Ignore the Latest Oil Crash and Buy This Driller

Description

Oil's latest price collapse sees the North American benchmark West Texas Intermediate (WTI) trading at around US$52 a barrel, well below the multi-year high of over US$76 per barrel reached in early October 2018.

This has triggered fears that oil has entered a new bear market because of a growing global supply glut. While this has hit many energy stocks hard, it should not prevent investors from adding **Whitecap Resources Inc.** (TSX:WCP) to their portfolio.

Solid results

Whitecap reported some impressive third quarter 2018 results that underscored the quality of its oil assets. Average daily production shot up by an impressive 30% year over year to 75,529 barrels of oil weighted predominantly to light and medium crude, meaning that it isn't exposed to the deep-discount applied to Canadian heavy oil.

And that, along with a solid increase in profitability as shown by Whitecap's operating netback for the quarter rising by 29% compared to a year earlier to $32.78 per barrel produced gave the driller's earnings a solid lift.

Whitecap reported funds flow from operations of $205 million, almost double a year earlier and an almost 19-fold increase in net income to $69.5 million.

The marked growth in profitability of Whitecap's operations can be attributed to significantly firmer WTI prices, which more than offset higher transportation and production expenses. It is also worth noting that general and administrative expenses fell significantly by 15% year over year to $1.10 per barrel, while depreciation and amortization decreased by 4% to $17.86 a barrel.

This, along with a focus on reducing operational cost, should help to boost Whitecap's profitability in coming months. The driller's operating netback would have been higher had it not incurred a $5.69 loss per barrel because of its commodity hedges.

Nonetheless, now that crude has crashed again, those hedges will protect against the financial downside caused by WTI trading at less than US$60 a barrel. If oil does recover to see WTI trading at around US$70 a barrel as some analysts are predicting, Whitecap's profitability will receive a healthy boost because a large portion of those risk management contracts are due to expire at the end of 2018.

That will reduce the losses incurred by those hedges should WTI firm to above US$60 a barrel**,** further boosting Whitecap's profitability.

Whitecap also continues to strengthen its balance sheet, thereby reducing the risks associated with weaker crude. It finished the third quarter with long-term debt of $1.24 billion, which represented a 3% decrease over the same quarter in 2017 and was compliant with all lending covenants.

Oil likely to rebound

While crude has dropped sharply in recent weeks because of rising global inventories and fears that demand would weaken, the growing consensus among energy analysts is that it will rebound before the end of 2018.

That rally may not take it back to the multi-year highs witnessed over a month ago, but WTI could easily reach US$60 a barrel before the end of the year.

This is because the bearish sentiment surrounding the outlook for crude appears over baked, and OPEC at could very well announce further production cuts to lift prices and restore confidence to energy markets at its December meeting, which could give it a healthy lift.

Why buy Whitecap?

Whitecap is an appealing intermediate upstream oil producer that owns high quality light oil assets, thereby eliminating the financial impact of the deep-discount applied to heavy oil known as Western Canadian Select (WCS).

When considering that Whitecap's oil reserves totalling 1.1 billion barrels have been independently valued at $12.79 per share after income taxes**,** more than double its market value, it indicates that the stock is very attractively valued.

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1. Dividend Stocks
2. Energy Stocks
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1. TSX:WCP (Whitecap Resources Inc.)

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