



This Small Cap Driller Is Poised to Soar

Description

Crude has pulled back sharply in recent weeks to see the North American benchmark West Texas Intermediate (WTI) down by over 12% since the start of 2018 to be trading at around US\$52 a barrel.

This has spooked investors and triggered considerable [bearish sentiment](#) over the outlook for crude, as a range of bullish fundamental indicators have failed to lift prices. Even the reinstatement of sanctions on Iran and deteriorating Venezuelan oil output have failed bolster prices amid growing fears that a new oil glut has emerged.

While this bodes poorly for many Canadian energy stocks, especially those [producing bitumen](#) and other forms of heavy crude, the latest pullback of many quality energy stocks has created an opportunity for contrarian investors to acquire quality companies at attractive valuations.

One such driller is **Storm Resources Ltd** (TSX:SRX), which has lost 20% for the year to date or almost double WTI's decline.

Now what?

Storm Resources is a relative newcomer to the energy patch, having commenced operations in 2010. The driller is focused on what has been characterized as one of Canada's hottest emerging [natural gas plays](#): the Montney, where its acreage for the first nine months of 2018 produced on average 19,900 barrels of oil equivalent daily.

Storm Resources has net reserves of 106 million barrels of oil equivalent, of which is 83% weighted to natural gas with an after tax net-present-value (NPV) of \$824 million, or roughly \$6.75 per share, which is triple its market value. That highlights the considerable amount of potential upside available to investors, particularly given that Storm Resources is expanding production and focused on reducing costs.

For the third quarter, production grew by an impressive 35% year over year to 20,455 barrels of oil equivalent, of which 83% was weighted to natural gas.

Notably, 10% of Storm Resources petroleum output for the quarter was composed of condensate. The demand for condensate is growing at a solid clip, as it's a crucial diluent used by oil sands producers to make bitumen viscous so that it can be transported by pipeline.

As a result of the strong demand, Storm Resources realized an average price of almost \$85 per barrel of condensate sold during the third quarter, which was \$3 a barrel higher than the average benchmark price for Canadian light crude known as Edmonton Light Oil.

Storm Resource's focus on reducing operating expenses, which saw production costs for the third quarter fall by 8% year over year to \$5.54 per barrel produced and transportation down by 2% to \$5.98 a barrel, is boosting its profitability. This saw the driller's operating netback – an important measure of operational profitability – rise by an impressive 17% year over year to \$12.96 per barrel after allowing for hedging losses.

As a result of this solid operational performance, Storm Resources is on track to achieve its full-year 2018 production guidance of 19,500 to 20,500 barrels of oil equivalent daily. Because of cost reductions as well as firmer condensate and natural gas prices, Storm Resources revised its projected annual funds flow from operations upwards to be somewhere between \$90 million and \$96 million. At its mid-point, this is 15% greater than the driller's original 2018 guidance issued in November 2017.

Storm Resource's reserves as well as production should continue to grow because of its drilling program. The company boosted its 2018 spending on drilling and well-development by \$5 million to \$85 million, allowing Storm Resources to improve the quality of the wells it is drilling and thereby boosting their productivity.

During 2019, it anticipates drilling eight wells and completing a further 11 wells, thereby further boosting reserves and production. Storm Resources is also focused on expanding its higher margin condensate output through improved well design and the targeting of formations with higher rates of condensate.

So what

All of these initiatives will give Storm Resources earnings a healthy lift, which will help to boost its market value. This, along with its quality assets and trading at a steep discount to its NPV, makes it a particularly attractively valued play on higher oil and natural gas.

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Date

2025/09/30

Date Created

2018/11/26

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