This Heavy Oil Junior's Share Price Could Double in Value

Description

One of the fast emerging favorites among investors in Canada's oil patch is oil junior **Blackpearl Resources** (TSX:PXX). It is an oil weighted junior – which is rare to find in the patch – specializing in both conventional and SAGD heavy oil production. Heavy oil makes up almost 90% of its total crude production and reduces the company's exposure to the softer margins and the pricing uncertainty surrounding natural gas production.

Solid assets and development potential indicate sounds growth prospects
Blackpearl's core assets are the Mooney, Onion Lake and Blackrod properties, which combined, produce around 10,000 barrels of oil daily. Mooney is a conventional heavy oil property located in northern Alberta and has the capacity to produce on average 7,000 to 10,000 barrels of crude daily.

Onion Lake is also a conventional heavy oil property and it contributes around 50% of Blackpearl's total oil production. But unlike Mooney it also has the capability to produce around 12,000 barrels of oil daily using steam assisted gravity drainage from oil sands.

Blackrod is Blackpearl's flagship oil sands property, located in Athabasca oil sands region in northern Alberta. It has the potential to produce upwards of 80,000 barrels of crude daily from SAGD and is currently producing 200 barrels of bitumen daily.

Outstanding full-year 2013 results
The company reported some solid 2013 financial and operating results, revenue jumped a healthy 12% and net income a whopping 1,400% in comparison to 2012. This significant growth in the company's bottom line was partly driven by higher crude production, which jumped a healthy 4% and a higher average price per barrel, also up 4% for the same period.

Blackpearl also reported a higher operating net back per barrel – a key measure of an oil company's profit margin – which jumped almost 3% in comparison to 2012 on the back of lower royalty payments, thus boosting profitability.

But the significant growth in Blackpearl's bottom line can primarily be attributed to two one-off items that were accounted for in 2013. Blackpearl reported lower impairment charges, which were down by

40% in comparison to 2012 and a one-off gain of $3.6 million from the sale of conventional non-producing heavy oil properties in Saskatchewan.

This highlights how adjusted EBITDA is a better way to measure and compare the performance of an oil company, both quarter over quarter and year over year. Adjusted EBITDA does not include taxes, depreciation, amortization, impairment charges or one-off gains from the sale of assets.

This number gives a more accurate measure of an oil company's core profitability. For 2013, Blackpearl's adjusted EBITDA in comparison to 2012 remained relatively flat at $75 million, indicating it continues to steadily maintain its core operating profitability.

Finally, Blackpearl also reported a healthy 29% increase in its oil reserves at the end of 2013, indicating the core value of its assets has grown significantly. This significantly boosted its pre-tax net asset value — after being discounted by 10% per annum — to $2.2 billion or just over $7 per share. That highlights Blackpearl's financial and operational strength, which has yet to be fully accounted for by investors.

Future outlook remains solid
For 2014, Blackpearl's management has provided guidance that expects average daily oil production to grow by between 3% and 8% to 10,000 and 10,500 barrels of crude. When coupled with a higher expected heavy oil price in comparison to 2012, Blackpearl's financial performance can only continue to grow.

There is also considerable potential for Blackpearl's oil reserves and production to continue growing over the longer term. In comparison to 2013, the company has roughly tripled its 2014 capital expenditure to between $260 million and $270 million.

Over 60% of that capex has been flagged for use in the construction of the Onion Lake enhanced oil recovery project, which has been fast-tracked in preference to developing the Blackrod SAGD project. This decision was made because of the significant capital expenditure required to fund the Blackrod development, which Blackpearl's management believed could not be appropriately raised given current market conditions.

Blackpearl estimates that on completion Onion Lake's oil production will more than double from 5,000 barrels of oil daily to 12,000 barrels of oil daily. This will provide the company with additional cash flow needed to fund the Blackrod SAGD project.

A further 20 to 25 conventional oil wells are also scheduled to be drilled at Onion Lake, which along with further development of the Mooney asset, should see further production growth over the course of 2014.

All of this bodes well for Blackpearl to boost oil production and reserves over the short to medium term, boosting revenue, cash flow and ultimately its bottom line. Any significant growth in oil reserves – which is highly likely with estimated contingent oil reserves of 691 million barrels across its three core properties – will significantly boost Blackpearl's core asset value.

Foolish bottom line
Solely on the basis of its 2013 operating and financial results, it is clear Blackpearl remains undervalued by the market. But when coupled with its solid asset development program, it is clear its

operational and financial performance as well as its underlying asset value can only continue to grow.

CATEGORY

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