



2 Contrarian Canadian Oil Stocks to Profit From the Oil Price Collapse

Description

Energy stocks are under considerable pressure, because of the latest oil price collapse. The international Brent price has plummeted by 58% for the year to date, while the North American benchmark West Texas Intermediate (WTI) has tumbled by roughly the same. A combination of coronavirus fears, the price war between Russia and Saudi Arabia, and a looming global recession mean that a recovery is some time off.

Nevertheless, it has created a significant contrarian opportunity to acquire quality drillers that possess solid fundamentals at very attractive valuations. Here are two energy stocks that possess solid fundamentals and that are on sale today.

Debt-free driller

I have [been bullish](#) on **Parex Resources** ([TSX:PXT](#)) for some time. It delivered a stunning 48% during 2019 to beat the S&P/TSX Composite's 19%. The driller has lost 57% since the start of 2020, creating an opportunity to acquire a high-quality energy stock at a bargain-basement price. Parex's operations are in Colombia, which is Latin America's fourth-largest oil producer.

It is trading at a deep 68% discount to the after-tax value of its oil reserves, highlighting that there are considerable capital gains ahead once oil rebounds. Parex has a rock-solid, debt-free balance sheet and finished 2019 holding US\$397 million in cash.

That provides Parex with considerable financial flexibility, allowing it to weather the current storm engulfing global energy markets. The ability to access international Brent pricing gives Parex a financial advantage over its North American peers. This is because Brent is trading at a US\$3 per barrel premium to WTI.

Oil sands giant

Canadian Natural Resources ([TSX:CNQ](#))([NYSE:CNQ](#)), regardless of the protracted oil price slump,

is a free [cash flow-generating machine](#). For 2019, it delivered record free cash flow of a very impressive \$4.6 billion. That improvement can be attributed to lower costs, which, coupled with higher benchmark heavy oil prices, boosted the netbacks on Canadian Natural's oil output.

A large tranche of that capital was used to repay debt and strengthen Canadian Natural's balance sheet. The company repaid a monster \$2.8 billion in debt during 2019, finishing the year with debt of 1.9 times adjusted EBITDA. This indicates that its debt is at manageable levels.

Canadian Natural's ability to generate considerable free cash flow, even in an environment weighed down by weaker oil, allows it to reward investors with a steadily increasing dividend. It has hiked the payment for the last 19 years straight to see it yielding, because of the sharp decline in its market value, a very juicy 12% at the time of writing.

The 33% payout ratio highlights that dividend is sustainable. Even a marked drop in net income won't affect the sustainability of Canadian Natural's dividend. Such a high double-digit yield coupled with the poor outlook for crude does mean that management could consider cutting the payment.

Key to Canadian Natural's ability to thrive, even in a difficult operating environment, is the low-cost nature of its assets. A large proportion of its production comes from oil sands operations, which are low-decline-rate, long-life assets. The low decline rate means that Canadian Natural doesn't need to invest large amounts of capital to sustain oil production.

It has a company-wide decline rate of 10%, which is around a third of shale oil, highlighting the low operating costs of its assets compared to shale. This further enhances Canadian Natural's profitability and capability to emerge from the latest turmoil to strike oil markets unscathed.

Looking ahead

The short-term outlook for oil is poor. It will, however, over the long term, rebound once coronavirus fears subside and the economic impact is quantified. When crude rebounds, quality oil stocks will rally sharply. This is particularly the case for Parex and Canadian Natural, which have solid fundamentals and are trading at deep discounts to their fair value.

CATEGORY

1. Energy Stocks
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2. TSX:CNQ (Canadian Natural Resources Limited)
3. TSX:PXT (PAREX RESOURCES INC)

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