Talisman Energy: Is Now the Time to Invest?

Description

Despite missing consensus analyst estimated earnings for the first quarter 2014, deeply troubled globally diversified oil explorer and producer **Talisman Energy** (TSX: TLM)(NYSE: TLM) still reported some promising results. These indicate the company's transformation program, which is key to unlocking shareholder value and building a sustainable future, is gaining further traction.

Recent poor financial results overshadow a solid improvement in operations
Key among these results was a strong growth in cash flow, which shot up a healthy 6% compared to the previous quarter and 19% compared to the first quarter 2013. This significant cash flow growth – a key measure of the health of an oil explorer and producer – can be primarily attributed to solid growth in the volume of oil and natural gas liquids produced coupled with higher realized crude prices.

Higher margin oil and natural gas liquids production for the first quarter 2014 was up by 4% compared to the previous quarter and 10% compared to the same quarter in 2013. Total oil and gas production remained relatively flat quarter-over-quarter but grew a healthy 6% year-over-year.

However, more importantly Talisman's netback per barrel of oil – a key measure of the profitability of oil companies' operations – shot up a healthy 19% quarter-over-quarter and 11% year-over-year to U.S. $28.44 per barrel. This significant improvement in the company's netback can be primarily attributed to higher crude prices coupled and narrowing price differentials between Canadian heavy crude and West Texas Intermediate.

Although this netback is still significantly lower than many of its peers, with **Crescent Point Energy** (TSX: CPG)(NYSE: CPG) reporting a first quarter netback of $55.95 and **Husky Energy** (TSX: HSE)(NYSE: HSE) $44.81 per barrel.

But all of these factors contributed to a significant improvement in Talisman's bottom line. First quarter 2014 net earnings grew a massive 1.5 times quarter-over-quarter and a whopping three times year-over-year to $491 million or $0.47 per share. This is an impressive improvement in Talisman's financial performance with it reporting net losses for the previous two quarters and the first quarter of 2013.

Disappointingly, Talisman didn't meet analyst expectations for the quarter missing the consensus analyst estimated earnings per share by U.S. $0.02 per share or 40%. As a result the market has taken a negative view of Talisman's overall performance, despite the solid improvement in operational results, with its share price plunging almost 3% since the results were announced. This leaves Talisman's share price down by almost 5% over the last year and continues to highlight the degree of caution with which the market views the company.

Transformation program continues to yield results
Another pleasing aspect of the company's performance over the last year has been its ability to rebuild its shattered balance sheet through the sale of a range of assets. The most recent was the divestment of 75% of Talisman's holdings in the Montney for $1.5 billion in March 2014, with those funds being used to reduce its debt by around $1 billion.

As a result by the end of the first quarter Talisman's net debt had fallen by a very healthy 21% quarter-over-quarter and 8% year-over-year to U.S. $3.8 billion. But this still leaves Talisman heavily leveraged particularly in comparison to cash flow with net debt being a massive four times operating cash flow, which is one of the highest debt-to-cash flow ratios among its peers.

This ratio is more than double Crescent Point's net debt of 1.6 times operating cash flow and Husky Energy's net debt of two times operating cash flow, highlighting one of Talisman's key weaknesses.

However, the company is working hard to continue reducing debt by raising funds through the sale of non-core assets and this coupled with steadily growing cash flow should see this ratio fall over time.

Trades with some attractive valuation ratios
Despite all of these issues Talisman does appear attractively priced with an enterprise-value which is a mere 11 times its oil reserves and equivalent to $59,000 per barrel of crude produced daily.

This is significantly lower than Crescent Point's enterprise-value of 30 times its oil reserves and Husky Energy's 12 times its oil reserves. Both companies also have an enterprise-equivalent to $180,000 and $114,000 per barrel of crude produced daily respectively.

Clearly Talisman is not out of the woods yet, but with the company reporting some solid improvements in its operational results for the first quarter it is clear its transformation program is gaining traction. These factors coupled with it continuing to trade with some attractive valuation metrics makes now the time for investors with a strong stomach, to contemplate taking the plunge into Talisman.

CATEGORY

1. Investing

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1. NYSE:VRN (Veren)
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