Drilling for Value in the Energy Patch With Twin Butte Energy Ltd., Long Run Exploration Ltd., and Enerplus Corp.

Description

It has been a roller-coaster year for investors in Canada's energy patch. Energy stocks were strong in the first half, but have been plunging as crude prices hit their lowest level since 2010. This triggered a frenzied sell-off of energy stocks, with the **S&P TSX Capped Energy Index** plummeting 18% over the last three months, creating some exceptional bargains among Canadian energy stocks.

Looking at three key valuation multiples — Enterprise Value to EBITDA, EV to oil reserves, and EV to barrels of crude produced daily — I have identified three energy companies from the patch that offer investors considerable value.

EV to EBITDA gives an apples-to-apples comparison of the relative value of an energy company among its peers. The EV-to-oil reserves ratio allows us to see just how undervalued or overvalued an oil company is based on its oil reserves. Finally, EV to barrels of crude produced daily, also referred to as price per flowing barrel, gives us an idea of how cheap or expensive an oil company is based on the volume of its oil production.

In all three metrics, the lower the multiple, the more undervalued the company.

Twin Butte Energy Ltd.

Relative newcomer to the patch **Twin Butte Energy Ltd.** (TSX: TBE) saw its share price smashed earlier this year after revising its 2014 production guidance downwards. This revision occurred because of a range of technical issues, including higher-than-expected decline rates on its vertical wells, which were affecting production volumes.

This, coupled with softer crude prices, has dragged share prices down by 10% over the last three months, leaving the company attractively priced with an EV of five times EBITDA and 17 times its oil reserves, as well as a price per flowing barrel of $56,000.

I expect to see Twin Butte's share price rebound strongly, after the company has implemented a drilling strategy to reduce decline rates and boost production volumes. As this gains momentum, its profitability will improve, despite the difficult operating environment. That should translate into a healthy appreciation of its share price.

Long Run Exploration Ltd.

Over the last three months, **Long Run Exploration Ltd.'s** (TSX: LRE) share price has plunged a massive 47%, with the market concerned over the impact of significantly weaker crude prices on its pile of debt and monster 15% dividend yield. Long Run now trades at an EV of six times EBITDA and eight times its oil reserves, along with a price per flowing barrel of $45,000.

The accretive acquisition of **Crocotta Energy Inc.** during the third quarter of 2014 has significantly boosted Long Run's oil reserves and production. It further enhances Long Run's focus on light oil and natural gas liquids, which over time will boost margins through a higher operating netback.

This focus is already paying dividends, with higher-margin light oil production for the third quarter spiking a healthy 23% year-over-year. Its netback of $31.41 for the same period remained above the crucial $30 per barrel, despite softer crude prices.

Each of these aspects bodes well for Long Run sustaining profitability, despite the difficult operating environment, and will act as a catalyst to push its share price higher as oil prices rebound over the longer term.

Enerplus Corp.

Mid-cap energy company **Enerplus Corp.'s** (TSX: ERF)(NYSE: ERF) share price has been crushed over the last three months, down 39%. This has left Enerplus with some particularly appealing valuation multiples. These include an EV of a mere five times EBITDA and 13 times its oil reserves, along with a price per flowing barrel of $52,000.

When coupled with its diverse and high-quality oil assets located in the relatively low-risk jurisdictions of Canada and the U.S., it appears very attractively priced.

Enerplus is also well-positioned to remain profitable despite weaker crude prices, with it generating a healthy operating margin for each barrel of crude produced. As a low-cost producer, Enerplus' stock should appreciate as oil prices start to rebound over the longer term.

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1. NYSE:ERF (Enerplus Corporation)
2. TSX:ERF (Enerplus)

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