



Value Investors: These 2 Energy Stocks Are Ridiculously Cheap Right Now

Description

It's been a painful couple of months for crude oil.

After peaking at just over \$75/barrel in early October, the price of the commodity has headed steadily lower. It bottomed out at just over \$50/barrel yesterday before recovering ever so slightly today in early trading. Still, that's a decline of more than 30% in just over a month and this might not be the end of it.

The big story here in Canada is the price differential between the North American benchmark and Alberta's heavier crude. As I write this, Western Canadian Select trades at just over \$10 per barrel, which is a massive difference of \$40/barrel. Compare that to May, when the gap was closer to \$15/barrel.

This difference has been devastating for the stocks of major Alberta-based producers, even if they mostly deal in lighter oil. The good news for investors is it creates two possible catalysts for an investment — one is a recovery in Western Canadian Select, while the other is the oil market in general recovering.

Here are two Western Canadian producers primed to head much higher when either crude market starts to recover.

Baytex Energy

Baytex Energy Inc. ([TSX:BTE](#))(NYSE:BTE) does have some Alberta heavy oil exposure — approximately 20-25% of production comes from two heavy oil fields outside of Lloydminster and Peace River — but the majority of its production is light sweet crude. The company produces more oil in Texas than it does in Alberta, and transportation for its Alberta production is secured.

The company recently closed on its acquisition of Raging River Resources, which significantly boosted its exposure to Alberta's Duvernay fields, located in the Northwest corner of the province. It also got interesting exposure to a new area it's dubbing East Duvernay, which is located more in Central Alberta. This new area has the advantage of being located close to areas with already rich oil infrastructure.

The big worry for Baytex is its balance sheet. Even after taking steps to pay down its debt, the company still owes some US\$2 billion to creditors versus a market cap of just \$1.3 billion. The good news is the company is projecting free cash flow of over US\$100 million even if crude only averages \$60/barrel in 2019. If the commodity recovers and averages \$80/barrel next year, Baytex could generate up to US\$500 million in free cash flow.

That kind of cash generation would go a long way towards improving Baytex's balance sheet and help the stock price enormously.

Paramount Resources

Paramount Resources Ltd. ([TSX:POU](#)) solidified its balance sheet in 2015-16 when the oil market was at its worst and has lately been putting that cash back to work buying various assets around Alberta. This has grown the company into a light oil-heavy powerhouse producing nearly 100,000 barrels per day.

The new Paramount has large positions in both the Motney and Duvernay fields in Alberta, two locations that aren't feeling as much pain as heavy oil producers. The company's expansion plans there will add significant production by 2021. Paramount's solid balance sheet ensures this new era is easily affordable.

Investors should also note that Paramount also has significant natural gas production, a commodity that has quietly outperformed conventional oil over the short-term.

Shares currently trade hands at \$7.20 each, which is close to 2015 lows and represents just 40% of stated book value. Note that the stock recovered from those 2015 lows to nearly \$25 per share in 2017. I doubt many investors would be unhappy about that kind of return from today's lows.

The bottom line

Both Baytex and Paramount are well positioned when crude oil eventually recovers. Both have high emphasis on light oil, which looks poised to outperform its heavier counterpart. When oil recovers — and it will, we just don't know when — investors who buy these two stocks today will be very glad they did.

CATEGORY

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2. TSX:POU (Paramount Resources Ltd.)

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