Is This 6.5% Dividend Yield Canada’s Top Upstream Energy Stock?

Description

Oil has pulled back in recent days, as further supplies emerge after Russia claimed that crude was overvalued. Those factors — along with the Trump administration planning to tap into the U.S. Strategic Oil Reserve — have made global energy markets nervous that world oil supplies will expand once again.

This shouldn’t prevent investors from bolstering their exposure to oil with higher prices here to stay, despite the latest gyrations. One driller that appears attractively valued is **Bonterra Energy Corp.** (TSX:BNE). It has gained a stunning 19% since the start of 2018 and appears poised to surge further.

Now what?

Bonterra is focused on the Cardium shale formation in northwestern Alberta. It has oil reserves of almost 100 million barrels, of which 70% are weighted to oil and natural gas liquids. All of Bonterra’s oil reserves and production are made up of light as well as medium crude, which means that it is not impacted by the deep discount applied to Canadian heavy oil known as Western Canadian Select (WCS). While the price differential between the North American benchmark West Texas Intermediate (WTI) and WCS has converged in recent weeks, WCS still trades at a notable US$19-per-barrel discount, which is almost five times greater than the discount applied to Canadian light oil.

Bonterra’s oil reserves at the end of 2017 were independently valued at $1.3 billion, or roughly $40 per share, before income taxes and after the application of a 10% discount in accordance with industry methodology. This is more than double Bonterra’s market price, indicating the tremendous potential upside that exists should oil firm further.

The driller has been steadily expanding its oil production, which, for the first quarter 2018, shot up by 8% year over year. For the full year, it is expected to grow by over 4%, allowing Bonterra to take full advantage of higher crude and giving its cash flow as well as its bottom line a healthy boost.

Importantly, Bonterra is a low-cost operator. Its wells have a low decline rate, which has been estimated to be at around 22%, meaning that less capital needs to be invested to sustain production.

As a result, Bonterra has estimated 2018 all-in costs of just under $22 per barrel of oil produced, highlighting its exceptional profitably in an environment where WTI is trading at close to US$70 a barrel. That means its cash netback — an important measure of profitability — was an impressive $23.81 a barrel for the first quarter 2018. That netback will continue to grow because of firmer prices.

For these reasons, it is easy to understand why Bonterra is free cash flow positive with WTI at US$55 per barrel. Now that crude has rallied to be hovering at around US$70 a barrel, the driller's free cash flow and, ultimately, its cash reserves will receive a healthy boost. Those additional funds can be directed towards exploration, well development, and strengthening its balance sheet.

So what?

Unlike many of its peers, Bonterra didn't eliminate its dividend when oil crashed in late 2014. Instead, it trimmed its monthly dividend to an affordable and sustainable $0.10 per share, which sees it now yielding a very tasty 6.5%. If crude remains firm or even rises yet again for a sustained period, it isn't difficult to see Bonterra electing to hike that dividend, because with WTI at US$65 a barrel, the driller has an estimated total payout ratio of a respectable 79%.

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mattdsmith