1 Top Oil Stock Poised to Soar in 2019

Description

Crude keeps whipsawing wildly as energy markets overreact to a mix of positive and negative news for petroleum. Even the announcement of the latest round of OPEC production cuts was insufficient to buoy prices and prevent the latest price collapse. The North American benchmark West Texas Intermediate (WTI) has recovered in recent days to be trading at almost US$49 a barrel and analysts expect it to rally further.

The introduction of mandatory production cuts by Alberta's provincial government has also bolstered the prices of Canadian crude oil blends, including Western Canadian Select and Edmonton Par buoying the outlook for Canadian drillers. One appealing undervalued intermediate oil producer that's poised to soar in coming months as oil moves higher is **Surge Energy Inc.** (TSX:SGY), which has lost 23% over the last year compared to 17% for WTI.

Quality oil assets

Surge is focused on light and medium crude production from the Greater Sawn, Sparky, Shaunavon and Valhalla plays. It finished 2017 with oil reserves of 95 million barrels that were 82% weighted to higher margin crude. This minimizes the impact of weaker Canadian natural gas pricing on its financial performance. Those reserves were independently valued at $6.06 per share, roughly four times Surge's market price, thereby illustrating the considerable potential upside available should oil firm further.

The driller's production continues expanding at a solid clip, thereby allowing it to take full advantage of higher oil while also being able to offset revenue lost due to weaker prices. For the third quarter 2018, Surge's production grew by a notable 20% year over year to 18,029 barrels daily due to the success of its drilling program and the $320 million acquisition of **Mount Bastion Oil & Gas Corp.**

During the quarter, Surge completed 12 net wells, bringing 10 to production with the two remaining wells expected to be brought online before the end of 2018, further adding to its oil output. For that period, Surge's average daily production exceeded its forecast 2018 exit production, which bodes well for even further growth during 2019. The growth of the driller's oil output will be supported by its drilling activity and the ongoing integration of Mount Bastion's assets into its operations.

While crude has weakened significantly since the third quarter, Surge's financial performance shouldn't be impacted as sharply as expected. This is because the oil production cuts mandated by the provincial government of Alberta have significantly narrowed the differential between Canadian crude benchmarks and WTI.

Canadian light crude, or Edmonton Par is now trading at a US$3.92 per barrel discount to WTI compared to a record of over US$37 per barrel in November 2018, when WTI was trading at US$63.69 a barrel. That sees Canadian light trading at US$44 per barrel even after WTI's latest price collapse compared to US$26.50 at the start of November 2018.

This bodes well for the financial performance of light oil producers operating in Canada like Surge despite crude's latest weakness. Even if WTI remains weaker than it was during the third quarter, it's likely that Surge will report credible financial results for the fourth quarter and over the duration of 2019.

In a move that jolted markets and contributed to the sharp sell-off of Surge's stock, the company decided not to proceed with its previously announced annual dividend hike of $0.025. Instead, it maintained its annual dividend at $0.10 per share, which even without the increase still yields a very juicy 6% and appears sustainable with a payout ratio of 83% for the first nine months of 2018.

The sustainability of that payment will be further enhanced by higher oil prices triggered by OPEC's latest round of production cuts kicking in and the narrower price differential between Canadian light crude and WTI.

Surge also finished the third quarter in a sound financial position. It had almost $36 million in accounts receivable, $150 million available to be drawn from its existing revolving credit facility, and long-term debt of $288 million, a manageable two-times operating cash flow.

Why buy Surge?

Surge is a very attractively valued light and medium oil producer that will benefit substantially from oil's latest rally, which should see WTI rise over US$50 a barrel, and the far lower discount applied to Canadian light crude. Because of the value of its oil reserves alone, Surge appears heavily undervalued by the market and offers considerable potential upside. If investors buy now, they can lock in a very tasty 6% plus dividend yield.

CATEGORY

1. Dividend Stocks
2. Energy Stocks
3. Investing

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1. TSX:SGY (Surge Energy Inc.)

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