Now Is the Time to Load Up on This Top Oil Stock

Description

After pulling back sharply, crude has rebounded to see West Texas Intermediate (WTI) trading at close to US$70 a barrel, having gained 21% for the year to date. While this has sparked a surge of interest in energy stocks, one Canadian upstream driller, **Whitecap Resources** (TSX:WCP), has failed to perform, losing 11% over the same period. This has created an opportunity for investors seeking to bolster their exposure to oil by investing in a high-quality, low-cost light and medium oil producer that is poised to soar.

Now what?

Whitecap is focused on producing oil from the Cardium, Boundary Lake, Viking, and Deep Basin plays in Western Canada. It has oil reserves totaling 483 million barrels, which have been calculated to have a net asset value (NAV) of $15.37 per share, which is almost double its current market value. This indicates the considerable amount of upside that exists for investors — even more so when it is considered that the NAV of those reserves will expand.

You see, the current value was calculated using an assumed average price for WTI of US$58.50 per barrel for 2018 and US$58.70 for 2019, both of which are well below the current spot price and lower than the average price for the year to date.

Importantly, Whitecap's assets have a low decline rate of 19%, which is one of the lowest among Canadian intermediate upstream oil producers. The lower the decline rate, the less sustaining capital is required to preserve production levels, indicating that these are low-cost assets to operate. This becomes apparent when considering Whitecap's second-quarter 2018 operating netback of $31.75 per barrel of crude produced, which is one of the highest among Canadian upstream oil producers.

Notably, Whitecap incurred a significant loss on its hedging contracts, which it established prior to the end of 2017 to offset the financial impact of weaker oil. Like many upstream oil producers, which — unlike integrated energy majors — are particularly exposed to the movements of oil prices, management didn't anticipate that oil would rally as substantially as it has since the end of 2017.

This means for the second quarter, because of those risk-management contracts, Whitecap incurred a loss of $142 million, although hedges for 32,750 barrels of production, or 43% of its total second-quarter output, are due to expire at the end of 2018. That means for the second half of 2018, 55% of total production is hedged, which then falls to 34% for 2019 and then 8% for the first half of 2020. As the proportion of hedged production falls significantly, it will give Whitecap's profitability and earnings a solid boost.

Another pleasing aspect of the driller's operations has been its ability to consistently grow its oil production. For the second quarter, it reported oil output of 75,813 barrels daily, which was 85% weighted to crude and other petroleum liquids and a remarkable 35% greater than the equivalent period in 2017. This not only leaves Whitecap on track to achieve its 2018 guidance, but the considerable weighting to oil means that it isn't significantly exposed to the financial impact of weaker natural gas prices.

So what?

It isn't difficult to see Whitecap's market value soaring after the end of December 2018, when a significant portion of its oil hedges unwind, which will give earnings a significant boost if oil remains firm. While investors wait for this to occur, they will be rewarded by its regular dividend, which yields just under 4% and, with a targeted 2018 payout ratio of 77%, is sustainable.

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