



Surge Energy Inc. Was Recently Rated a Buy: Is Now the Time to Invest?

Description

The doom and gloom surrounding oil prices continues to underscore the risks associated with investing in the energy patch. While small-cap energy stocks are the most vulnerable in the current harsh operating environment, **Surge Energy Inc.** ([TSX:SGY](#)) was recently rated as a buy and it is easy to see why.

Now what?

Why does Surge shape up as a solid play on a rebound in crude prices?

First, it has a high-quality asset base with oil reserves totaling 112 million barrels and these reserves continue to grow.

Surge reported that its reserves had shot up 52% year over year in 2014, and even with sharply reduced expenditure on developing existing oil assets, these reserves should continue growing in 2015. More impressively, after taking into account sharply lower crude prices, these reserves have been independently valued at \$7.36 per share. This is almost double Surge's current share price and highlights the potential upside available to investors.

Over half of these reserves are also classified as developed and producing. This mitigates much of the risk and costs associated with developing reserves to the point where they are producing and commercially viable.

Second, oil production continues to grow at an impressive rate.

The 2014 production shot up by 68%, compared with 2013, to an average of over 18,000 barrels daily. This is expected to grow, despite a sharp reduction in capital investment in drilling and development. Surge has predicted average production to be 20,000 barrels daily in the first half of 2015, which is 27% higher than the equivalent period in 2014 and 11% higher than the full year average for 2014. This strong growth will make up some of the revenue and cash flow lost because of low crude prices.

Third, Surge has hedged 45% of its 2015 oil production at a price well above the current price for West

Texas Intermediate (WTI). This will help to further shield cash flow from low crude prices.

Fourth, even after slashing its dividend by almost half, it continues to reward investors with a very juicy 9% dividend yield.

More promising is that it appears to be sustainable, with Surge forecasting an all-in-sustainability ratio of 65% based on WTI averaging US\$58 per barrel.

Finally, Surge has moved quickly to reduce its debt to a manageable level.

Earlier this year it completed asset sales totaling \$35 million and also monetized some of its hedging contracts, yielding a profit of \$35 million. These proceeds were directed towards repaying debt and it has the capability to make further asset sales if required.

So what?

The current harsh operating environment and ongoing uncertainty surrounding the outlook for crude has made investing in the oil industry and small-cap oil producers particularly risky.

However, I believe that Surge represents one of the best opportunities among intermediate oil producers to play the rebound in crude. While this may be some time off it, appears attractively priced and is well positioned to weather the current storm in oil prices.

CATEGORY

1. Energy Stocks
2. Investing

TICKERS GLOBAL

1. TSX:SGY (Surge Energy Inc.)

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