2 Stocks Under $5 That Will Soar if Oil Recovers

Description

Even as oil prices languish, numerous energy analysts are predicting a rebound in the second half of the year. For example, **Citigroup** is predicting an average Brent price of US$52 barrel in the fourth quarter and has identified oil as the “trade of the year.”

If you’re looking to make this bet, you should go with one of the more troubled producers (i.e., one with a poor balance sheet). While these companies may be more risky, their shares have been absolutely hammered and their stock prices will take off if oil recovers.

Below are two examples.

1. Paramount

Paramount Resources Ltd. (TSX:POU) was the worst-performing stock on the TSX last year, losing nearly 80% of its value. And 2016 hasn’t been much better; the stock is already down by more than a third.

It’s no secret why Paramount has fared so poorly. The company entered 2015 with $1.5 billion in net debt, a 32% increase in just 12 months. And when oil prices plunged, this debt became harder to manage.

The numbers tell the story. Through the first nine months of 2015, Paramount generated $74 million in cash flow from operations. Meanwhile, its capital expenditures exceeded $400 million. To make up for the shortfall, the company increased its net debt by $350 million. And that was when average WTI oil prices exceeded US$50 per barrel. With oil prices stuck near US$30 the situation is undoubtedly much worse.

Bankruptcy is now a legitimate possibility for Paramount. But there’s also plenty of upside if oil prices recover. To put this in perspective, the last day that WTI closed at over $40, Paramount shares closed at $7.98–double the current share price.

2. Penn West

Penn West Petroleum Ltd. (TSX:PWT)(NYSE:PWE) hasn't fared any better than Paramount. The company has suffered from a botched acquisition, poor operational results, an accounting scandal, a heavy debt load, and falling oil prices. Put it all together and the stock is down more than 95% over the past five years.

But beneath it all the company is well positioned for an oil recovery. The balance sheet has improved dramatically mainly thanks to asset sales, and its remaining plays have very strong economics. And the last time that WTI was above US$40, Penn West traded nearly 50% higher.

Like Paramount, Penn West is an enormously risky stock. But there's an easy way to manage this risk: buy fewer shares. By doing so, you'll get a much more effective bet–with the same amount of risk–than you would get with an oil major.

CATEGORY

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TICKERS GLOBAL

1. TSX:POU (Paramount Resources Ltd.)

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