Avoid or Hold? These 3 Energy Stocks Vary in Quality

Description

Deep undervaluation isn't always a good thing. Once the fine line between a value opportunity and a value trap has been crossed in the wrong direction, an investor may have to make the tough decision to stick it out or try and stop the bleeding. But what makes the difference between a falling knife and a stock with a healthy balance sheet that's simply lost momentum?

What to avoid

Down 8.33% in the last five days, **Pengrowth Energy** (TSX:PGF) seems to fall into both categories, struggling to return to its pre-November prices while its multiples get lower. Discounted by more than 50% of its future cash flow valuation, it's trading at a market-weight per-asset price with a P/B ratio of 1.5 times book.

While a one-year past earnings growth of 18.2% is positive, Pengrowth Energy's five-year average is negative to the tune of 0.6%, and its balance sheet is typified by a comparative debt level of 296.7% of net worth. This latter characteristic counts this stock out as a possible buy for the risk-averse investor, particularly one seeking a long-range position.

However, discerning would-be buyers with a sense for market confidence should be aware that more shares have been snapped up than shed by Pengrowth Energy insiders in the last six months, and in pretty significant volumes. This confidence, coupled with a decent future outlook, may signify that better things could lay ahead for this deeply undervalued stock.

What to hold

Healthy stocks with sturdy balance sheets are the order of the day, but they're not necessarily easy to come by. Picking stocks for a low-risk portfolio — especially if a long-term position is being sought — should take into consideration a company's level of debt, its average management tenure, its track record, as well as its outlook, among other factors.

Stocks such as **Parkland Fuel** (TSX:PKI) show a bit of all of the above, with five-year returns of 82.4% that outperformed the market as well as the industry for the same period. A solid track record illustrated by one-year past earnings growth of 151.2% and a five-year earnings average of 20.9% shows why this stock is worth holding on to.

However, not entirely unlike the previous ticker described here, Parkland Fuel has a balance sheet that leaves something to be desired, marked as it is by a high debt level at 125.7% of the company's net worth. Would-be shareholders should also consider whether buying at overvaluation (the stock is selling at nearly three times the book price, and with a P/E of 24.8 times earnings and) is a sound strategy.

Investors may want to go for a competitor like **Vermilion Energy** (TSX:VET)(NYSE:VET), which had a good year (see a one-year past earnings growth of 336.3%) and has a cleaner, if not perfect, balance sheet that carries 68% of debt. Vermilion Energy is a better play for value at the moment, with a lower P/E at 17 times earnings, and trading below the double-book mark.

A high dividend yield of 8.41% is on offer here, and it looks reliable too. Dividends per share have been nice and stable over the last 10 years, while also increasing over the same period. While a slightly negative annual growth in earnings is expected in the coming years, this latter analysis is subject to change, while that passive income looks relatively well assured.

The bottom line

Looking beyond Vermilion Energy's high yield, the best stock here is arguably Parkland Fuel at the moment, with its decent-enough yield of 3.03% matched with a respectable 23.5% expected annual growth in earnings. That said, there is at least one reason why a TSX index trader might want to buy Pengrowth Energy: it's looking at a 121.8% expected annual growth in earnings, which would certainly give growth investors something to think about.

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2. TSX:PKI (Parkland Fuel Corporation)
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