2 Beaten-Down Stocks With Massive Upside Potential

Description

Investment gambles pay off wildly at times, and buying heavily beaten-down and distressed stocks at their weakest valuations can set one up for massive capital gains and juicy income yields on proven cyclical high-dividend payers.

I have two stocks on my watch that fit the above profiles today.

Bonterra Energy

Bonterra Energy (TSX:BNE) is an oil and gas exploration, development, and operating company with one of the most favourable low-cost production profiles in the Western Canadian Sedimentary Basin.

Widening price differentials for Canadian oil late last year amid weakening world prices on the commodity ravaged the industry, and Bonterra wasn't spared, as management announced a 90% dividend cut to preserve the balance sheet, and shares tumbled further.

It's sad to note that, at around $5 a share, Bonterra stock is trading at 10-year lows, yet price differentials are back to historically normal levels, and WTI is back near US$60 per barrel. Both factors that led to a beating on Bonterra shares are gone, but the valuation is still trending lower.

Unlike its larger peers, which were negatively affected by the mandatory production cuts, as the Alberta government intervened to save the industry from the devastating effects of a supply glut on transportation terminals, Bonterra's normal and budgeted production is below the mandatory cut-off, and the company's operations aren't affected.

The company's operating performance is heavily leveraged on oil prices and production levels. Management is repairing the balance sheet, while the cash flow savings from the prior dividend cut are invested in development activities, propping up the company for a better productivity profile, just as world oil prices have rebounded 32% from their December 25th levels.

Most noteworthy, the company's usually high-yielding dividend payout is cyclical, in line with oil prices and production levels. The current monthly dividend yields 2.4% annually today, and I would expect income investors to flock back into the stock when management finally “reinstates” the juicy payout as soon as the balance sheet is done with.

Massive capital gains and increasing income yields could accrue to contrarian investors who buy the shares at 35% of their book value today.

CannTrust Holdings

Down over 60% in a month, shares in marijuana producer **CannTrust Holdings** (TSX:TRST)(NYSE:CTST) have been hit by a massive scandal after company produced cannabis in five unlicensed rooms for months and covered up with falsehoods to the regulator, Health Canada.

A significant inventory has been held, and the company has since halted sales as investigations are underway, and there’s significant uncertainty as to what will be the company’s fate in the coming days.

There’s an equivalent of a J-Factor risk on the stock — a judge’s decision factor that is affecting valuation, with Health Canada being the all-important judge who will determine the punishment and ultimate fate of the company.

Any lenience on the part of “the judge” could result in a massive share price recovery, and leniency in these circumstances means a regulatory fine and a management shakeup without a licence revocation.

Further, the cannabis producer has some high-quality assets and a healthy balance sheet that could still support the share price and attract strategic buyers, including a $43 million cash and marketable securities balance in March, which was beefed up recently when the company closed a new equity financing round for US$160 million ($209 million) in net proceeds in May.

CannTrust has some strategic investments in CannaTrek and Stenocare that should be worth something, too.

That said, there’s the issue of contingent liabilities from regulatory penalties and lawsuits that remains unknown to any potential bidder. Stiffer penalties will instill discipline in a nascent highly regulated industry, and it’s up to Heath Canada to determine what manner of punishment to mete out to an errant CannTrust management team, but there are limits to the amount of penalties that the regulator may impose.

The biggest worry is the risk of a licence suspension and a lengthy investigation and remediation process while the company may still be unable to generate any sales during the period. The previously unlicensed rooms have since been licensed, but the technicality that production commenced before a regulatory go-ahead is highly punishable.

The stock could skyrocket if Health Canada passes a weaker-than-expected “sentence,” but, of course, there’s considerable risk here.

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Date
2025/07/19
Date Created
2019/07/26
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