2 Canadian Oil Plays Offering Solid Potential Upside

Description

Even with crude trading at its lowest point since March 2010, there are a number of Canadian energy companies that remain profitable. But even these companies were caught up in the frenzied sell-off of energy stocks over the last month.

However, this has created some deep-value investing opportunities for long-term contrarian investors seeking exposure to crude. Let's take a closer look at two energy companies that offer considerable potential upside over the longer term.

Parex Resources Inc.

Canadian-domiciled **Parex Resources Inc.** (TSX: PXT), which operates in Colombia, has seen its share price plunge 18% over the last month. This can be primarily attributed to softer oil prices and the market's overblown perception of risk concerning its operations.

The market's perception of risk can be attributed to Parex's small size and because the majority of its assets are located in the higher-risk jurisdiction of Colombia. But contrary to this perception, Parex's operations remain on solid footing.

Colombia is not nearly as risky an area as commonly believed. Its internal security situation has improved markedly while the government has introduced a range of measures to reduce corruption, boost regulatory transparency, and safeguard foreign investments in the oil industry.

More important, one of Parex's key attributes is its high-quality asset base. The company holds 3 million acres in proven oil producing basins and has reserves of 58 million barrels of crude. These reserves are heavily weighted to higher-margin light crude and have been independently valued at $12 per share, which is a 16% premium over Parex's current share price.

Oil production continues growing at a healthy rate. In the third quarter, it shot up 26% compared to the previous quarter, and an impressive 55% against the same quarter in 2013. Such strong production growth, coupled with the success of Parex's drilling program, allowed the company to increase its full-year production guidance by 25%, boding well for another year of strong financial results.

Parex also continues to generate a solid operating margin, or netback per barrel of crude sold. For the second quarter, it reported a netback of $61.65 per barrel, which is well above the netbacks generated by its peers operating in North America. The company is also able to access premium Brent pricing, and with Brent trading 6% higher than WTI, it gives Parex an advantage over many of its North American peers that have their sale prices indexed to WTI.

For all of these reasons, I believe Parex is well-positioned to weather the current difficult operating environment. I also expect its oil reserves and production to continue growing because of its exploration acreage in proven oil producing basins, coupled with an impressive drilling inventory. This should translate into stronger financial results and a higher share price.

Cenovus Energy Inc.

Integrated energy company **Cenovus Energy Inc.** (TSX: CVE)(NYSE: CVE) recently surprised the market, reporting third-quarter 2014 earnings that were 26% higher than the consensus analyst estimate.

It achieved this impressive result because of a significant increase in oil production, which for the third quarter was up 23% compared to the equivalent quarter in 2013. This production is heavily weighted to higher-margin crude oil, allowing Cenovus to capture a higher margin for each barrel of oil produced. This is reflected in its impressive third-quarter 2014 netback of $51.83 per barrel for oil and petroleum liquids.

Another important aspect of Cenovus' operations is its upstream, or refining, business. This provides a natural economic hedge against softer crude prices, allowing Cenovus to more effectively manage its margins. When coupled with growing production, these are key reasons for Cenovus beating consensus earnings estimates, and they will continue to contribute to strong bottom-line growth.

With a range of projects under development, the majority of which are expected to go to first production between now and the end of 2015, Cenovus is well-positioned to continue growing crude production. When coupled with the company's solid margins, that growth should translate to solid financial performance despite softer crude prices, making now the time for investors to take the plunge.

CATEGORY

1. Energy Stocks
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1. NYSE:CVE (Cenovus Energy Inc.)
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3. TSX:PXT (PAREX RESOURCES INC)

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