale. Existing or future competition in the mining industry could materially adversely affect the company's prospects for mineral exploration and success in the future.

Company Name	Disclosures
Stikine Energy Corp. (SKY-TSXV)	1, 9

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