Why Parex Resources Inc. Is the Best Way to Play the Rebound in Oil

Description

The global sell-off of oil stocks triggered by the rout in crude has created some stellar buying opportunities for risk tolerant investors willing to bet on oil prices rebounding. One company that stands out as a speculative play for all the right reasons is Canadian small cap **Parex Resources Inc.** (TSX:PXT).

So what?

Parex operates predominantly in Colombia, with the majority of its oil wells located in Colombia's proven Llanos basin southeast of the capital Bogota. It has a solid portfolio of assets with long life oil reserves of 91 million barrels.

After seeing its share price plummet 45% since the rout in crude began six months ago, Parex is now trading with some attractive valuation metrics. This includes an enterprise value (EV) of a mere four times EBITDA, but attractive valuation ratios alone do not tell the full story.

While it may be a small-cap stock that significantly increases the risk investors face, it possesses many of the attributes of far larger high quality peers. These include a fortress balance sheet, with long-term debt of only US$42 million and a high degree of liquidity with US$34 million of cash and cash equivalents. This gives Parex a negligible degree of leverage with net debt totalling US$8 million, which is significantly lower than its annualized cash flow, even after allowing for the markedly softer oil prices we are currently witnessing.

Such an attribute is important for investors, because it is those oil companies with mountains of debt and are highly levered that have been the most harshly dealt with by the market. This includes the likes of **Lightstream Resources Ltd., Penn West Petroleum Ltd.,** and **Pacific Rubiales Energy Corp.,** which have seen their share prices plunge by 79%, 65%, and 81% respectively over the last six months. Each of these companies is highly levered with net debt of more than double their operational cash flow. Since the slump, all three are also struggling to fund sufficient capital expenditure to grow oil production and meet their financial obligations.

However, even after revising its 2015 guidance in early January of this year, Parex is still able to fully fund its 2015 production sustaining and exploration program from operational cash flow. This is even after assuming that the price of crude will average between US$50 and US$60 per barrel for the remainder of this year, which is one of the lowest forecast oil prices used in 2015 guidance by a Canadian listed oil company.

The surge in the U.S. dollar also augurs well for the company's financial performance, because it sells oil at U.S. dollars but operational costs are incurred in Colombian pesos and Canadian dollars, which have weakened considerably.

Finally, it is able to access international Brent oil pricing. This gives it a distinct advantage over

Canadian based oil companies because they receive the North American benchmark oil price, or West Texas Intermediate (WTI) for the oil sold. Brent trades at a 9% premium to WTI and I expect this to widen with crude inventories in North America continuing to grow because of the supply glut. These growing inventories will apply further downward pressure to the price of WTI.

So what?

For all of these reasons I believe Parex is nicely positioned to weather the rout in crude prices and see its share price significantly appreciate as the price of oil rallies. It is also a far less risky play than many of its Canadian peers because of its solid balance sheet and ability to generate higher margins through accessing premium Brent pricing.

CATEGORY

1. Energy Stocks
2. Investing

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1. TSX:PXT (PAREX RESOURCES INC)

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