$1,000 Invested in Each of These Oil Stocks Could Make a Fortune in 5 Years

Description

Canadian oil stocks are being punished by the latest oil price collapse. While the short-term outlook for energy stocks is poor, oil's 75% plunge since the start of 2020 has created a once-in-a-generation opportunity to acquire quality oil stocks at extremely attractive valuations.

There is no doubting that while the immediate outlook is gloomy, oil prices will eventually rebound, giving those energy stocks that survive the current crisis a substantial lift. This is particularly the case considering that oil stocks offer levered exposure to the price of crude. That means those companies will experience significantly higher gains once oil rallies.

Here are two oil stocks that will rally significantly, generating outsized returns once oil prices recover.

Leading Colombian oil producer

Frontera Energy (TSX:FEC) is the largest private oil producer in Colombia, South America's third-largest petroleum producer. It has lost 62% for the year to date, indicating that it is attractively valued. The driller has been making steady progress to unlock value from its diversified portfolio of oil acreage in Colombia, Peru, Ecuador, and Guyana.

While Frontera withdrew its 2020 guidance as part of its response to the impact of the coronavirus, it still reported solid first-quarter 2020 numbers. Oil production fell by a modest 6% year over year to an average of 63,572 barrels daily. That was despite Frontera slashing spending on exploration and development drilling as well as shuttering 15,000 barrels daily of uneconomic production.

The driller is undertaking a range of initiatives to boost profitability while protecting its earnings and balance sheet at this difficult time. Key among those are Frontera's focus on reducing costs. This includes cutting executive salaries, reducing general costs, and renegotiating pipeline tariffs.

Frontera’s solid balance sheet endows it with the financial flexibility to weather the current crisis ingood shape. The driller finished the first quarter with US$265 million in cash and a further US$96million in restricted cash, providing it with considerable liquidity.

Importantly, Frontera’s long-term debt is a modest US$332 million with no material debt repayments until 2023, giving the driller plenty of breathing space to wait for oil to rally.

Frontera is trading at less than a third of its after-tax net asset value of around $13 per share, underscoring the considerable upside ahead when oil rallies, making now the time to buy.

Upstream conventional driller

Surge Energy (TSX:SGY) has been roughly handled by the market because of the latest oil price collapse. The intermediate oil producer is down a whopping 75% since the start of 2020, and the market is pricing it for bankruptcy.

That is a very real risk for Surge, which reduced its dividend by 90% in early March and suspended the payment last month. It reported some worrying first-quarter 2020 results. Surge’s net loss for the period ballooned to a concerning $615 million compared to $8 million a year earlier. That can be attributed to a sharp 35% year-over-year decline in oil production and substantially weaker oil prices.

Nevertheless, on a positive note adjusted funds flow only declined by 28% year over year to $30 million. Surge’s net debt of $385 million at the end of the quarter was 12% lower than for the equivalent period in 2019.

The driller’s operating netback, an important measure of operational profitability, only fell 22% to $21.16 per barrel, which is a healthy number in such a difficult operating environment.

Those numbers bode well for Surge’s survival.

However, while oil has rallied from its April lows, Surge’s second-quarter results will be worse, explaining why it is priced by the market for bankruptcy. Other measures being taken to increase Surge’s survivability include its oil price hedges, which will blunt the impact of weaker oil on earnings. Costs will fall further as it reduces expenses through a range of cost-cutting measures, including the curtailment of 21% of its pre-coronavirus oil production.

Surge is in a risky position and is especially vulnerable to the fallout from sharply weaker oil. The risk/reward equation is moving in favour of investors, but Surge is a highly speculative play on an oil recovery for only the most risk-tolerant investors.

CATEGORY

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1. TSX:FEC (Frontera Energy Corporation)

2. TSX:SGY (Surge Energy Inc.)

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