Is This Deeply Discounted Driller a Safe Investment?

Description

Toward the end of 2018, upstream oil explorer and producer **Bonterra Energy** (TSX:BNE) slashed its monthly dividend to a token $0.01 per share because of the sharp impact of weaker oil on its finances.

That saw its stock roughly handled by the market with Bonterra losing 68% over the last year, sparking claims by some pundits that it is very attractively valued and poised to deliver considerable value for investors.

Let's pop the hood and see whether Bonterra is a solid play on higher crude.

Trading at a discount

An attractive aspect of Bonterra's operations is that it's trading at a deep discount to the value of its oil reserves. Bonterra's proven and probable reserves have an after-tax net present value of just over $1 billion, which after deducting long-term debt and decommissioning liabilities give it an after-tax net asset value of $17 per share.

This is almost six times greater than Bonterra's current market value of $3 per share, indicating considerable upside available for investors.

That becomes more apparent when considered that value is based on an estimated 2019 average for the Canadian light oil benchmark Edmonton Par of $75.27 per barrel**,** which is around 1% lower than the average year to date.

Bonterra's NAV should also expand in value as oil rises and because of its growing reserves, which have expanded by 12% between 2015 and the end of 2018.

Mixed results

Bonterra's decision to cut its dividend along with other moves to shore up its balance sheet and preserving cash flows were the right decisions because of the difficult operating environment being experienced.

It's only vulnerable to weaker crude, but also the gyrations of Canadian benchmark oil prices. The light oil benchmark has widened because of the **Canadian National Railway** strike and an oil leak at the Keystone pipeline, which saw it shutdown at the end of October.

Bonterra's production is also declining, which is not a beneficial development amid an operating environment where crude is rising in value.

For the third quarter 2019, the driller's oil output fell by 7% year over year to 12,136 barrels daily, causing operating cash flow and earnings to fall.

This can be attributed to Bonterra reducing its spending on drilling and well development as part of its strategy of preserving cash flows and shoring up its balance sheet.

For the first nine months of 2019, capital expenditures totalled $48 million compared to $74 million for the same period a year earlier.

This marked reduction in spending on developing its existing assets doesn't bode well for Bonterra to be able to expand production during the immediate future.

As a result of the sharp decline in production, Bonterra reported a $1.3 million loss compared to a $5.8 million profit a year earlier despite a marked reduction in capital expenditures for the quarter.

Foolish takeaway

Bonterra appears very attractively valued given that it's trading at a deep discount to the net asset value of its proven and probable oil reserves, indicating considerable upside ahead.

The company is a risky bet on higher crude because of declining production and the significant degree of debt, but that will be mitigated by firmer crude, making any investment in Bonterra highly dependent on the outlook for oil.

While optimism regarding crude is growing, there is still the risk of another price collapse occurring in 2020, which some analysts believe is highly likely. For these reasons, any investment in Bonterra should be treated as speculative.

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