



Steer Clear of Talisman Energy Inc.

Description

Softer crude prices have created a frenzied sell-off oil stocks with many companies now seeing their share prices bouncing around new 52-week lows. This now sees some pundits now claim there is considerable value to be found among energy companies.

One which has attracted the attention of investors is troubled global oil explorer and producer **Talisman Energy Inc.** (TSX: TLM)(NYSE: TLM), with its share price having plunged 53% over the last year. This has left it with some very attractive valuation multiples with an enterprise value of a mere 4 times EBITDA and 8 times its oil reserves.

It seems like only yesterday when renowned corporate activist Carl Icahn bolstered the hopes of shareholders by taking a 7% stake in the company, garnered some board seats, and started agitating for change. But despite these attractive multiples and the involvement of Icahn I now believe Talisman is dead money.

Let me explain why.

First, there is already considerable value built into its share price from a combination of investor activism and the hopes associated with the successful implementation of its turnaround strategy.

This has in the past seen a number of analysts claim Talisman could be worth as much as \$17 a share if it is able to unlock the value of its core high value assets and divest itself of its poor quality assets. But to date all attempts to unlock this value have failed, with a number of potential suitors including Spanish integrated energy major **Repsol SA** choosing to look elsewhere for acquisitions.

Second, Talisman has a portfolio of scattered non-strategic assets, many of questionable quality, with high decline rates and low reserve life, located in higher risk jurisdictions. This is particularly unattractive for many investors and makes it difficult to garner a lot of interest.

Talisman's North Sea assets in particular are highly problematic and continue to weigh heavily on the company's performance. When crude was at \$100 per barrel they were cash flow negative and now with Brent — the international oil benchmark price — at \$79 per barrel, these assets will drag

down performance even more.

The North Sea assets have some of the highest royalty and operating costs of any of the assets held by Talisman. This has made them particularly unattractive assets in the eyes of potential buyers despite Talisman pushing hard to offload them.

The low quality of Talisman's assets becomes even more apparent when examining the operating margin or netback per barrel it is able to generate for each barrel of crude produced.

For the third quarter its netback was \$25.07 per barrel, which is one of the lowest among its peers and leaves little room to absorb the impact of softer crude prices before cash flow and profitability is impacted. This netback was achieved with the price of WTI averaging \$97 per barrel over the quarter and Brent at \$102 per barrel.

Now with WTI at \$76 per barrel and Brent at \$79 per barrel I expect to see Talisman's profitability hit hard and its netback to fall despite its hedging program mitigating some of this risk.

It is difficult to see how Talisman can continue operating profitability in the current operating environment dominated by weaker crude prices. I also don't believe the company will ever be able to divest itself of its poorer quality non-core assets, particularly those in the North Sea, leaving them as a thorn in its side which will continue to impact its bottom line for years to come.

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