These Oil Stocks Are Already Off to a Fast Start in 2017

Description

What a difference a year makes.

At the beginning of last year, oil prices were still sliding down a seemingly bottomless pit, forcing oil companies to take drastic action to stay afloat. This year, however, prices are on a more stable footing thanks to improving market fundamentals.

Producers are much more confident than they were a year ago, and many are slowly starting to ramp drilling activities back up. However, few are off to as fast a start as **Encana Corp.** (TSX:ECA)(NYSE:ECA) and **Penn West Petroleum Ltd.** (TSX:PWT)(NYSE:PWE), which both recently boosted their 2017 growth guidance.

Ahead of schedule

Back in October, Encana released an ambitious five-year growth plan forecasting 60% production growth by 2021, assuming oil averaged $55 per barrel and gas was around $3. Those prices would enable the company to earn lucrative returns on its best drilling locations, putting it in the position to double its corporate margin and fuel a 300% increase in cash flow over the next five years.

Encana expected to hit the ground running in 2017. It has plans to increase production from its four core assets by 15-20%, while increasing its corporate margin to $8 per barrel of oil equivalent (BOE).

However, thanks to strong performance in the fourth quarter of last year, Encana now expects to exceed its 2017 forecasts for production growth and margin. The company now sees its corporate margin rising to $10 per BOE this year, or 25% above the plan, thanks to lower costs than anticipated as well as the expectation that production volumes in the second half will be higher than initially expected. Further, Encana sees 2017 volumes landing in the upper range of, or exceeding, its initial guidance.

Given that it is still very early, Encana has plenty of time to push through additional cost savings or productivity gains, allowing it to outpace its initial guidance even further. Also, it has the asset base and financial flexibility to accelerate its growth plan should oil and gas prices run above forecast.

Adding a little more fuel to the plan

Penn West spent most of the last year right-sizing its balance sheet. Those actions, which included selling two core assets, cut the company’s net debt from $2.1 billion at the start of the year to $484 million as of the end of September. Further, these moves pushed the company’s leverage ratio down from a concerning 4.5 times senior debt-to-EBITDA to a much more palpable 1.95 times.

As a result, Penn West is now back on solid ground, which allowed it to get back to work and start drilling oil wells. It commenced its ramp-up in August by boosting capital spending 80% to $90 million. Further, it had plans to spend $150 million on capex in 2017, which would drive 10% production growth within cash flow at $50 oil prices.

However, with crude rising above that level, Penn West announced its intention to boost 2017 spending to $180 million. That capital would enable the company to grow production by 15% from its core areas over the course of the year.

Further, that spending level represented just 80% of projected funds flow from operations, meaning the company should generate excess cash flow this year, assuming commodity prices do not tumble. That excess cash flow gives Penn West the flexibility to increase its budget later this year if commodity prices continue to rise.

Investor takeaway

Encana and Penn West spent most of the last year working to improve their balance sheets and drive down costs. Those efforts paid off, allowing both companies to restart their growth engines by year end thanks to stabilizing oil prices.

However, after just a few short months, both have exceeded the initial expectations, which has them on pace to deliver even stronger results in 2017. Further, with ample financial flexibility and resource potential, each has the capability to continue outperforming, especially if oil prices rise above the current forecasts. That is great news for investors, who could enjoy a banner year in 2017.

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