Another Oil Stock Joins the 10% Growth Club

Description

During the past couple of years, there had been one clear trend in the oil sector: producers were slashing spending so much that few were investing enough to maintain their production, let alone grow it.

However, there has been a noticeable shift in the sector over the past few months as several Canadian oil and gas producers have unveiled new long-term growth plans, detailing their ability to deliver double-digit production growth at the current oil price. These plans are a remarkable achievement that shows just how far the producers have come over the past few years.

The latest company to unveil its long-term growth outlook is **Enerplus Corp.** (TSX:ERF)(NYSE:ERF). Here's why it is now part of that elite group.

Drilling down into Enerplus's plan

Enerplus announced that it plans to spend $450 million this year on capex, which, when combined with its current dividend, matches its expected cash flow at $55 oil. That money will enable the company to drill enough new wells to increase its production to an average of 92,000-97,000 barrels of oil equivalent per day by the fourth quarter. At the midpoint, that is up 6.2% from the 89,000 BOE/d it expected to produce during the fourth quarter of last year.

What's noteworthy about Enerplus's plan is that it sees liquids production growing by a robust 25% over the course of the year, fueled by 50% growth in Bakken shale output.

That higher-margin liquids growth sets the company up for even stronger growth in subsequent years. In fact, the company expects to increase its production by 10% annually through 2019 with liquids output growing 20% annually over that same time frame. More importantly, the company plans to achieve that growth while living within cash flow at $55 oil and $3 natural gas.

What's fueling this growth

One critical aspect of Enerplus's plan is a deep inventory of high-quality drilling locations in the Bakken shale of North Dakota. The company can drill these wells for around $8 million, which is 43% less than just a few years ago. Because of those lower drilling costs and an increase in well productivity, these wells can earn returns of 30-55% at $50 oil.

Those returns compare favourably to the high-return wells that rivals are using to fuel their double-digit growth plans.

Encana Corp. (TSX:ECA)(NYSE:ECA), for example, can earn a minimum 35% after-tax rate of return at $50 oil on its premium drilling locations across four North American shale plays. Because of that, Encana expects to grow its production and cash flow by 60% and 300%, respectively, over the next five years.

Meanwhile, **Crescent Point Energy Corp.** (TSX:CPG)(NYSE:CPG) can earn internal rates of returns between 17% and 22% on Bakken shale wells drilled in the U.S. at $52 oil and even higher returns in some of its other areas. Crescent Point Energy sees its exit-to-exit production increasing 10% this year.

That said, high-quality acreage alone isn't enough to fuel double-digit production growth. Just ask **Baytex Energy Corp.** (TSX:BTE)(NYSE:BTE) and **Pengrowth Energy Corp.** (TSX:PGF)(NYSE:PGH). In Baytex Energy's case, it sees its output growing just 3-4% this year, despite having ample locations that can earn +50% returns at $50 oil. Meanwhile, Pengrowth Energy sees its production declining in 2017, despite the fact it can earn returns ranging from 30% to 50% at $50 oil on its projects.

The crucial factor holding back growth at Baytex and Pengrowth is that both have too much debt, which is eating into their ability to grow. For perspective, Baytex and Pengrowth have debt-to-enterprise-value ratios of more than 60%, while Crescent Point, Enerplus, and Encana have less than 30% debt-to-enterprise-value ratios. As a result, the lower-leverage producers are doling out less money to creditors for interest payments, which gives them more cash to invest in high-return drilling locations.

Investor takeaway

Enerplus has the two factors oil companies need to grow at lower oil prices: high-return drilling locations and low leverage. Because of this, the company can join the elite group of producers projecting double-digit output growth at current prices over the next few years. Should that growth materialize as expected, it could be all the fuel the stock needs to continue moving higher even if oil prices do not budge.

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