



These 3 Canadian Oil Stocks Are Now Hugely Undervalued

Description

Investors love to quote Warren Buffett's infamous line about value investing: "...be greedy when others are fearful and fearful when others are greedy." The current pullback in Canadian energy stocks (many of which are down 30% just since December and over 50% since last year's highs) is exactly what fear looks like.

Some of these names are extremely high quality with excellent double-digit production growth, low-risk balance sheets, and positive cash flow into the mid-\$40-per-barrel price range. Investors are ignoring these opportunities largely due to pessimism around the oil market.

Investors who are pessimistic about oil prices over the medium to long term should keep the following in mind.

Firstly, the recent sell-off in oil stocks is due to short-term thinking by the market. There was recently a large inventory build which, partially due to seasonal factors, scared investors. Currently, U.S. refineries producing 1.5 million barrels per day are offline (which is higher than the five-year range for this time of year) due to refinery maintenance, which saps demand.

Secondly, the market is already under supplied. In fact, globally, one million more barrels per day was consumed than produced in February.

While the market may be focused on rising U.S. production, it is ignoring the fact that production almost everywhere else is falling. OPEC compliance to production cuts has been good, and Saudi Arabia has clear incentive to support oil markets for their own budget situation. Saudi Arabia is the largest OPEC producer and exceeded their production cut target by 180,000 barrels per day in the first two months of 2017.

Here are three names set to benefit from the coming upswing.

Spartan Energy Corp. (TSX:SPE)

Out of 41 Canadian energy names, Spartan Energy is the fourth-worst performer over the past six

months. This is quite surprising, given that Spartan is almost universally considered to be one of the most high-quality oil producers in Canada. Up until very recently, the stock was one of the most overvalued in the Canadian energy space.

The reasons for the overvaluation are fairly clear. Spartan is a light-oil producer (meaning it gets a premium over heavy oil for its product) and produces in southeast Saskatchewan, which is consistently ranked as having top economics in North America.

The company has a highly respected and competent management team; in combination with their high-quality asset base, management was able to grow production per share by 13% despite the weak oil price environment. In a mere three years, Spartan grew from a \$25 million start-up to an intermediate producer with a market capitalization of over \$1 billion.

The most attractive feature about Spartan is that it can comfortably grow production by 10% per year at the minimum with oil prices down to US\$45 per barrel. The company is currently trading at a discount to its peer group, and once sentiment returns to the stock, it should return to trading at the large premium it once did.

Birchcliff Energy Ltd. ([TSX:BIR](#))

Birchcliff produces about 78% natural gas, but it's poised to benefit from upside in both oil and natural gas prices. The main benefit to Birchcliff is that it has a significant production growth runway. In 2017 alone, Birchcliff is set to grow production of 62,000 barrels of oil equivalent to 80,000 barrels of oil equivalent. This is set to increase by another 20% in 2018. Birchcliff is able to fund the entire growth plan with its own internal cash flow.

Birchcliff currently trades at a 30% discount to its Albertan natural gas peer group, and this discount should unwind as Birchcliff accomplishes its plans.

Baytex Energy Corp. ([TSX:BTE](#))(NYSE:BTE)

Baytex has been one of the hardest-hit names in its peer group and currently trades at about six times its debt-adjusted cash flow compared to its peer group at seven and its own historical average of about seven.

Much of the reason Canadian energy names (including Baytex) sold off is due to fears over a Trump border adjustment tax, but it is important to remember that about half of Baytex's production comes from the Eagle Ford in the United States. This means that even if such a tax were implemented, Baytex would actually benefit on the American half of its production.

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