

Oil firm searches for niche

Pursues turnaround after troubles, losses

Ken Alltucker

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Ask about Sonoran Energy's future, and chief executive Peter Rosenthal gushes about the prospects for the small oil exploration company. Sonoran's connections with former CIA operatives, Middle Eastern businessmen and oil contractors abroad add up to a lucrative future, he said. "I think we have the ability to maybe land a large project internationally," Rosenthal said. "If we do that, this oil company will change overnight."

It would seem to be a golden time for a small oil company with global ambitions. With the price of oil near \$65 per barrel, investors are showering millions of dollars on companies with a proven record of finding and extracting crude oil. Such companies have remade the economies of places where they operate, pumping millions into towns from Alberta, Canada, to rural Texas. The boom largely has bypassed Chandler-based Sonoran, one of just a few publicly traded oil companies in the Valley but one of several small companies in the area traded for pennies a share as an OTC bulletin board stock.

The company's stock price quadrupled in early 2004 as it announced plans to build lucrative oil fields in Iraq. Those plans crumbled, Rosenthal said, as gun-toting insurgents scared away companies and private investment. Sonoran's shares have plunged to less than 25 cents. Rosenthal again is trying to drum up interest in Sonoran's stock through news releases, investment seminars and shareholder newsletters. A rising share price could add critical value to a small company long on prospects but short on cash.

His pitch: Sonoran is on the cusp of turning a small profit with its oil and gas wells in Texas and Louisiana. The big payoff will come later when the company taps a major oil field, a "company maker," he said. But financial analysts say investors must consider other factors, too. Sonoran has lost money in every quarter, routinely filed late financial reports, employed a revolving door of chief financial officers and been duped by a felon who promised a corporate turnaround.

The company also has been a prolific issuer of its own stock. The small company has more than 80 million shares outstanding, far more than some more established companies with solid profits.

"This would be a very speculative investment for sure," said Brian Hamilton, a senior financial analyst for Raleigh, N.C.-based ProfitCents. "This is essentially a startup company. The risk would be if the company doesn't deliver in future earnings and revenue increases."

Rosenthal acknowledges that the oil industry can be a speculative, high-risk business, although he believes Sonoran is heading in the right direction. "The oil business is taking calculated risks," Rosenthal said. "Sometimes you make it, and sometimes you don't."

Newcomer to Valley

Sonoran Energy is an oddity in the Valley: an oil and gas exploration company in a region better known for its new homes and strip malls. The company's corporate functions relocated from London to the Valley two years ago when it agreed to negotiate with and later buy a local company, Scottsdale Oil Field Services. Sonoran's far-flung global business operates from a nondescript suburban Chandler office.

Rosenthal, a native of Denmark who most recently lived in London, said the company wants to establish long-term roots in the Valley. Among his goals: creating a Valley oil club for movers and shakers interested in talking about the business. The company's goal is to turn a small profit on a handful of oil and gas wells in Louisiana and Texas until it lands a major international project. Sonoran's east Texas wells now produce about 100 barrels of oil per day. Its Louisiana wells yield as much as 325 barrels per day, Rosenthal said.

All that oil means that, for the first time, the company's annual revenue cracked the \$1 million mark. The company's most recent annual report, issued Sept. 15, shows the oil company's revenues more than tripled to \$1.9 million over the past year.

Once the company repairs wells and equipment damaged by Hurricanes Katrina and Rita last year, Rosenthal said, the company should take in more money than it spends. That's a crucial measure for a company that has lost more than \$23 million over the past four fiscal years.

Rosenthal said the company's balance sheet has improved. That's the message he wants to convey to investors. Part of Sonoran's trouble, Rosenthal said, is that the company has failed to promote its vision to investors. Rosenthal has stepped up those efforts. He has made presentations to potential investors in Los Angeles and Las Vegas and to financial analysts in Phoenix.

In May, the company published its first shareholders' newsletter. A central theme: the company's share price.

"We also share the concern many shareholders have with the low price of our stock," Rosenthal wrote in the newsletter. "This has been particularly frustrating as the fundamentals of the company steadily improve and we achieve some of our goals of building an independent oil and gas company."

Entertainment to energy

Sonoran wasn't founded as an energy company. It has gone through a metamorphosis since its 1998 launch by a pair of investors, Gino Punzo and Barry Forward. Then called Showstar Entertainment, the business consisted of event promotions such as booking acts at Indian casinos and selling T-shirts, according to documents filed with the Securities and Exchange Commission.

During the heady days of the dot-com boom, the company launched a Web site, Showstar Online, where it sold art. Showstar attempted to tap Wall Street riches widely available in the dot-com era despite the startup company's lack of a proven operating record and a string of quarterly losses. The company didn't excite investors much; its stock traded for a penny a share.

Faced with the prospect of shutting down because it couldn't raise money, the company decided to radically change its business. Under the direction of then-CEO John Punzo, Showstar ditched its Internet roots and turned to the oil-and-gas industry. In June 2002, Showstar changed its name to Sonoran Energy and rapidly began acquiring remote oil and natural gas wells in California and elsewhere.

A key part of the new oil-and-gas strategy would hinge on attracting investors. Sonoran completed a 1-for-25 reverse stock split. Reverse stock splits are a tool, often used by struggling companies, to prop up a company's share price. Despite the reverse split and the switch to the oil business, Sonoran's shares continued to trade well below \$1.

California consultant

Desperately in need of financing help in late 2003, the company turned to a Southern California financier, Mark Roy Anderson, for money and ideas. Anderson seemed like a white knight for the struggling company.

Although Anderson denies it, Sonoran officials said that he represented himself as a wealthy investor and the son of Robert Anderson, the former chairman and chief executive officer of Arco, the West Coast's largest gasoline retailer through its chain of am/pm mini-marts. He is not Anderson's son. But Mark Roy Anderson brought fresh ideas. He introduced a plan to get rid of Sonoran properties that were draining precious cash, and he recommended buying oil and gas fields that could yield more money.

All these things were enough to convince ex-CEO Punzo, a one-time Canadian restaurant owner with no oil-and-gas experience before Sonoran, that Anderson was a consultant who could turn things around. However, court documents filed by Sonoran suggest Punzo was unaware that Anderson has served prison time for a scheme.

During meetings at Anderson's Beverly Hills office and by phone, Anderson said he would invest \$3 million as long as Sonoran agreed to follow his advice. Anderson's strategy: sell California oil and gas wells that were draining cash, buy more lucrative properties and swap out management.

Following Anderson's suggestions, Sonoran pursued several acquisitions of oil and gas wells in Louisiana. Anderson found properties, negotiated sales terms and arranged financing. Anderson also wanted a new management team experienced in the oil and gas industry. He sought out a London oilman, Paul Bristol, who was named chief executive officer in December 2003.

Because the company didn't have much cash, Bristol and Anderson instead were paid with company shares. The idea was that Bristol and Anderson would share the company's wealth as its prospects improved. In a deal Anderson helped negotiate, Sonoran gave Bristol 3 million shares of company stock. Anderson was awarded 925,000 shares for his recruiting efforts.

Surge in 2004

When Bristol took over in December 2003, the company's share price had never cracked \$1. That soon changed. Bristol had more than two decades of experience in the oil and gas world, working for companies in London and Africa. Sonoran's share price soon performed better than it ever had - or has since. The one-time penny stock jumped to a high of \$4.25 on Jan. 14, 2004. It's unclear what led to the share price run-up, but it seemed that Anderson's moves were paying off. Sonoran touted its efforts to build a worldwide oil company in news releases, advertisements on financial news TV and international media.

In early 2004, the company issued three news releases promoting its efforts to find and extract oil in Iraq. The company said it opened a new office in Iraq and hired an Iraqi geologist and another consultant that formerly served the Iraqi Oil Ministry. The timing was significant. Iraqi dictator Saddam Hussein had just been captured. U.S.-led coalition forces patrolled Baghdad's streets. And it seemed to be a matter of time before foreign oil companies could exploit the nation's rich reserves.

While investors seemed to embrace the company's new direction, Sonoran's brief period of rising shares soon faltered. Shares soon dipped below \$1 and haven't broken that barrier yet. "The share price was much higher (in early 2004)," Rosenthal said. "I think it was the expectations that we would hit a big project in Iraq."

A declining share price wasn't the company's only challenge. Bristol resigned in April 2004 and was replaced by Rosenthal. A Los Angeles Superior Court lawsuit filed by Sonoran claims that Anderson became unhappy with Bristol, his handpicked chief executive, and pushed for his removal.

Anderson said he did not force Bristol's departure and was as surprised as anyone when the British resident abruptly quit. Bristol could not be reached for comment. "I was very happy with him," Anderson said. "I thought he was talented and competent. The share price skyrocketed when he got on board."

Fraud allegations

After Bristol left and Rosenthal took over day-to-day operations, Sonoran soon learned that some deals Anderson patched together began to unravel. Sonoran claimed in a Los Angeles County Superior Court lawsuit that several deals Anderson arranged were nothing more than frauds and that he provided just a fraction of the \$3 million financing. In one deal, Anderson persuaded Sonoran to buy and then sell a group of oil and gas leases in North Dakota. The company issued nearly 1.2 million shares to pay for the leases, known as the South Little Knife Project, but the company said in court documents that it never took ownership of the wells and couldn't even get geological reports that would have estimated how much oil and gas the wells contained.

In a deal in Bakersfield, Calif., Anderson collected nearly 1.7 million shares by telling Sonoran that he would sell a property he didn't own. Sonoran paid out the shares but never claimed title to the property. "The biggest problem and challenge for the company was this investor, Mark Roy Anderson," Rosenthal said recently. "(He) turned out not to be useful for us." Anderson, however, said it was Sonoran's failure to follow through on terms that scuttled the deals he proposed. "Had they bought the properties I recommended, I would have fulfilled the financing commitment," Anderson said. At the time, Rosenthal said, Punzo and other Sonoran representatives were unaware of Anderson's past.

In 1991, Anderson was convicted of a scheme to bilk investors out of millions of dollars by promising tax shelters to those who agreed to help fund historic building renovations. The deal ensnared about 1,500 investors who poured in \$50 million. Anderson pled no contest to fraud charges. He was sentenced to seven years in prison and agreed to pay nearly \$7 million to his victims. Anderson later appealed his conviction, and he was released from custody in March 1996, according to the U.S. Bureau of Prisons.

In 2005, Sonoran sued Anderson to recoup about 8 million shares of company stock that Anderson and his related companies were paid for deals he brought to Sonoran. The two sides in June settled the Los Angeles County Superior Court lawsuit. Anderson gave back the shares to Sonoran and the company agreed to give Anderson Bakersfield-area oil property.

Anderson said the settlement was "something I accepted, so I took it. That's pretty much it." With the settlement reached, Rosenthal believes potential investors will have more confidence in the company. "It's probably been an uncertainty that has scared some people away," Rosenthal said. "We are basically getting all the shares that he was issued, about 10 percent of the company."

Late financial reports

Rosenthal describes the dealings with Anderson as a "learning experience" that has delayed the company's march to growth and profitability. The company will perform tougher due diligence before it executes major financing deals, he said. In October 2005, the company reached a \$15 million financing deal with Cornell Capital Partners. And the company disclosed on Sept. 15 that it expects to close a \$12 million financing arrangement by Monday. Sonoran wants the money to pay off debt and to fund operations.

Rosenthal also acknowledges that the company has a history of filing late financial reports. Since March 2000, Sonoran and its predecessor, Showstar, have filed late quarterly or annual financial reports a dozen times. The most recent annual report, too, was filed late. Rosenthal said the company delayed the report to allow Tom Smith, the company's new chief financial officer, to review the numbers.

"I would say we've had our share of problems," Rosenthal said of Sonoran's financial reporting. "Initially, we really didn't have the money to work with." Corporate watchdogs say the failure to file timely reports could be an indication of a number of problems. Nell Minow, co-founder of the Corporate Library, a Portland, Me.-based corporate governance watchdog group, said it's generally a "very troubling sign" when a company consistently files late financial reports. She did not comment about Sonoran specifically.

Such late filings may be triggered by disagreements between auditors, management or others, said Carolyn Brancato, director of the Conference Board Governance Center. She also would not comment about Sonoran specifically. "If they want to be privately held and do whatever they want with the books, that is a different story," Brancato said. "Once you go into the public markets, you owe it to your investors" to file financial reports on time.

Global aspirations

Even with Sonoran's rough few years, Rosenthal is confident the company is poised to blossom into a profitable oil company. The strategy remains making enough money on its existing U.S. wells to survive until it lands a major project, either in the U.S. or overseas. The company struck an agreement with the government of Jordan to explore and develop an 11,250-square-kilometer region east of Amman. Unlike other Middle Eastern countries, Jordan doesn't produce much oil. It mainly depends on imports from other Middle East nations. Rosenthal said the company also would scout other parts of the globe for oil and gas deals, including Africa.

Despite the high price of oil, many small companies like Sonoran have struggled to compete with bigger companies that have established track records. Oil exploration is a risky business, with companies just a failed financing deal or an inaccurate geological report away from failure. "Cash flow is always an issue" for small oil companies, said Brian Milne, editor of the industry publication *DTN Refined Fuels*. "Every once in awhile, if you go out and put the effort and money into it and wind up with (little) product, that is a real problem. If you don't have the financial durability, that is an issue."

Compounding Sonoran's challenge is the intense competition for skilled workers in the boom oil market. Contractors that extract oil command high fees and wages. Those extra costs are difficult for a small company like Sonoran, said Bill McFie, Sonoran's executive vice president of oil operations. "For a company like us, it makes operations a little more difficult," McFie said. "It's a tough business. When you are Exxon Mobil, you have a little bit to fall back on. For us, unfortunately we don't." Rosenthal said because Sonoran has endured the Anderson deals and failed Iraq venture, the company and its share price is poised for a comeback.

"It is fairly easy to see we are undervalued," Rosenthal said. "I think we'll suddenly land something which will surprise a lot of people."

Reach the reporter at ken.alltucker@arizonarepublic.com or (602) 444-8285.