This Canadian Driller Is Among the Best Ways to Play Higher Oil

Description

The victory of Conservative candidate Ivan Duque in the second round of voting in Colombia's highly polarized presidential election on Sunday has removed much of the uncertainty surrounding the Andean nation's oil industry. The leftist candidate Gustavo Petro had announced a platform aimed at reducing Colombia's dependency on crude by winding down investment in the oil industry and ratcheting up manufacturing as well as agriculture.

Duque will retain the business-friendly approach of previous Conservative governments and promote foreign investment in Colombia's oil industry, which has been weighed down by weaker crude and security issues. That is good news for Calgary-based upstream oil producer **Parex Resources Inc.** (TSX:PXT), which owns and operates an extensive portfolio of oil properties in Colombia.

Now what?

Parex owns 1.6 million acres in Colombia that contain over 20 blocks and 134 million net barrels of oil reserves. That acreage is located in Colombia's prolific Llanos Basin in the central east of the country, and the Middle Magdalena basin is in the centre.

The driller's reserves were independently valued at US$2.5 billion after income taxes and the application of a 10% discount rate in accordance with industry methodology. This comes to US$16 per share, or US$2.76 less than Parex's current market price. The reason that Parex is trading at a premium to the value of its reserves is because of the high quality of its oil assets, ability to grow production, and rock-solid balance sheet.

Nevertheless, it is important to note that the value of those oil reserves will expand, because they were calculated at the end of 2017 using an assumed annual average oil price for Brent of US$64 per barrel for 2018, 2019, and 2020. This is just over $10 lower than the current price for Brent, meaning that Parex's reserves should rise significantly in value when calculated at the end of 2018.

The company's impressive drilling success rate and quality oil acreage, which possesses considerable exploration upside, indicates that Parex's oil reserves will grow, further boosting their value.

Because it operates in Colombia, Parex is able to access international Brent pricing for the oil that it produces, giving it a notable edge over its North American peers.

You see, Brent is trading at a substantial premium of almost US$10 to the North American benchmark West Texas Intermediate (WTI). That — along with low operating expenses because of a weaker Colombian peso coupled and reduced labour costs — makes Parex's operations extremely profitable.

For the first quarter 2018, the driller reported an operating netback — a key measure of profitability — of US$39.10 per barrel, which is significantly higher than many of its North American peers, including **Crescent Point Energy Corp.'s** US$24 a barrel.

Importantly, in an operating environment where the price of oil has firmed significantly to be trading well above industry estimates, Parex is growing its oil output at a decent clip. For 2018, production is expected to be a remarkable 21% higher than 2017, thereby significantly boosting Parex's earnings. When combined with rising profitability because of the driller's focus on controlling costs and higher oil prices, its bottom line — and, ultimately, its share price — will grow at a solid rate.

It should also be noted that Parex, unlike many of its similar-sized industry peers, has a fortress balance sheet with no debt and US$206 million of working capital. This makes it capable of weathering another decline in the price of crude, while giving it considerable financial flexibility, allowing Parex to increase spending on exploration and well development if higher oil remains in play for a sustained period.

So what?

Parex is one of the most attractive plays on higher crude, and its stock should appreciate at a solid clip over the remainder of 2018, as oil firms and many of the risks surrounding Colombia's economic outlook ease.

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