Can This Beaten-Down Oil Stock Ever Bounce Back?

Description

At the height of the last oil boom, heavy oil producer **BlackPearl Resources** (TSX:PXX) was being touted as the next hot oil sands play. After oil collapsed in late 2014 and entered a prolonged slump, the company found itself in a precarious position as investment capital and cash flows dried up. The sustained rally in crude, which has occurred since the start of 2018 and sees the North American benchmark West Texas Intermediate (WTI) up by 16%, has been a life saver for BlackPearl, which has gained 12% over the same period.

Now what?

During the second quarter 2018, BlackPearl reported that first oil was produced from its Onion Lake thermal expansion, adding 3,500 barrels daily to its overall oil output. The second phase of the project, which is expected to be completed by the end of the first quarter 2019, will boost Onion Lake's total production to 6,000 barrels.

Because of Onion Lake coming online, BlackPearl's second-quarter production shot up by 13% compared to a year earlier to 11,250 barrels daily. By the time it had reported those results, output had expanded further, reaching 13,000 barrels daily. This solid production growth places BlackPearl on track to achieve its 2018 exit guidance of 14,000 barrels daily. It also means that the company expects to meet the upper end of that guidance, where it forecast average production of 12,000 barrels daily.

In an environment where oil is rising in value, this is a particularly important attribute, because it will give the company's earnings a healthy boost — especially if WTI rallies further and breaks through the US$70-a-barrel mark.

This increase in production volumes coupled with higher oil was responsible for generating a 33% increase in gross revenue. Despite that higher revenue, BlackPearl reported a net loss of $7 million compared to a profit of $8 million for the equivalent period in 2017. While that appears to be a worrying result, especially in an operating environment where the realized average oil price was significantly higher, it is not as bad as it initially appears. This is because it was caused by unrealized losses on the risk management contracts that BlackPearl established to hedge against lower oil.

You see, at the end of 2017 the majority of energy companies and industry insiders did not anticipate that crude would rally as high as it has. This saw most upstream producers purchase derivative contracts aimed at reducing the impact of weaker oil, especially should it again fall below US$55 a barrel.

A large portion of those contracts, covering production of 9,700 barrels daily, unwind by the end of 2018. This means that if WTI continues trading at current levels or moves higher during the first quarter of 2019, BlackPearl's net income will receive a healthy boost. It is also expected that over the coming year, the price differential between Canadian heavy oil known as Western Canadian Select and WTI will narrow, further boosting BlackPearl's earnings.

So what?

BlackPearl is a risky bet on higher oil. Sharply reduced cash flows along with reduced investment in the energy patch have impacted the company's ability to invest enough capital to bring its core projects online. The risks are underscored by BlackPearl's weak balance sheet, where it has net debt of $128 million and a shortage of liquidity.

Nonetheless, if WTI moves higher and BlackPearl can successfully expand production through the ongoing development of its Onion Lake facility, then its value will soar.

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