Enerplus Corp. Remains One of the Best Levered Plays on a Rebound in Crude

Description

What: It has been a long time coming, but late last week **Enerplus Corp.** (TSX:ERF)(NYSE:ERF) announced that it was cutting its dividend after stating that it would avoid doing so in earlier 2015 guidance. This occurred after West Texas Intermediate (WTI) stubbornly remained at a round US$50 per barrel and therefore didn't rebound as quickly as many industry insiders had thought.

So what: Enerplus's dividend cut is part of a broad range of cuts to expenditures and costs that the company decided to implement as part of its revised 2015 guidance. The key goal of this revised guidance is to protect Enerplus's balance sheet and preserve cash flow in what is shaping up to be an extraordinarily difficult operating environment.

Enerplus's dividend was slashed by 44% to $0.05, while 2015 capital expenditure was cut yet again to be $480 million, or 40% lower, than in 2014. These cuts, along with some noncore asset sales, now give Enerplus an adjusted payout ratio of less than 100%. This will leave its balance sheet in a solid condition with a net-debt of around two times cash flow at the end of 2015.

Even after the significant reduction in capital expenditure compared to 2014, crude production in 2015 is only expected to fall by 6% to between 93,000 and 100,000 barrels daily. This will help to generate sufficient cash flow in order for it to meet its financial obligations.

More importantly, Enerplus's hedging program will soften the impact of significantly softer crude prices during the year. Enerplus currently has 52% of first-half 2015 oil production hedged at an average price of approximately US$92 per barrel and 24% of second-half production hedged at around US$94 per barrel. This will help to smooth out cash flow and preserve the strength of its balance sheet.

However, it is the quality of its oil and gas assets that make it stand out as one of the best levered plays on a rebound in crude. In 2014 Enerplus was able to grow its oil reserves by 6% year-over-year to 429 million barrels of crude. These reserves are composed of 50% oil and crude liquids that in the past have generated far higher margins than natural gas, making them far more profitable for oil companies.

I expect that once crude prices rebound, this will be the case again.

After crunching the numbers and allowing for WTI to be at US$50 per barrel, these reserves are worth $15 per share after royalties and tax. This represents a premium of approximately 50% over Enerplus's current share price, highlighting just how undervalued the company is because of the negative sentiment surrounding the energy patch.

Clearly, should crude rebound above this price, the value of Enerplus's underlying assets will increase markedly, and along with generating higher cash flow, will cause Enerplus's share price to appreciate.

Now what: Even after seeing its share price appreciate by 3% over the last month, I believe that in comparison to the value of its core underlying assets, Enerplus remains heavily undervalued by the market. This, in conjunction with the company now being well positioned to weather the storm surrounding the energy patch, makes it an ideal levered long-term play on a recovery in oil prices.

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