PetroKazakhstan Profits

Where Should I Invest My Gains?

by Tim Eriksen, m100 member

Tim Eriksen first bought shares in PetroKazakhstan (nyse: PKZ), a Canadian oil and gas company with production and refining operations in the Republic of Kazakhstan, in his Marketocracy fund on Nov. 28, 2001 at $5.38. On August 22, PKZ accepted an acquisition bid from CNPC for $55 a share. That's a 9 Bagger (952% return with dividends) but check out the chart to the right. It highlights his major buying and selling activity of PKZ. Tim made more on PKZ than any other member at Marketocracy so when Tim talks about PKZ, we listen. Here's what he has to say:

The story for PetroKazakhstan may not be finished yet as a higher offer may still come. The buyout price, while a nice premium to the pre-announcement price, still values the company at low price relative to earnings based on current oil prices. Currently I have taken profits on a portion of the shares and am holding the rest.

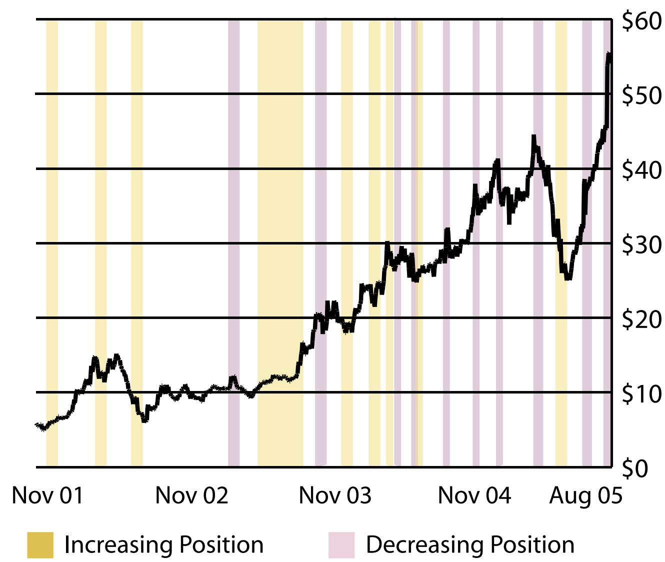
But where should I put the gains? After surveying the market, oil stocks, even with oil prices at all-time highs, still appear to be cheap. Wall Street seems to be expecting oil to fall back into the $40 to $50 per barrel range, yet the futures market is expecting prices to be near $60. Just to be safe, I wanted to find oil plays that will still perform decently if Wall Street is correct, but spectacularly if the futures market is right.

One higher risk play is Chaparral Resources (otc: CHAR), which is also based in Kazakhstan. Even though the shares trade over-the-counter, the company does file with, and is subject to, the SEC. Chaparral is a smaller firm that is 60% owned by Canadian based Nelson Resources. The shares trade around $6 and the company earned $0.17 per share in the second quarter when Brent crude averaged about $52 per barrel. Oil prices have risen dramatically since that time and the company has also been increasing production. I believe CHAR could see Q3 earnings nearly twice what it earned in Q2.

Chaparral is also working on ways to reduce its transportation costs by transporting oil via railcars by the middle of 2006. It currently must use expensive Kazakh government owned pipelines. My downside risk is also protected due to the higher production. If oil prices fall to near $50, CHAR would still earn more than it did in Q2 due to the increased production volume.

The Author's Performance

PetroKazakhstan (nyse: PKZ)
Stock Price & Trades 11/27/2001 to 7/31/2005



CHAR perfectly fits the scenario I was looking for.

A lower risk play on oil is Kerr-McGee (nyse: KMG). KMG's operations in the Gulf were not damaged due to Hurricane Katrina, although it is too early to tell if related production facilities and pipelines will be able to return to normal levels.

Wall Street seems to believe that the big gains for KMG have already been achieved, thanks to a large tender offer enacted a few months back to stave off an "attack" by Carl Icahn. But I believe the story is only beginning to unfold. The company recently sold its North Sea operations and is still planning on selling, or spinning off, its chemical division. KMG is also rapidly paying down debt generated from the tender offer.

KMG does have a significant hedging program in place. But the price swaps and costless collars have more attractive upper limits in the future. Thus earnings will still rise with higher oil prices. In addition, a significant portion of KMG's hedging program will drop off at the end of 2006. As we move into a new year in a few months, Wall Street will begin to focus more on 2007 earnings, which should help lift KMG's share price.

Thus while energy companies have performed well in the past year, many still have more upside potential even if oil prices retreat as low as Wall St. believes. If higher oil prices are not temporary and hold closer to the prices the futures market believes, energy stocks could do spectacularly.