Will Whitecap Resources Inc (TSX:WCP) Go Bankrupt in 2019?

Description

Conditions are looking dire for **Whitecap Resources Inc** (TSX:WCP). On December 14, for the first time in nearly a decade, shares fell below $4, down from a high of $18 in 2014. Yet on December 13, the company issued its monthly dividend of $0.027 (7.5% yield) as if nothing was amiss. However, investors have many reasons to worry.

Earlier in the year, a **Bank of Montreal** analyst wrote that many Canadian oil producers will soon no longer exist. “The message is clear,” they reported. “Merge, innovate or face extinction.” They noted that this “won’t be an overnight process and may take a number of years.”

With investors dumping Whitecap shares like never before, some are worried that extinction is coming more quickly than anticipated. Will the company go bankrupt in 2019?

Structural problems for every Canadian energy producer

It’s important to note that Whitecap’s troubles aren’t necessarily a product of their own making. While there are plenty of competitors that took on excess debt loads and developed risky properties at the top of the market, Whitecap has been fairly responsible.

While some investors balk at the company’s $2.9 billion in liabilities versus the current $1.8 billion market cap, only $1.2 billion of that debt is comprised of long-term debt. Total assets currently outnumber total liabilities 2 to 1. The remaining liabilities are composed of more flexible components, such as deferred income tax and decommissioning obligations. It’s certainly not a balance sheet to be proud of, but many competitors are faring much worse.

The company’s management has actually done an impressive job over recent years to set the company up for success—a tough statement to make for a company with shares down 60% in 2018, but the numbers back the story. Both production and reserves have grown every year since 2010. Timely hedging programs have protected profits during market routs, so while shares were volatile, the underlying financials remained reliable. It has also instituted strict cost saving initiatives across all of its development site, with ongoing operating costs falling by 50% or more.

Unfortunately, none of these initiatives could put a dent in the latest industry-wide storm.

In October, Western Canada Select’s discount to U.S. crude prices reached its highest level in years, surpassing a $40 per barrel differential. While U.S. producers were selling their production for $60 per barrel, many Canadian producers were forced to unload their output for prices as low as $15 per barrel—a price that made it impossible for anyone to turn a profit.

So why would a company participate at such low prices? Quite simply: there was no other option.

Surging oil sands production combined with limited pipeline and terminal infrastructure forced producers to enter a vicious bidding war, taking nearly any price to move oil that had nowhere else to go. And while crude by rail volumes nearly doubled from last year—a much more costly alternative to using over-supplied pipelines—Canada didn't have enough rail capacity to eliminate the bottleneck. According to Andrew Botterill, a partner at Deloitte in Calgary, Canada will need more pipelines and more domestic refining capacity to avoid another crisis, which could take years to develop.

Be greedy when others are fearful

Bank of Montreal and Deloitte analysts were right when they said this process could take years to play out, but a prolonged process could provide once-in-a-lifetime values for opportunistic acquirers. "While the equity markets may penalize acquirers in the short-term," the Bank of Montreal report noted, "we think well-priced acquisitions of quality assets can generate significant value for shareholders over time."

We already know that Whitecap is prepared for acquisitions. In 2017, it scooped up assets from **Cenovus Energy Inc** at impressive prices. While the purchase hasn't looked like a genius move just yet, it was executed at decade-low prices.

Whitecap has the liquidity to go after more acquisitions, especially if conditions turn even worse. Again, it may take years to fully play out, but prudent investors can take advantage of Whitecap's willingness to buy competitors at fire sale prices,—just be prepared for volatility along the way.

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rvanzo