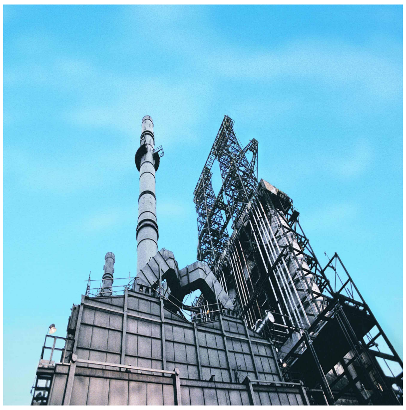

Oil Is Hovering Around $50 Per Barrel: Time to Load Up?

Description

With the price of Brent and WTI crude now trading near the $50 level, investors looking for excellent value plays have begun assessing a number of beaten-up Canadian oil and gas companies with the potential to churn out profits at or above the $50 WTI price level. The roller-coaster ride that is the oil and gas industry is one which has made some investors nauseous, and while short-term profits may be had by trading this volatility, I'm going to discuss why I believe the long-term fundamentals of a few specific companies such as **Altagas Ltd.** (TSX:ALA) and **Baytex Energy Corp.** (TSX:BTE)(NYSE:BTE) do not justify any sort of a premium (rather, a discount, perhaps) to current levels.

Trying to predict where the market price for crude oil will go is a gamble, and I won't pretend to be able to time the market on the upswing or downswing. I will, however, try to provide some insight into how I think about the oil and gas sector in Canada from a long-term perspective, and how taking a long-term view of the overall sector can reveal a few serious issues for this industry in Canada down the road.

Debt levels for many Canadian oil and gas companies are sky high

Companies such as Altagas, which have engaged in acquisitions (WGL Holdings) amid the current low commodity price environment, find themselves adding debt at a very precarious time for the industry overall. Investors and analysts have pointed to this trend as a potential headwind for the industry should oil prices stay at or below the $50 level, with long-term expectations for prices of crude oil and natural gas largely revised downward as newer extraction technologies continue to reduce the input cost of production globally. Both Baytex and Altagas have debt-to-equity ratios hovering around one; historic levels have traditionally been much lower.

Using a conservative long-term oil price doesn't bode well for many firms

Oil and gas companies, like households, build budgets based on expected income and expenses over a given period of time. Very large companies will typically try to take on debt which will accompany cash flows — a strategy that can allow firms to "outgrow" competitors in good times and chip away at market share in a competitive market.

In today's low commodity price environment, companies such as Altagas and Baytex are going to be tested in terms of their ability to improve operations to squeeze out any profitability (or at least limit losses) in the near term, while waiting for oil prices to rise. With capital-expenditure budgets based on a long-term price for oil which, in many cases, is much higher than the current level, companies such as Altagas and Baytex will be forced to continue cutting costs and improving efficiency in the near term.

Bottom line

Before you back up your truck and load up on Canadian oil and gas firms, make sure to take a look at the underlying fundamentals of these firms compared to their peers before making any decisions.

Stay Foolish, my friends.

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