



Can This Resurrected Energy Company Ever Reward Investors?

Description

While oil has [rallied sharply](#) since the start of 2018, some energy companies, including **Frontera Energy Corp.** ([TSX:FEC](#)), have lagged behind. Despite West Texas Intermediate (WTI) popping by 16% for the year to date, Frontera's shares have plunged by 9%, as it battles to ward off the stigma associated with its 2016 bankruptcy filing when it operated as Pacific Exploration & Production Corp.

Now what?

A key aspect of its operations that has been weighing on the stock has been declining production, which, for the first quarter 2018, came to 66,227 barrels daily net after royalties, or 9% lower than a year earlier. That sharp decline can be attributed to community blockades shutting down Frontera's Cubiro block in Colombia and greater than expected declines at its Colombian light and medium oil wells.

Production costs for the quarter also rose sharply to be US\$12.47 per barrel produced, which was a worrying 32% year-over-year increase.

Frontera's bottom line also declined substantially. Reported quarterly net income was US\$9.7 million, or roughly half of what it was a year earlier. That can be attributed to significant losses incurred on the hedges held by Frontera as part of its risk-management strategy as well as higher operating costs.

Nonetheless, Frontera is focused on positioning itself for growth. For the first quarter, capital expenditures totaled US\$79 million, or roughly double a year earlier. That allowed the driller to operate eight rigs throughout the quarter with five focused on its Quifa heavy oil block in Colombia's Llanos Basin and the remaining three at its Guatiquia block, which is also located in that basin.

Despite this significant ramp-up in drilling activity, 2018 production is forecast to remain flat or even dip slightly compared to 2017. That is not a positive trend for an upstream oil producer in an operating environment where oil is rising.

Management, however, recently expressed a strong vote of confidence in the company and its future while indicating that they believe the market is failing to recognize the company's true value. They did

this by notifying the TSX that Frontera intends to buy back up to 3.5% of its total float of common shares between now and July 2019.

Frontera's considerable oil reserves also indicate that the market is failing to recognize its fair value. At the end of 2017, the company was independently assessed to have net oil reserves of 154 million barrels valued at US\$1.5 billion, or \$38.63 per share, after income taxes and the application of a 10% discount. That comes to more than double Frontera's market value and vindicates management's decision to commence a share buyback. It also indicates the tremendous potential upside available to investors should Frontera prove itself capable of unlocking the considerable value held by those reserves.

The driller also has a solid balance sheet, finishing the first quarter with long-term debt of a mere US\$250 million and cash totaling US\$516 million. This gives Frontera considerable financial flexibility, as it works to [unlock value](#) from its considerable oil reserves and acreage.

So what?

Frontera is a tough energy stock to like, despite emerging from its restructuring in late 2016 with a solid balance sheet, considerable cash, and low debt. The negative sentiment attached to its near failure as Pacific Exploration is weighing heavily on market perception, particularly when there were allegations that previous management misled the market as to the company's financial health.

Nevertheless, it appears that the worst is behind Frontera, and the considerable value of its reserves indicates that it is attractively valued.

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