NuVista Energy: Why I Can't Fall in Love With This Oil and Gas Producer

Description

NuVista Energy (TSX:NVA) has performed exceptionally well over the past 12 months. Does the company deserve this unstoppable rise? Is it fueled by momentum, speculation, or the company's fundamentals? Let's try to crack the code to find out what is going on behind the scenes.

The transformation

The company's diverse asset base extends from the natural gas weighted region of northeast British Columbia and northwest Alberta to the Alberta Deep Basin and the heavy oil weighted area of Saskatchewan.

After an extensive divestiture program in the range of $240 million, the company managed to significantly strengthen its balance sheet in the second half of 2012. These dispositions, coupled with two placements, enhanced the company's financial flexibility in late 2012 when it announced its intention to focus on Wapiti, targeting the condensate component of the Montney gas.

Condensate is used as a diluent to ship heavy oil on pipelines and is priced at a premium to WTI and Edmonton Par crude oil, partly offsetting the relatively high drilling cost of the wells in Canada's Montney shale region. This is a capitally intensive area where the total drilling and completion cost per well is approximately $9 million.

NuVista believes that decreasing costs coupled with improved well performance will help it improve the economics of its Montney play. The recent drilling results look encouraging — the nine latest wells in that area show an average IP-30 of 1226 boepd (31% condensate). However, the total cost per well remains high at around $8 million.

The condensate premium

With net debt at $80 million in the first quarter of 2013 and full-year 2013 cash flow estimated at $75 – $85 million, NuVista does not have any serious debt problems, keeping the D/CF ratio (annualized) at around 1x.

However, NuVista’s key metrics show that it’s not “cheap.” The company currently has an enterprise value of $940 million. In the first quarter of 2013, the production was approximately 15,000 boepd (30% oil/liquids) and the company is currently producing approximately 17,000 boepd. Its 2P reserves are 94.1 MMboe (roughly 30% oil/liquids).

After all, it trades at $55,300/boepd and $10/boe of 2P reserves. The company also lost money in the first quarter. This valuation is not low considering its peers’ valuation as below:

Company	EV (Mil $)	Prod’n (boepd)	2P Reserves (MMboe)	$/boepd
Surge Energy	832	13,000 (78% oil/liquids)	54.6 (~75% oil/liquids)	64,000
Longview Oil	362	6,100 (79% oil/liquids)	38.3 (80% oil/liquids)	59,300
Spyglass Resources	560	17,340 (49% oil/liquids)	93.3 (~50% oil/liquids)	32,300
Rock Energy	65	3,214 (86% oil/liquids)	8.9 (79% oil/liquids)	20,200

The production figures above are based on the respective first-quarter 2013 reports, excluding **Surge Energy** (TSX:SGY) whose enterprise value, production and reserves figures have been calculated based on the latest corporate developments. A few days ago, Surge made an accretive acquisition and sold a small acreage with 650 boepd of production and 2.2 MMboe of 2P reserves.

All the aforementioned companies are much more oil-weighted, carrying either similar or much lower key metrics than NuVista. Most of them are also dividend-paying entities — an important criterion for income seekers. Surge Energy, **Spyglass Resources** (TSX:SGL), and **Longview Oil** (TSX:LNV) pay an annual dividend of 8%, 13%, and 12%, respectively. Meanwhile, **Rock Energy** (TSX:RE) is almost debt-free, which is a significant parameter for debt-averse investors.

That being said, NuVista's valuation carries a condensate premium that I believe is overrated. The company remains rooted in natural gas with a very low operating netback that stood at $14.02/boe in the first quarter of 2013. Although this netback might be slightly improved in the future to better reflect the economics of NuVista's Montney-focused recent drilling results, it is not enough to justify NuVista's premium valuation in comparison to other Canadian E&P companies.

The speculation premium

Apart from the condensate premium, I believe the rise of the stock has also been heavily fueled by the speculation that NuVista is a potential acquisition target. The fact that NuVista's Montney properties are close to **Sinopec's** acreage appears to be the primary reason for this speculation.

However, NuVista doesn't play alone in that field. **Tourmaline Oil**, **Perpetual Energy**, **7 Gen**, and few more companies are also operating in the same area. Furthermore, these four producers are neighboring with potential suitors and seemingly could also become acquisition targets.

I believe that such a speculative scenario should not be a buying criteria. As I wrote in my recent article about **Americas Petrogas**, such rumors failed to materialize and its stock plummeted from $3 in early 2013 down to $1 today. Due to an acquisition scenario, **Second Wave Petroleum** also rose to $3.50 in 2012 but the company was taken private at just $0.30 a few weeks ago.

From a commodities perspective, things don't look great for NuVista's core resource. Natural gas has been trading within a range lately. AECO has gone right up to the top of the range at ~$3.60 per thousand cubic feet (Mcf), but there is a lot of price resistance there.

Foolish Roundup

Bottom line: If you're looking for a mid-tier energy producer, there are much cheaper plays than NuVista out there. Falling in love with a stock has never been prudent and a proactive investor must always check out the big picture to not be caught by surprise.

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The original version of this post was created by Fool contributor Nathan Kirykos.

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1. Investing

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1. TSX:NVA (NuVista Energy Ltd.)

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