Use This Cheap Stock to Bet on Oil

Description

Markets are beginning to get a little unnerving. Even though the best deals are found when prices go down rather than up, it is still difficult to sit tight when every stock and asset class seem to be tumbling together in unison. It is when everything seems dim and markets are in chaos that it is time to start looking through the trash heap for bargains. There is certainly no trash heap with as many bargains at the moment as there is in the Canadian oil sector.

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In the oil patch, there is an abundance of cheap companies that have streamlined their fundamentals to the point where they are starting to make money, even with the oil price as low as it is. The biggest issue is that these companies have been beaten up for years now and are only getting lower.

Akita Drilling (TSX:AKT.A)(TSX:AKT.B) is a cheap driller with a price-to-book ratio of 0.6 that might be worth taking a look at as the price continues to drop. The drillers have been getting killed as production gets cut with lower oil prices. The stock has dropped around 20% over the past month in part due to the forced production cuts that are coming online in Alberta.

The company reported a net loss in the third quarter of 2018 in part due to its acquisition of U.S.-based Xtreme Drilling Corp. Funds flows from operations also decreased a significant 140%, once again due to the company's increased American operations. Refocusing on the United States required it to move drills south of the border, thereby incurring significant expense. Once the drills are in place, the American drills should make more money than if they were left in Canada.

The company aims to make itself a premium drilling company with equal operations in the United States and Canada, which would help diversify its assets away from Canada to a degree. The diversified drilling strategy helped Akita to increase its revenue by 51% over the same quarter of the previous year, since much of the added revenue was due to the revenue per day earned on American drills.

The driller has a lot of debt in large part due to the costs incurred from the Xtreme acquisition and the subsequent move to the United States. Akita intends to pay down the debt using the anticipated increase business and fund flows from its future American operations.

I'm afraid that investors might not have a lot of hope in the short run. These are value plays that should pay off if there is a meaningful jump in oil prices in the coming years. That single fact is both a blessing and the curse of these commodity dependent investments. When you buy shares of a company like Akita, you are beholden to the oil price. You are a speculator guessing that oil will someday revert to higher prices. This reversion is by no means guaranteed.

The truth is, there is probably more upside potential than downside risk with a stock like Akita. It is not a bad company; it is simply handcuffed to the price of oil. If oil comes around, then Akita probably will as well. In the meantime, recognize that putting money into the stock is speculative, collect dividends while they are available, and be ready to cut your losses if things do not turn around.

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krisknutson

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