Is Now the Time to Make a Bet on Twin Butte Energy?

Description

Canadian intermediate oil explorer and producer **Twin Butte Energy** (TSX: TBE) saw its shares plunge yesterday, with Bay Street being less than impressed with the company's revised full-year guidance. In one day alone its shares plunged by over 20% and have continued to fall in recent trading. But the key question for investors is whether this represents a buying opportunity?

What triggered the sell-off?
Twin Butte reported some impressive figures for the first quarter 2014, with record production of 22,529 barrels of crude daily, a 13% increase compared to the previous quarter and a healthy 31% increase compared to the first quarter 2013. It also reported a significant increase in higher margin crude and natural gas liquids production during the same period. Crude and natural gas liquids production shot up a healthy 3% quarter-over-quarter and 4% year-over-year, to make up 91% of total hydrocarbons produced.

But the company was forced to revise its 2014 guidance, due to a number of technical issues in its operations, key being higher than expected oil well decline rates for its vertical wells. This will cause 2014 production to fall, with Twin Butte management estimating overall 2014 production will now be around 22,000 barrels of crude daily, a 6% to 8% decrease from earlier estimates.

This has seen a number of analysts revise their price targets for Twin Butte, with CIBC dropping the 12 month price target by 10% to $2.25 per share. But the median 12 month estimate from across 16 analysts is $2.75 per share, which is a 67% premium over the last traded price of $1.65 per share.

A number of key values indicate Twin Butte is heavily undervalued
However, there are a range of signs Twin Butte's share price has been roughly handled by the market and it is now heavily undervalued.

The company's oil reserves have a before-tax net present value when discounted by 10% of $1,142,854, or $3.33 per share. This represents a hefty premium of 101% over the current trading price, highlighting the market has yet to recognize the value of Twin Butte's underlying core assets, its oil reserves.

Twin Butte's operating netback per barrel of oil produced continues to grow, up by 15% quarter-over-quarter and 19% year-over-year to $28.72 per barrel. The key drivers of this increase are higher average realized crude prices coupled with the company increasing higher margin oil and natural gas liquids production as well as continuing to grow its higher margin medium oil production.

This significant increase in operating netback should continue with Twin Butte focused on growing higher margin medium oil production in place of producing heavy oil and natural gas.

But it should be noted this netback is significantly lower than many of Twin Butte's peers, with **Lightstream Resources** (TSX: LTS) reporting a first quarter 2014 netback of $56.11 and **Surge Energy**

(TSX: SGY) at $49.20 per barrel of crude produced — emphasizing the lack of maturity in Twin Butte's operations.

Twin Butte also consistently maintains a high drilling success rate, which was 94% for the first quarter 2014 and 96% for the full year 2013. This highlights the quality of the company's exploration assets as well as solid return it is able to generate on the capital invested in exploration and development.

Appears attractively priced
Twin Butte also appears attractively priced in comparison to its peers, with a price-per-flowing-barrel of $75,000 and an enterprise value of 18 times its oil reserves. Its price-per-flowing-barrel is one of the lowest among Canadian intermediate oil producers, significantly lower than Surge Energy's $130,000 per barrel and Lightstream Resources' $106,000 per barrel.

Pays a dividend with a monster yield
The company continues to pay a monthly dividend of $0.016, which after the plunge in Twin Butte's share price leaves it with a monster yield of almost 12%. Furthermore, this monster dividend yield appears sustainable despite the company having reported both a first quarter 2014 and full year 2013 net loss. This is because Twin Butte continues to maintain a policy of ensuring capital outflows, capital expenditure, and dividends combined do not exceed 100% of the company's funds flow from operations.

The market's reaction to Twin Butte's revised 2014 guidance smacks of a significant overreaction, with many signs the company is well positioned to continue performing strongly. Furthermore, with a monster dividend yield in excess of 11% patient investors will continue to be rewarded as the wait for the expected rebound in the company's share price.

CATEGORY

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Author
mattdsmith