Why Obsidian Energy Stock Gained 120% This Year

Description

What happened?

Energy stocks have been on a roll this year. It seems like they will dwarf last year's epic ascent in 2022. At least the latest quarterly numbers and current oil and gas prices certainly hint that. One TSX energy stock that has been unstoppable since last year is **Obsidian Energy** (TSX:OBE)(NYSE:OBE). It is up 520% in the last 12 months and 120% in 2022.

So what?

Obsidian Energy reported its full-year 2021 earnings last week. Its free cash flow almost doubled to $218 million in 2021 relative to 2020. It continued to repay debt with the incremental free cash flow. Its net debt declined from $467 million to $413 million at the end of Q4 2021.

Almost all the oil and gas producers are seeing record profits since the pandemic. However, the bigger reason behind the sentiment change is this crude oil rally has brought their balance sheets in so much superior shape that none of the previous rallies did.

The supply constraints have already been pushing oil prices higher. The Russia-Ukraine tensions have magnified that impact, which recently sent Brent crude oil close to US$106 a barrel.

High oil prices previously resulted in higher capex plans and, thus, increased production. However, this time, energy producers have been little enthusiastic about increasing their production and more focused on improving their balance sheet strength.

Obsidian Energy's net debt-to-EBITDA ratio fell below one in the latest reported quarter, while it was close to three in late 2020. The net debt-to-EBITDA ratio is an important metric to analyze energy stocks and implies how many years a company would take to repay its debt.

Obsidian is an $880 million company that produces around 25,000 barrels of oil per day. In the last 12 months, the company reported a net income of $414 million against a loss of $771 million in 2020.

Now what?

Obsidian Energy stock is currently trading close to $11, its four-year-high levels. It is trading 2.5 times its earnings and looks highly discounted. Peer energy stocks are trading at a much higher valuation.

Note that current higher oil prices could notably boost its earnings when it reports Q1 2022. So, higher earnings growth prospects and discounted valuation could continue to push the stock higher.

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