4 Top Ways to Play the Coming Spike in Oil Prices

Description

During the summer, energy analyst Art Berman stated in an interview that sometime in the next five years, there will be a "moonshot" in oil prices. In other writings, he suggested this price spike could exceed US$90 per barrel and potentially last for a year or slightly longer (based on previous price spikes) before oil falls once again.

Berman's argument is tough to argue with. For the past two consecutive years (it's looking like 2016 will be the third year), global capital expenditures for exploration and production have declined. Going forward, between 2015 and 2020, Wood Mackenzie estimates that $1 trillion will have been cut compared to expected levels before the oil-price crash. This works out to about 150 projects and 19 million barrels of oil.

This is a problem. While capital cuts are necessary for oil companies to survive in the short term (and have little immediate impact), they have massive impact down the line. Capital is required to not only maintain production (global oil production declines by 2.8 million bpd annually), but also to grow production to meet the estimated 1.2 million bpd in annual demand going forward to 2020.

While many investors to point to the tight oil supply in the U.S. which can come online quickly, this is currently less than 5% of global production, and the available reserves are fairly small according to Berman. Longer-term projects will be needed, and investment for these has been cut.

Here are four ways to play coming strength in oil.

1. Crescent Point Energy Corp. (TSX:CPG)(NYSE:CPG)

Crescent Point's strengths are fairly well known by investors. The company has the highest profit per barrel among its 57 member peer group, has eight of its nine core plays ranked in the top 20 North American plays by payout time, and has a large inventory of high-returning wells that are economic under US$45 per barrel.

Crescent Point shares are currently weak because it raised equity one month ago to increase its capital expenditures in 2017 from $950 million to $1.4 billion and to raise production. Investors were unhappy about this, and the stock currently trades at a major discount to its peer group as a result. Once investors begin to look beyond this, the company should recover to catch up with its peers and perform well with rising oil prices.

2. Baytex Energy Corp. (TSX:BTE)(NYSE:BTE)

Baytex has a reputation of being one of the most leveraged names in Canada to rising oil prices. This is because the company has fairly high debt levels (6.6 times 2017 cash flow compared to the group average of 2.2), and also because the company has about 33% of its production coming from heavy oil.

Heavy oil prices trade at a discount to light oil but will rise faster when oil prices recover. While investors are worried about Baytex's debt, it has no debt repayments due until 2021, and rising oil prices should make investors less concerned about debt levels and therefore give it a higher valuation.

3. Canadian Natural Resources Limited (TSX:CNQ)(NYSE:CNQ)

Canadian Natural is a large producer (about 800,000 bpd in 2016, the highest in Canada) with fairly low debt levels (2.2 times 2017 cash flow). This makes Canadian Natural a fairly safe name, especially considering the company is expecting very strong free cash flow in 2017 should oil prices rise to US$60 per barrel.

Canadian Natural expects $1.4 billion in free cash flow in 2017, and, at the same time, the company has a plan to grow its production by 200,000 bpd by the end of 2019.

4. Cardinal Energy Ltd. (TSX:CJ)

Cardinal Energy is a smaller producer (market cap of only $720 million) that produces a heavier grade of oil, which should give it strong leverage to rising prices. At the same time, the company has low debt levels (less than one times cash flow) and a high-quality asset base and plenty of very lucrative drilling opportunities ahead.

CATEGORY

1. Energy Stocks
2. Investing

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1. Editor's Choice

TICKERS GLOBAL

1. NYSE:CNQ (Canadian Natural Resources)
2. NYSE:VRN (Veren)
3. TSX:BTE (Baytex Energy Corp.)
4. TSX:CNQ (Canadian Natural Resources Limited)
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