Is the Recent Pullback in Oil Stocks the Perfect Opportunity to Buy?

Description

After last week's pipeline spill in North Dakota, many smaller pure-play oil companies were once again sold off. This comes after years of these companies struggling to remain profitable.

Canadian oil companies have been through a lot over the last five years. First the oil price came crashing down, which caught many companies, especially highly leveraged ones, off guard.

The companies then had to deal with a massive price differential between Canadian oil and West Texas Intermediate (WTI), which hurt a lot of operations.

It also didn't help that investors were fleeing, sending the stocks tumbling and making it impossible to raise any money.

The government in Alberta then moved to introduce curtailments in the industry, which may have helped the industry as a whole, but hurt individual companies that were better positioned for the market environment.

Now, shares have been sold off again, over fears that if the pipeline closure becomes extended, it could impact Canadian producers as the pipelines bottleneck once again.

While this news is potential risky for some companies, it has also created a great buying opportunity, especially if it doesn't last.

Two of the best small-cap oil producers, who have had their share price decimated in the last five years, are **Cardinal Energy Ltd** (TSX:CJ) and **Bonterra Energy Corp** (TSX:BNE).

Cardinal Energy

Cardinal is a small-cap energy producer that does roughly 20,500 barrels of oil equivalent per day (BOEPD) in production.

Its production is split pretty evenly with 44% light oil and natural gas liquids (NGLs), 44% Western Canadian Select oil and 12% natural gas.

What's really attractive about Cardinal is that is has some of the lowest decline rates in Canada, at roughly 10%. This is a huge advantage and gives it flexibility that many other companies don't have.

It has done really well in reducing its costs to improve its netbacks. It managed impressive netbacks of $26.93 in the second quarter, on average WTI prices of just $59.81.

One of the ways it's reducing costs is by saving as much power as it can. Cardinal has installed four gas generators to create its own power and reduce costs, especially because the price for electricity has increased in Alberta.

It also wants to reduce its risk by paying down debt and reducing its reliance on third parties and variable costs. The target for debt is to get it down to 1.0 times cash flow.

These are prudent priorities that will ensure the best potential for the capital that's invested.

After all, its goal is to provide stable and long-term dividends that provide investors with decent growth over time, and its dividend, which currently yields 8.4%, is doing just that.

Bonterra

Bonterra, another small-cap oil producer, is one of the most undervalued oil and gas stocks in Canada. Since 2014, its stock is down by more than 90%, as it struggled with high debt loads and uncontrollable industry economics.

Now, after a few years of finding its feet, it has stabilized its position, yet its stock is still being sold off as if it were a toxic asset.

Bonterra, despite the picture painted from its share performance, is actually one of the better small-cap energy producers.

Its 21% decline rate, although larger than Cardinal's, is still substantially lower than the industry average, which is around 28%.

Bonterra, will do approximately 12,500-13,000 BOEPD in production this year, with 31% natural gas, 62% oil, and the remaining 7% NGLs.

Its debt reduction over the last few years has been crucial, but it has executed well and now sits in a much better position.

Going forward, Bonterra is focused on its development projects as well as generating free cash flow growth as it expands production.

Even on the company's most conservative oil price forecast, it's still expected to make a ton of cash flow and its dividend, which yields about 3.1%, will be covered.

Bottom line

While the continued shut off of the Keystone pipeline is a serious risk, both stocks have been sold off so much there is still real value at these levels.

If you need energy exposure, I would seriously consider the discount the market is currently offering, as these stocks are high-quality, and when the market turns around, they could bring massive growth.

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1. TSX:BNE (Bonterra Energy Corp)
2. TSX:CJ (Cardinal Energy Ltd.)

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danieldacosta