



\$40 Oil Won't Last: 4 Ways to Play the Coming Rebound

Description

With oil prices down 20% from June, the market has turned firmly bearish on oil. Hedge funds hiked their short positions on WTI by 166% from the end of May to late July, which marks one of the largest hikes in crude history for such a short time period.

Does this mean prices still have more downside?

They very well might have more downside (some firms are calling for US\$35/bbl), but one thing is for certain: any further downside will likely be short-lived.

Oil prices have been resilient. A recent piece by John Kemp demonstrated that even though crude prices fell US\$4.45 per bbl between May 30 and July 19 (to US\$44.65), a much larger drop should have been expected based on the past relationship between the build in hedge fund short positions and crude prices (as low as US\$37/bbl by July 19).

Why have prices been so resilient compared to the past?

Unlike in 2015, the market is much closer to balance with many expecting a deficit in the market by 2016, and the IEA seeing a full-year deficit for 2017. With U.S. production down nearly one million bpd year over year and demand growing by over one million bpd annually, U.S. production will need to rise to meet demand growth. Prices much higher than US\$40/bbl will be required to do so.

Here are four excellent ideas for playing the rebound.

1. Crescent Point Energy Corp.

Crescent Point Energy Corp. (TSX:CPG)(NYSE:CPG) is considered a best-in-class name, because it excels in nearly every area. With an estimated netback (profit per barrel) of \$27 per barrel in 2016 at US\$45 per barrel, Crescent Point leads its 42 peer group. This lead holds even at US\$30 per barrel.

These netbacks are a result of Crescent Point's extremely high-quality asset base, and the top three North American plays when ranked by time to recoup drilling capital costs are all Crescent Point plays.

Crescent Point adds value to its top-tier asset base through technology initiatives like water-flooding.

The company is working to lower the overall annual production decline rate (there's been a 20% improvement since 2011). Water-flooding has the effect of hiking the oil Crescent Point can recover from a well with very little incremental capital spending. The end result is plenty of free cash flow.

2. Suncor Energy Inc.

Suncor Energy Inc. ([TSX:SU](#))([NYSE:SU](#)) is an excellent name for investors who want exposure to oil, but who may have a more pessimistic view on the size or the timing of the oil-price recovery. Suncor offers a few clear benefits to investors: a strong balance sheet, a highly visible production-growth outlook (production is expected to grow from 606,000 bpd this year to 781,000) in 2018, and a strong free cash flow outlook for 2017 and beyond.

On top of strong production growth from several projects coming online (like Fort Hills and Hebron), Suncor's strong balance sheet and the large amount of distressed oil assets makes the company very likely to make another acquisition, which could provide more production growth and be accretive to earnings.

3. Birchcliff Energy Ltd.

Birchcliff Energy Ltd. ([TSX:BIR](#)) is different than the above names because it is a natural gas-weighted player with close to 90% of its production from natural gas. Birchcliff recently made a transformative acquisition, purchasing \$625 million of Montney shale properties from **Encana**.

This acquisition increased Birchcliff's exposure to the lucrative Montney formation, while also reducing its debt-to-cash flow ratio by an estimated 63% thanks to the equity financing of the deal. This gives Birchcliff huge exposure to rising natural gas prices with less leverage.

4. Baytex Energy Inc.

Finally, investors comfortable with high-risk, high-reward names should consider **Baytex Energy Corp.** ([TSX:BTE](#))([NYSE:BTE](#)). Baytex has fairly high leverage compared to its peers thanks to a poorly timed entry into U.S. shale before the oil price collapsed, which means the company typically sells off hard during oil price drops like the one just seen.

This also means that Baytex will rally significantly as oil prices rise (as it did earlier in the year), and, being one of the most oil-price-sensitive names on the TSX, Baytex is a smart play for those expecting oil prices to rally significantly.

CATEGORY

1. Energy Stocks
2. Investing

POST TAG

1. Editor's Choice

TICKERS GLOBAL

1. NYSE:SU (Suncor Energy Inc.)
2. NYSE:VRN (Veren)
3. TSX:BIR (Birchcliff Energy Ltd.)
4. TSX:BTE (Baytex Energy Corp.)
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Date

2025/09/03

Date Created

2016/08/05

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