

## Marcial: Apache, an Undervalued Oil Play

The U.S. independent oil-and-gas company trades at a discount to its peers, but investors and analysts say the stock's potential is strong

By [Gene Marcial](#)

With crude oil prices creeping up again, to around \$71 a barrel from \$33 in February, some investors are recalibrating their exposure to oil stocks. Crude prices are still nowhere near their stratospheric high last year when they zoomed to more than \$140. But oil stocks, although not yet entirely back in favor, have been catching fresh attention.

One of those attracting investor interest: Apache ([APA](#)), one of the largest U.S. independent oil-and-gas exploration and production companies, operating in North America, the North Sea, Egypt, Australia, offshore China, Argentina, and Poland. Apache has proved reserves of 2.4 billion barrels of oil equivalents.

"A big part of Apache's attraction is its large stake in the U.S. and its high success rate in oil drilling of about 93%," says Joseph Tatusko, chief investment officer at [Westport Resources Management](#), which owns shares. About 61% of its proved reserves are in North America, he notes.

Apache is poised to be among the first out of the gate when the economic recovery gains traction, says Tatusko. As a group, oil stocks usually are among the first to rally, and "we expect Apache will be in that advancing first team," he adds.

The stock has already shot up from its 52-week low of 51.03 on Mar. 9 to 84.20 a share on June 12. True, it is still way below its 52-week high of 145 hit on July 2, 2008, but Tatusko sees it rising by at least another 20% from its current price this year. Part of the reason is some institutional investors are staying with the stock. Among them is JPMorgan Chase ([JPM](#)), which bought 2.2 million shares (as of Mar. 31, 2009), boosting its stake in Apache to 2.1%.

### FINANCIAL DISCIPLINE

Apache currently trades at a discount to its large-cap peers. However, "we expect Apache to catch up," says Fadel Gheit, senior oil analyst at Oppenheimer ([OPY](#)) (it seeks to do business with Apache), who rates the stock outperform. Apache's stock has advanced about 8% so far this year, while its peers on average have gained some 17%.

One reason why Gheit is confident Apache will be able to catch up is its "strong operating and financial disciplines, which are Apache's key competitive advantages, especially in industry downturns," he argues.

Gheit also expects the company to make more selective property acquisitions in negotiated transactions that create long-term value for its shareholders, as it has done over the years. It has a history of augmenting its production volume growth through acquisitions.

Industry analysts warn that the risks in oil-and-gas drilling in terms of heavy costs and the rate of success remain enormous, exacerbated by the recession and the continued reluctance of financial institutions to extend credit.

Apache, however, is among the few that isn't bogged down by credit problems, in part because of its strong free cash flow and balance sheet, with \$2 billion of cash on hand. Gheit notes that Apache's operating cash flow in the first quarter was \$983 million. And its debt ratio of 11% is among the lowest in the sector, he notes.

One other positive Gheit points to: Apache continues to adjust its operating cost to the current oil and gas price environment, and is determined to keep its capital expenditures closely tied to its operating cash flow. Despite the economic downturn, Apache still expects to boost production this year, although at a rate closer to the low end of its previous guidance range of 6% to 14%, he says, due to reduced capital spending and an expected delay in production at its Van Gogh development offshore western Australia.

## **PRODUCTION VOLUME GROWTH**

For the second quarter, Gheit figures the company expects production overall to rise 3% to 5% above 2009's first-quarter level.

Gheit's 12- to 18-month price target for the stock is 98, and he forecasts earnings of \$3.34 a share for 2009 and \$6.78 for 2010. His estimates are based on an average crude oil price of \$48 and a price of \$4 per million cu. ft. of natural gas.

"We believe (Apache's) current valuations are compelling, given the company's potential for strong volume growth, diversified asset base, and solid project pipeline," says Thomas R. Driscoll, oil analyst at Barclays Capital ([BCS](#)), who rates the stock overweight. (Apache is a non-investment banking client.) Some 25% of production volume growth comes from Egypt. Australia, the North Sea, and Argentina each account for 10%, he says.

Without a doubt, the oil patch has become more slippery for investors since the sharp fall of crude prices from the lofty levels reached in February 2008. But with 15 Wall Street analysts recommending buying the stock and 11 rating it a hold, Apache seems to be standing on solid ground.

*Unless otherwise noted, neither the sources cited in Gene Marcial's Stock Picks nor their firms hold positions in the stocks under discussion. Similarly, they have no investment banking or other financial relationships with them.*

*[Marcial](#) writes the Inside Wall Street column for BusinessWeek. In 2008, FT Press published the book Gene Marcial's 7 Commandments of Stock Investing.*