Don’t Let its Recent Dividend Cut Deter You From Buying This Energy Stock

Description

Oil may have rallied powerfully in recent weeks, but it still hasn’t boosted natural gas prices or assisted energy companies focused on natural gas, like **Peyto Exploration and Development Corp.** (TSX:PEY). Natural gas, despite appearing ready to break out of its protracted slump, remains weak because of an ongoing supply glut. The glut has forced Peyto to dramatically change its strategy, including cutting its dividend, significantly reducing capital spending, and strengthening its balance sheet. While these factors, along with its stock plunging by 58% over the last year, make it appear to be an unappealing investment, there is much to like about Peyto.

Now what?

The greatest problem natural gas producers face is that there is a tremendous multi-year supply glut weighing on prices. This glut, despite a significant uptick in natural gas consumption in recent years, shows no signs of going away anytime soon. Even after staging solid recovery at the end of 2016 and into 2017, natural gas producers continue to experience weak earnings, and many, including Peyto, have been forced to slash spending. The driller took a knife to its dividend, slashing it by 45% to $0.06 per share, and it cut capital spending by a third with the option to reduce it even further.

Nonetheless, the market didn’t react overly negatively to Peyto’s decision with its stock falling 7% after the announcement was made. It shouldn’t deter investors from considering the driller as an investment, because it remains a solid investment for those investors seeking exposure to natural gas and its impending recovery.

By sharply cutting spending, Peyto has further increased its financial flexibility, leaving it well positioned to weather any further weakness in natural gas prices, while preserving its financial strength.

As a low-cost producer, it is capable of remaining profitable, even if natural gas prices remain anemic. For the third quarter 2017, it reported combined operational and transportation costs of $2.56 per barrel. While this was 3.6% higher year over year, it is still lower than many of Peyto’s peers.

Notably, that increase was due to higher property taxes and administration fees rather than operational issues or cost blowouts. On a positive note, Peyto’s general and administrative costs for the quarter dropped by an impressive 25% year over year.

More importantly, regardless of the ongoing slump in natural gas, Peyto has remained profitable, reporting earnings per share of $0.27, which was 12% higher than the previous quarter and almost double a year earlier.

Management have also expressed their confidence in the outlook for Peyto by applying to the TSX to implement a share-buyback scheme, which could see it acquire up to 10% of its public float. Such a move makes sense in the current difficult operating environment, which sees Peyto trading at less than half of its 52-week high.

While the short-term outlook for natural gas remains muted, there are a range of emerging catalysts that will act as powerful long-term tailwinds. Key among them is the push to cleaner sources of electricity, which has led to the phasing out of coal-fired power plants and their replacement with natural gas.

You see, natural gas fired plants are proving to be a cheaper and more reliable source of electricity than many renewables, while producing significantly less emissions than coal.

So what?

Peyto has been hit hard by the prolonged weakness of natural gas, but its latest moves will boost its financial flexibility and preserve its financial position, leaving it well positioned to profit from the long-awaited recovery of natural gas. This along with its quality assets, low costs, and depressed stock makes now the time to invest.

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mattdsmith