Pacific Energy Res. (PFE-T, $1.53)

Recommendation: Buy

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WELLINGTON WEST
Capital Markets Inc.

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All values in C$ unless otherwise noted.

Current Price	$1.53
Target Price (12-Month)	$3.25
Implied Capital Gain	112%

Changes

	Old	New
Production (boe/d) '08E	9,367	8,278
CFPS FD 2008E	$0.04	($0.02)
Production (boe/d) '08E	14,237	12,354
CFPS FD 2009E	$0.53	$0.41
Recommendation	Buy	Unch.
Target Price	$4.00	$3.25

Company Profile

Pacific Energy is an oil exploration and production company based out of Long Beach, California. The company has core areas in California, Alaska, and Wyoming. The company has a large, established, long-life reserve base that is currently producing ~6,700 bopd. The company plans to ramp-up production by redeveloping proven producing fields, while drilling selected high-impact exploration plays on existing lands.

Pacific Energy Realigns Long-term Focus with Sale of Onshore California Assets

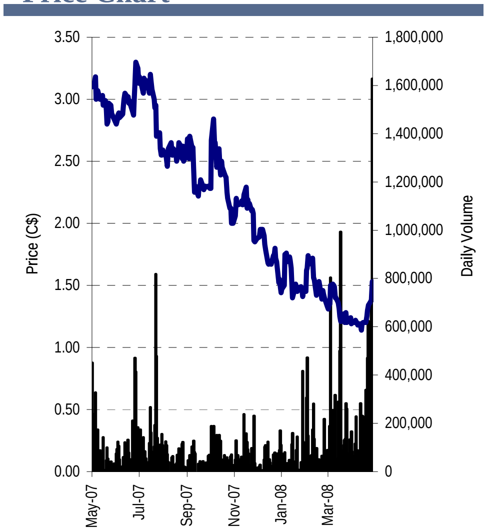
- **What's the deal? US$135mm for ~900 bopd; $7.62 per 2P barrel**
  Non-core asset divestiture yields a price of US$150,000 per flowing barrel; onshore asset portfolio carried 2P reserves of ~17.7 mmboe.

- **Deal shows PFE's management is executing on debt reduction plan**
  PFE plans to reduce debt from ~$460mm to ~$380mm with proceeds; post repayment, PFE trades at 3.8x 2009E Debt/CF.

- **Post-sale, PFE has ~81 mmboe in 2P reserves & 6,700 bopd in prod^{n}**
  Prod^{n} expected to reach ~10,800 bopd by Q4 with ramp to full prod^{n} at Eureka; we model PFE exiting 2009 at a prod^{n} rate of ~12,500 bopd.

- **Target revised to $3.25 from $4.00 on asset sale – Buy rating**
  Our risked NPV/sh falls to $3.09 from $3.67 as we carried a higher value for onshore assets; PFE can now focus capex on two core assets.

Price Chart



Source: PCQuote

Financial Summary

Shares O/S (FD, M)	243.0	52-Week Trading Range	$1.12-$3.38
Market Capitalization (M)	$372	Average Weekly Volume	612,512
Net Debt (M)	$358	Market Float (M)	$327
Enterprise Value (M)	$730	Risked NPV/Share	$3.09

Forecasts	2006	2007	2008E	2009E
Production (BOE/d) *	705	4,000	8,278	12,354
Weighted Avg. Realized Price (US$/boe) *	$44.69	$72.12	$77.26	$76.27
Revenues (M)	$11.5	$105.2	$250.8	$351.7
DACF (M)	($2.8)	($4.6)	$82.9	$173.5
CAPEX (M)	$36.7	$21.3	$67.6	$80.0
EPS (FD)	($0.17)	($0.56)	($0.22)	$0.21
CFPS (FD)	$0.07	($0.33)	($0.02)	$0.41

Valuation	2006	2007	2008E	2009E
EV/DACF		n/m	8.8x	4.2x
EV/BOE/d (per unit production)		n/m	$88,153	$59,068
P/E		n/m	n/m	7.4x
Debt/CF		n/m	n/m	3.8x
Target EV/DACF		n/m	16.0x	7.7x

Source: Company reports, Wellington West Capital Markets Inc.

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Investment Summary and Outlook

Pacific Energy has grown rapidly in a short period of time by employing a strategy of acquiring assets with established long-life reserves and solid production growth potential, at below market prices, while also capturing considerable exploration and delineation upside. 100% of the company's assets are in the United States and are spread around three core areas in California, Alaska and Wyoming. We expect Pacific Energy's production to increase from the current level of ~6,700 bopd to ~10,800 bopd by the end of 2008 as the company restores production from the Eureka platform offshore California and carries out select recompletions and infill drilling. We calculate a risked NPV/sh of $3.09 for the company's asset portfolio, for which we carry 91 mmbbls of reserve potential. Going forward, we foresee sustainable production growth as the company focuses on developing its existing reserve base with the potential for reserves increases through exploration and step-out drilling in offshore California and Alaska.

Corporate Update – Onshore Asset Sale

$135 million sale of onshore California assets = debt reduction

As part of their plan to reduce corporate debt levels, Pacific Energy announced that they have reached a definitive agreement to sell all of their onshore assets, encompassing ~900 bopd of production and 17.7 mmbbls of 2P reserves for $135 million in cash. The assets being sold include the company's Wilmington, San Joaquin, and other Los Angeles basin properties and leave Pacific Energy to focus on the development of their offshore California Beta Unit and offshore Alaskan assets in the Cook Inlet. The transaction implies a sale price of ~$150,000 per flowing barrel of current production, $13.50/bbl of proven reserves, and $7.62/bbl on a 2P basis.

Proceeds from the asset sale are expected to be used primarily to pay down existing debt (US$80–US$90 million) and hedging liabilities, with the balance to be used for funding of the company's 2008 capital program directed towards restoration of full production from the Eureka platform and drilling of infill wells on producing assets in Alaska. The sale is expected to reduce corporate debt levels to a balance sheet carrying value of approximately US$380 million, implying a 2009E debt to cash flow ratio of ~3.8x. We currently model 2009E capex of $80 million and cash flow from operations of $100 million, implying that the company would generate $20 million in free cash flow in 2009 under our current assumptions.

Sale leaves Pacific Energy with 81 mmbbls in 2P reserves & 6,700 bopd

Based on the company's remaining 2P reserves and current production levels, Pacific Energy maintains a reserve-life-index of 33.1 years, highlighting the potential for accelerated development of the existing reserves base to bring value forward. With production from the Eureka platform on-track to be fully restored by Q4 2008 and modest production additions from the Alaskan assets, we expect that Pacific Energy will exit 2008 with production of 10,800 bopd, ramping up to 12,500 bopd by the end of 2009.

At 12,500 bopd and $90/bbl WTI, we expect annualized cash flow of $110 million.

Two more options on the table for accelerating debt reduction

We believe additional options with respect to further debt reduction involve: 1) partial reclamation of the Beta Unit reclamation bond and 2) the possible sale of a portion of the company's offshore Alaskan assets. With initial production of ~1,000 bopd from the Eureka platform now restored, Pacific Energy is working on freeing up half of the $100 million cash environmental bond currently held in trust by the offshore regulation authority (MMS) in exchange for a surety bond to be paid upon decommissioning of the platforms at the end of the life of the Beta Unit field. A $50 million recovery of the environmental bond could be expected to reduce total debt levels to ~$330 million (~3.3x 2009E debt to cash flow). Though potentially unnecessary, we also contemplate the possibility of the sale of a portion of the company's offshore Alaskan assets, perhaps 10-15 mmbbls of 2P reserves, which we believe could be valued at between $8-12/bbl (though there is a lack of hard recent transaction data for Cook Inlet asset sales). Such an asset sale could potentially further reduce Pacific Energy's debt by anywhere from $80 million to $180 million, which we believe would bring total debt to attractive levels and still leave the company with a net 2P reserve base of between 66 mmbbls to 71 mmbbls.

Alaska Update

Alaska Development Program Planned to Ramp Up Through 2009

Pacific Energy's current plans call for up to a five-well infill/re-drill program to start at their 100%-owned Redoubt Shoal field in July 2008 with a further increase in drilling activity in 2009. New wells are expected to produce at initial rates of 400–800+ bopd and will target undeveloped reserves in undrained portions of existing producing fields. Installation of submersible pumps in selected wells is also planned this season to offset natural declines in selected producing wells. In our model we assume modest production increases in Alaska in 2008, taking net production from 4,200 bopd to 4,900 bopd by the end of the year. Our modeled 2009 Alaska exit rate is 5,500 bopd which may be conservative given Pacific Energy's proposed accelerated work program with their partner, Chevron, in the Macarthur River / Trading Bay Unit. We intend to revisit our Alaskan production forecasts as more clarity emerges with respect to the 2009 work program.

The 100%-owned Corsair prospect remains one of the company's highest priority exploration targets and is expected to be drilled in mid-2009. Under the terms of the amended Corsair Unit agreement, and assuming Pacific Energy can demonstrate the ability to transport a rig to the Cook Inlet in time for drilling, the company has until June 30, 2009 to commence drilling. The Corsair prospect is in shallow water and requires a jack-up rig for drilling, which Pacific Energy is in the process of procuring. Corsair is believed to be prospective for 500 Bcf of gas and up to 137 million barrels of oil in two deeper zones. We currently carry a 45% COS and a risked EMV/sh of $1.81 for Corsair, which we estimate could be worth as much as $4/sh in a full success case.

Valuation and Summary Recommendation

We are reducing our target to $3.25 from $4.00 and maintaining our Buy recommendation on Pacific Energy as we incorporate the onshore asset sale and associated impact on our NPV and cash flow estimates. We remain bullish on Pacific Energy and believe the company continues to effectively balance production growth plans with de-levering of the balance sheet.

We expect the company to ramp up production from current levels of ~6,700 bopd to ~10,800 bopd by the end of 2008 and ~12,500 by the end of 2009. The three main drivers of our production estimates over the next 12 months are: 1) the re-establishment of full production from the Eureka platform in the Beta field, offshore California, 2) the drilling of four successful development wells off Beta Unit's Ellen platform, and 3) successful implementation of the company's development/optimization plan in the Cook Inlet, Alaska. With the increase in production planned through 2009, we expect operating costs to fall to $20/bbl in Q4 2009 from $40/bbl in Q1 2008.

Our 2009E projected CFPS of $0.41/sh and risked NPV/sh estimate of $3.09 drive our $3.25 target and are weighted equally at 35% in our blended valuation outlined in Exhibit 3. The downward revisions in our 2009E EPS and CFPS estimates (EPS of $0.30/sh drops to $0.21/sh and CFPS of $0.53/sh drops to $0.41/sh) reflects the loss of production from the onshore California assets. Our risked NPV/sh estimate of $3.67 is revised downward to $3.09 as a result of the onshore California assets being sold for less than what we were carrying in our model (US$135mm sale price vs. ~US$236mm modeled). Despite the fact that the transaction is dilutive on an NPV basis, we believe the company is now better positioned to focus on their two core assets in offshore California and Alaska. Our EMV/sh estimate of $6.97 (20% weighting) and acquisition value of $1.72 (10% weighting – based on risked resource potential) round out the remaining components of our $3.25 target price for Pacific Energy. Components of our risked NPV/sh and risked EMV/sh estimates are outlined in Exhibits 1 & 2, respectively.

Exhibit 1: WWCM Risked NPV/sh Valuation Breakdown

Prospect/Field	WWCM Unrisked resource estimate (mmbbls, net)	COS (%)	WWCM Risked resource estimate (mmbbls, net)	Unrisked NPV/sh	Risked NPV/sh
Alaska	57.8	80%	46.3	$2.74	$2.19
Beta Unit	61.0	80%	48.8	$2.96	$2.37
Net Debt				$1.47	$1.47
Total	**118.8**		**95.1**	**$4.23**	**$3.09**

Source: Wellington West Capital Markets Inc.

Exhibit 2: WWCM EMV Valuation Breakdown

Prospect/Field	WWCM Unrisked Reserves (Gross, mmboe)	Unrisked EMV/sh	COS (%)	Risked EMV/sh
Alaska	60.6	$2.87	80%	$2.30
Beta Unit	100.0	$4.77	60%	$2.88
Wyoming	500.0	$5.32	20%	$1.04
Corsair	100.0	$4.03	45%	$1.81
Alaska Upside	200.0	$12.14	5%	$0.42
Net Debt		$1.47		$1.47
Total	**960.6**	**$27.65**		**$6.97**

Source: Wellington West Capital Markets Inc.

Our work suggests that Pacific Energy is trading at ~0.5x our risked NPV estimate, which leads us to propose that Pacific Energy continues to be an attractive "value play" at current price levels. We believe Pacific Energy gives investors exposure to a large, long-life resource base with significant development, step-out and exploration upside. In our view the asset portfolio is well-balanced between development work and high-impact exploration potential in Alaska. Exploration aside, we believe the company can reach ~12,500 bopd in production by the end of 2009 on the existing 2P reserve base if current development plans are executed as planned.

Exhibit 3: Summary Valuation Table (all numbers net of debt)

Valuation Matrix	Forecast	Target Multiple	Value	Weighting	Weighted Value
Risked NPV/share	$ 3.09	1.0	$ 3.09	35%	$ 1.08
2009E CFPS	$ 0.41	5.0	$ 2.04	35%	$ 0.71
Asset EMV/share	$ 6.97	1.0	$ 6.97	20%	$ 1.39
Acquisition Value	$ 1.72	1.0	$ 1.72	10%	$ 0.17
				12 month target price	**$ 3.36**

Source: Wellington West Capital Markets Inc.

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Company Name	Ticker Symbol	Applicable Disclosure
Pacific Energy Resources Ltd.	PFE-T	2, 3, 11*

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(*toured Alaskan office and facilities in October 2007)

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