Tourmaline Oil

Energy
TSX: TOU
Market Outperform | No Action

Calgary Portfolio Management Trust

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Return on Investment

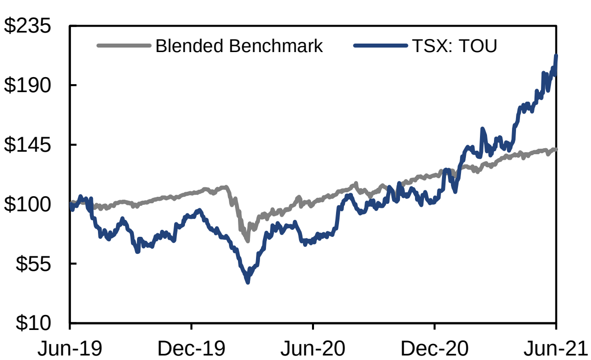
Current Share Price	$35.43
Target Price	$41.00
Dividend Yield	1.41%
Implied Return	17%
Conviction Rating	N/A

Market Profile

52-Week Range	$12.33 - $36.18
Market Capitalization ($mm)	$10,520
Net Debt ($mm)	$1,785
Enterprise Value ($mm)	$12,305
Beta (5-Year Monthly)	1.91

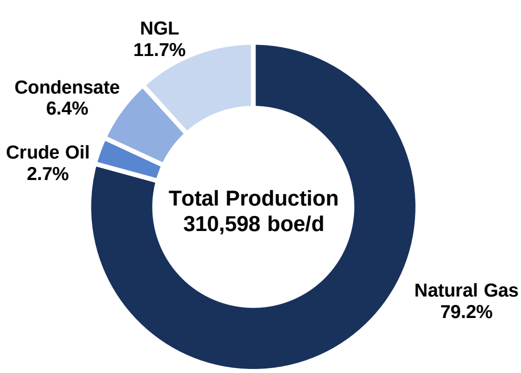
Metrics	2020A	2021E	2022E
Revenue ($mm)	$2,250	$4,003	$4,401
EBITDA ($mm)	$1,546	$2,317	$2,409
DACF ($mm)	$1,152	$2,250	$2,381
EV/EBITDA	8.0x	5.3x	5.1x

Historical Trading Performance (Indexed to $100)



Source: S&P Capital IQ

Figure 1: 2020 Production Mix



Source: Company Filings

Business Description

Tourmaline Oil (TSX: TOU) is an upstream energy company focused on aggressive exploration, development, production, and acquisition of energy assets in the Western Canadian Sedimentary Basin (WCSB). Headquartered in Calgary, Alberta, TOU is Canada's largest natural gas producer, maintaining operations in the Alberta Deep Basin, Northeast British Columbia Montney, and Peace River Triassic Oil Complex. In 2020, TOU averaged production of 310,598 boe/d. The Company's production mix consists primarily of natural gas (79.2%), but also includes crude oil (2.7%), condensate (6.4%), and natural gas liquids (11.7%).

Industry Overview

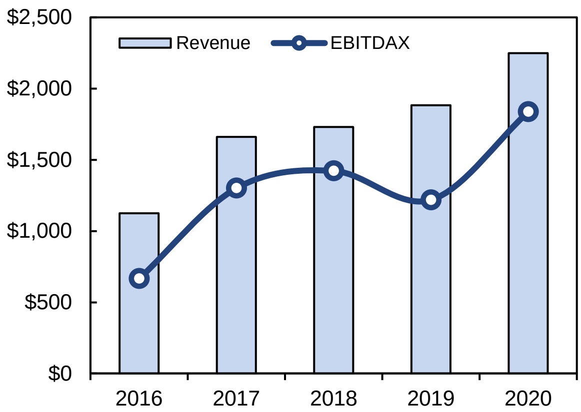
Energy demand and supply recovered significantly from multi-year lows induced by the COVID-19 pandemic in Q2 2020. A strong rebound in global economic activity has increased oil consumption to 94.8mmbbl/d in Q1 2021, which is only a ~0.7% decrease YoY. Oil production is expected to keep pace with rising demand as OPEC+ members accelerate production. As a result of this supply growth, the EIA forecasts oil prices to decline, with WTI decreasing to US$66/bbl in 2021. Alternatively, natural gas prices are expected to rise due to increased domestic demand, with AECO spot prices expected to reach $2.99/mmbtu and $3.15/mmbtu in 2021 and 2022, respectively. However, despite positive macroeconomic indicators, emerging COVID-19 variants remain a concern for the industry. Uncertainty due to the COVID-19 pandemic will continue to affect economic recovery and price forecasts in the upcoming months.

Mandate Fit

Quality Management: Michael Rose has been the President and CEO of TOU since he founded the Company in 2008. With over 38 years of experience in the oil and gas industry, Rose's direct involvement since the start of TOU has resulted in the Company's rapid growth. Notably, Rose oversaw the successful sale of Duvernay (another company he founded) for $5.9B prior to joining TOU. Under Rose's leadership, TOU has consistently delivered against targets. Directors and Officers own ~8% of fully diluted shares outstanding. ESG metrics are also prioritized by management, with TOU achieving a 31% reduction in CO_2 emissions intensity between 2013 and 2019. TOU currently possesses the lowest GHG emissions intensity among senior Canadian energy peers. Other ESG initiatives implemented by TOU include multi-well pad drilling, in-line well testing, and diesel displacement.

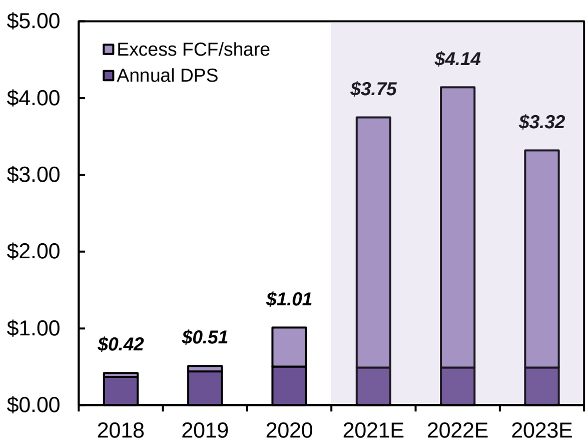
Competitive Advantage: TOU's greatest competitive advantage lies in its superior margins. TOU possesses the lowest completed per stage well costs in Montney and the Alberta Deep Basin, achieved through continuous engineering design improvements that have reduced costs by 50% since 2012. The Company has also achieved an efficient cost structure by reducing operating expenditures from $4.87/boe in 2014 to $3.14/boe in 2020. TOU's ability to streamline operations and leverage efficiencies over the past year has directly impacted its market share; the Company currently represents 12% of WCSB receipts, 15% of Canadian gas rigs, and 20% of WCSB gas additions in 2020.

Figure 2: Revenue and EBITDAX ($mm)



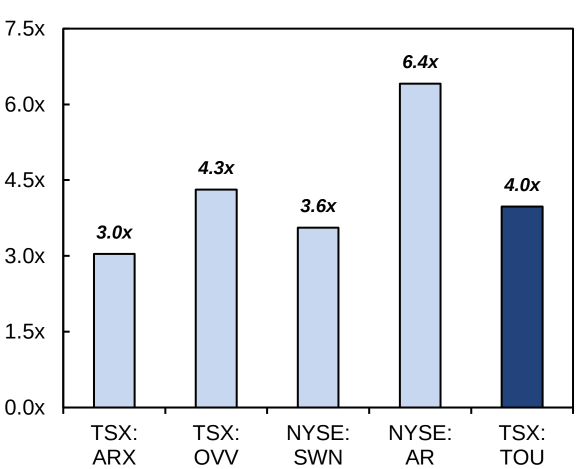
Source: Company Filings

Figure 3: TOU Free Cash Flow ($/share)



Source: Company Filings

Figure 4: NTM EV/EBITDA vs. Peers



Source: S&P Capital IQ

Additionally, TOU's pending acquisition of Black Swan Energy provides the Company with another competitive advantage. The addition of Black Swan increases TOU's production to 160,000boe/d, solidifying its position as the largest producer and acreage holder in North Montney. Synergies from this consolidation play will deliver significant benefits to the Company's Gundy complex and Conroy project. Furthermore, the acquisition delivers even greater potential upside as electrification, carbon capture sequestration, and hydrogen projects are all likely components of future infrastructure buildout at Black Swan. The deal is expected to close in July 2021.

Balance Sheet: TOU possesses a strong balance sheet that supports its growing operations and ongoing development. TOU's 1.0x LTM Net Debt/EBITDA is lower than its peer group average of 3.7x. Furthermore, the Company has maintained a debt-to-equity ratio of 16.4% over the past five years, averaging net debt of $1,549mm. With a revolving credit facility of $1.8B, TOU is unlikely to experience capital access issues in the medium-term. TOU's current ratio of 1.2x also demonstrates its ability to satisfy short-term obligations.

Growing Free Cash Flows: TOU's unlevered LTM FCF is $161.8mm. Management expects FCF yield to reach 12% in 2021 and 14% in 2022 as TOU continues to reduce drill capital costs and increase operational efficiencies. Organic production growth is expected to provide a base FCF growth of ~5% each year. The Company's cumulative five-year FCF target is $5.8B.

Attractive Valuation: TOU's valuation remains attractive despite volatility in the energy industry. Notably, TOU's 4.0x NTM EV/EBITDA is lower than the peer group average of 4.3x. Upstream gas-weighted companies with similar EV were used in TOU's peer group. The Company's peer group consists of ARC Resources (TSX: ARX), Ovintiv (TSX: OVV), Southwestern Energy Company (NYSE: SWN), and Antero Resources (NYSE: AR).

TOU was valued using a 60/40 weighted average of a 2P NAV model and 2021E EV/DACF multiple of 5.6x. A greater emphasis was placed on the NAV model as it provides a more accurate reflection of TOU's low production cost per boe.

Risks

Variable drilling program results could impede TOU's growth. Operational issues or underwhelming results in the Company's drilling and development program will negatively impact share price. TOU is also subject to fluctuations in commodity prices, especially as COVID-19 casts uncertainty on price forecasts. Although TOU is partially hedged for 2021, volatile pricing could prevent the Company from reaching FCF targets. Other risks include the impact of government policy relating to royalties, income taxes, and environmental regulation, as well as foreign exchange risk and infrastructure constraints during initial production.

Investment Thesis and Outlook

The CPMT believes TOU possesses both a unique operational advantage and the financial strength required to sustain rapid growth in the long-term. TOU's superior margins and strategic consolidation in the North Montney provide the Company with a competitive edge over its peers. Furthermore, quality management and TOU's commitment to ESG targets ensures that the Company remains flexible and adaptive to innovation in the oil and gas industry. However, the CPMT recommends no action due to the continued volatility in the industry caused by the COVID-19 pandemic.