1 Beaten-Down Driller to Play Higher Oil

Description

Canadian oil stocks have fallen afoul of investors seeking to bet on higher crude with the wide price differentials between domestic oil prices and the North American benchmark West Texas Intermediate (WTI) weighing on their financial performance. This has created an opportunity for investors seeking to access outsized returns by bolstering their exposure to crude. One of the most attractive options is light oil producer **Whitecap Resources** (TSX:WCP), which has lost 41% over the last year compared to WTI only being down by 11%.

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Quality oil assets

As of the end of 2018, Whitecap was independently assessed to have net proven and probable reserves of 427 million barrels of oil equivalent, which are 77% weighted to light and medium oil. Those reserves have been determined to have an after-tax net present value of $5.5 billion, or $13.12 per share, which is almost three times greater than Whitecap's current market value, highlighting the substantial upside available.

Importantly, Whitecap has a proven history of growing its oil production. Full-year 2018 oil output grew by almost 30% year over year to 74,415 barrels daily and was 85% weighted to crude as well as other petroleum liquids. Because of firmer oil, revenue surged by 47% to $1.5 billion, which, along with improved profitability, saw Whitecap report net income of $65 million compared to a $124 million loss in 2017.

That can be attributed to a variety of factors, key being a 7% year-over-year increase in Whitecap's operating netback to $29.33 per barrel sold. This is one of the highest among its peers operating solely in Canada. The driller's improved netback can be attributed to higher realized sales prices for oil and natural gas, which offset operating expenses rising by 9% and a 33% increase in transportation costs. Whitecap was also able to boost profitability because of a 16% decrease in general and administrative expenses, which fell to $1.10 per barrel for 2018.

Nonetheless, the company is forecasting that 2019 production will decrease when compared to 2018 to somewhere between 70,000 and 72,000 barrels daily. The main reason for this is the need to reduce capital expenditures, which, at $450 million, will be 13% lower than last year. Whitecap's decision to reduce spending can be understood in the context of the desire to remain profitable and cash flow positive in the difficult operating environment being witnessed.

This will also help to ensure that sustainability of Whitecap's dividend payment, which is projected to total $135 million during 2019 with a total payout ratio of 93% if WTI averages US$55 per barrel over the course of the year. The likelihood of the North American benchmark averaging US$55 a barrel or greater is high when it is considered that WTI is currently trading at over US$56 per barrel and likely to rally further because of short-term supply constraints.

It should also be noted that because of Whitecap's judicious use of debt, including targeting debt of 1.6 times funds flow for 2019, Whitecap has far more financial flexibility than many of its debt-laden peers. For this reason, the company has been able to continue making dividend payments, unlike many of its larger upstream peers, although that current monthly payment is less than half of the dividend paid in 2015. Despite that significant decrease, Whitecap's dividend still yields a very attractive 7% further enhancing the driller's appeal as a play on higher oil.

While Whitecap has been gradually winding down its commodity hedges to enhance its ability to benefit from higher oil, 42% of its 2019 production is still hedged. That protects it from any further downside caused by lower oil while helping to minimize hedging losses should crude spike significantly and rise above the average oil price locked in by Whitecap.

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Why buy Whitecap?

The driller appears very attractively valued when it is considered that it is trading at a deep discount to the net present value of its oil reserves. When this is considered in conjunction with its low decline rates in its wells, considerable exploration upside, diversified oil production, which is predominantly weighted to crude, and a juicy 7% dividend yield, it ranks as one of the best means of playing higher oil.

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