



3 Dirt-Cheap Energy Stocks

Description

Bay Street and investors in general have mostly stayed away from the unloved energy sector. As a result, many publicly listed oil and gas producers are trading at [dirt-cheap valuations](#).

However, the sector is still an essential part of the Canadian economy. If investors are able to sustain the short-term pain and believe in the medium- to long-term comeback of the sector, they have a good chance of outsized price appreciation from the following well-run [energy stocks](#) that are trading at dirt-cheap valuations today.

Encana

Encana (TSX:ECA)(NYSE:ECA) stock is the largest of the three with a recent market cap of about \$9.6 billion. It has an investment-grade credit rating of BBB.

In the past three years, its revenue increased by 42%. Last year, its net income was over US\$1 billion, and it generated free cash flow of over US\$300 million.

At \$6.87 per share as of writing, ECA stock trades at a price-to-book ratio (P/B) of about 0.69, which is at the low end of the P/B range of 0.64 to 1.86 in the past five years.

The stock is relatively cheap compared to its historical levels partly because it increased its debt levels to acquire Newfield Exploration. At the end of the first quarter, Encana had net debt of US\$7.4 billion versus about US\$1.7 billion of EBIT generated in 2018.

If the company pays off its debt over time, ECA stock should be able to trade at much higher levels. Currently, **Thomson Reuters** has a 12-month mean target of US\$10.50 per share on the stock, which represents 103% near-term upside potential. Additionally, the stock also offers a yield of about 1.5%.



TORC Oil and Gas

TORC Oil and Gas (TSX:TOG) has a recent market cap of about \$885 million. Its recent debt/cap is about 19%.

In the past three years, its revenue more than doubled. Last year, its net income was nearly \$17 million, and it generated free cash flow of about \$108 million.

At \$4.06 per share as of writing, TOG stock trades at a P/B of about 0.59, which is a five-year low, while the high end is 1.12.

At the end of the first quarter, TORC had net debt of \$359 million versus about \$66 million of EBIT generated in 2018.

Currently, Reuters has a 12-month mean target of \$7.69 per share on the stock, which represents 89% near-term upside potential. The stock's current yield of about 7.4%, paid in the form of monthly dividends, will also add to the total returns. Notably, the company recently raised its dividend per share by 13.6%.

Assuming a WTI oil price of US\$50 per barrel, TORC estimates a payout ratio of 97% after accounting for maintenance capital, while the WTI oil price currently trades at about US\$53 per barrel.

Birchcliff

Birchcliff Energy ([TSX:BIR](#)) has a recent market cap of about \$758 million. Its recent debt/cap is about 27%.

In the past three years, its revenue rose 90%. Last year, its net income was \$102 million, and it generated free cash flow of more than \$21 million.

Birchcliff guides for an average production of 76,000-78,000 barrels of oil equivalent per day, with a production mix of 79% natural gas, 7% light oil, 6% condensate, and 8% other natural gas liquids. It estimates to generate adjusted funds flow of \$330 million and free funds flow of \$126 million for the year.

At \$2.84 per share as of writing, BIR stock trades at a P/B of about 0.43, which is the biggest discount it has experienced in the last 10 years. Its five-year P/B is 1.02.

At the end of the first quarter, Birchcliff had net debt of \$677 million against about \$185 million of EBIT generated in 2018.

Currently, Reuters has a 12-month mean target of \$5.86 per share on the stock, which represents 106% near-term upside potential. The stock's current yield of about 3.7% will also boost the total returns. It last increased the dividend by 5% in Q1.

In Q1, Birchcliff only paid out less than 8% of its adjusted funds flow as dividends. So, it's hard to imagine the stock cutting its dividend.

Foolish takeaway

Encana, TORC, and Birchcliff are good considerations for value digging, as they trade at big discounts from their book values. Although no one knows when the energy sector will actually turn around leading to the stocks trading at more fair valuations, short-term price gains of 15-30% are not all that uncommon if you time the market right.

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TICKERS GLOBAL

1. TSX:BIR (Birchcliff Energy Ltd.)

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