Can This Cashed Up Oil Sands Company Ever Perform?

Description

The last year was difficult for many intermediate upstream oil sands companies. The sharp decline in the price of Canadian heavy oil, which hit record lows in November 2018, despite the North American benchmark West Texas Intermediate (WTI) trading at over US$55 a barrel. This forced the provincial government of Alberta to introduce mandatory production cuts, which almost immediately buoyed the prices of Canada's two key oil benchmarks Western Canadian Select (WCS) and Edmonton Par.

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Unfortunately, while that was a positive for many smaller pure upstream oil producers like **Athabasca Oil** (TSX:ATH), it has had considerable unintended fallout, which has impacted the energy patch. Athabasca's massive cash hoard of around $325 million is garnering considerable attention from investors.

Attractively valued

Athabasca closed the sale of its Leismer infrastructure assets for $265 million in early March 2019, significantly boosting cash on hand. The company needs to focus on reducing its massive pile of debt, which, by the end of 2018, stood at $581 million, or a worrying seven times its trailing 12-month operating cash flow.

Nonetheless, after allowing for Athabasca's considerable cash balance, that ratio falls to under two times for net debt to operating cash flow, which indicates that the company's net debt is manageable.

Athabasca also has significant proven and probable oil reserves of 1.3 billion barrels that have a net asset value of $8.94 per share, which is more than 10 times greater than its current share price. This indicates that there is considerable potential upside available to investors if oil rallies further.

For these reasons, it is easy to understand the increased interest in Athabasca.

While it does appear to be an attractive investment, the company is still facing substantial headwinds. A large portion of its debt totalling US$450 million matures in 2022, meaning that it may struggle to meet its financial obligations if crude remains weak and is unable to accrue sufficient cash to meet those repayments in full.

While Athabasca has considerable oil reserves, only 6% are categorized as developed producing, which means it will take considerable amounts of capital to advance its undeveloped reserves to the point where they are capable of being extracted and generate cash flow. There is also no certainty that Athabasca's undeveloped oil reserves will be profitable to extract.

On top of this, there is the ongoing threat that as Edmonton unwinds the mandatory production cuts, the price of WCS will collapse, once again making Athabasca's operations unprofitable, especially when it is considered that bitumen makes up 94% of its reserves and 71% of the company's oil output. When these headwinds are considered in conjunction with the potential for another oil price collapse, it is clear why Athabasca is trading at such a deep discount to its oil reserves.

Is it time to buy Athabasca?

When it is considered that Athabasca appears very attractively valued because it is trading at less than a 10th of the value of its proven and probable oil reserves as well as a lower enterprise value to debt adjusted cash flow than many of its peers, it is an intriguing play on higher oil. The company is not without risks and if oil's rally ends abruptly and the price falls sharply, there is every likelihood that Athabasca's market value will decline significantly. For these reasons, investors seeking to boost their exposure to oil should consider less heavily levered upstream oil producers that are less reliant on heavy oil production.

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