How Has Advantage Oil & Gas Ltd. Avoided the Oil Rout?

Description

With oil and natural gas prices down over 50% in just 18 months, it's no surprise to see pain in the sector. While smaller operators such as **Tourmaline Oil Corp.** are down around 50% over that time period, even mega-producers such as **Exxon Mobil Corporation** have experienced drops of about 25%.

How then has **Advantage Oil & Gas Ltd.** (TSX:AAV)(NYSE:AAV) avoided a tumble? In fact, shares have advanced around 32% in the last 18 months. Over the last three years shares are up a massive 160%. What's the secret?

Savvy management

While most companies two years ago operated on the assumption of US$4 mcfe natural gas, the management team at Advantage decided to build a business that can withstand even the most depressed energy-pricing environment. Even with natural gas prices down to US$2 mcfe today, Advantage is still expected to generate surplus cash flow of around $40 million.

To pull this off, management had to work its savvy in multiple ways.

First and foremost, it concentrated only in areas of super low-cost production. It has the industry's lowest cost of production at roughly US$0.55 mcfe. It's nearly impossible to imagine a scenario where the company can't be profitable.

Second, management had the foresight to hedge a significant amount of production through 2017; 52% of 2016's production and 22% of 2017's is hedged above US$3 mcfe. This combined with rock-bottom production costs allows Advantage to generate excess cash even in the worst of scenarios.

Solid balance sheet with higher production

Total debt this year should only be 1.6 times cash flow. So if Advantage chose to, it could pay off over half of its debt load in 2016 alone. It also has $286 million in undrawn credit facilities. Strong internal cash flows and ample levels of committed financing have allowed Advantage to avoid tapping the equity market for over seven years. Compared with the rest of its industry, Advantage shareholders can sleep easy.

With over 1,000 drill locations left, however (with estimated ROIs of 50% or more), Advantage should continue to pour excess cash back into the business. From 2015 to 2017 the company is targeting 22% annual production growth, all while maintaining its attractive cost position. This year alone it should easily achieve production growth of 38%, crushing its average competitor's growth of less than 20%.

A safe place to be

Even if natural gas prices fell another 20%, Advantage would still generate around $140 million in operating cash flow and $20 million in free cash flow. By 2017 the company anticipates $1.09 in cash flow per share, all while growing production and lowering its leverage ratios. A reliable cost position and hedging program should ensure that these targets are highly achievable.

It's no wonder Advantage shares have advanced throughout falling natural gas prices–the company can turn a profit in nearly any environment.

CATEGORY

1. Energy Stocks
2. Investing

TICKERS GLOBAL

1. TSX:AAV (Advantage Oil & Gas Ltd.)

Category

1. Energy Stocks
2. Investing

Date
2025/07/21
Date Created
2016/02/04
Author
rvanzo