Is This Latin American Energy Stock an Attractive Investment?

Description

Despite oil's latest rally that sees the international benchmark Brent up by 12% since the start of 2018, upstream oil producer **Frontera Energy Corp.** (TSX:FEC) continues to languish. The driller's second quarter 2018 results, in which it reported a net loss of US$184 million — more than three times greater than the same period in 2017 — certainly hasn't instilled any confidence in the company's operations.

Now what?

Frontera is the oil company that materialized from the bankruptcy of Pacific Exploration and Production Corp. in late 2016. While it emerged with a clean balance sheet and considerable assets, it has battled to throw off the stigma associated with its brush with the corporate undertaker and unlock value for investors.

Despite claims by management to the contrary, its latest results on all appearances appear poor. Net oil production plummeted by 11% compared to a year earlier, and this, along with higher production and diluent costs as well as a range of asset write-downs, was responsible for the net loss. The marked deterioration in oil output was caused by higher than expected decline rates as well as community blockades at its operations in Colombia's Llanos Basin and an outage of the NorPeruano pipeline in Peru.

Another concerning aspect of Frontera's second quarter results is that expenses rose sharply compared to the same quarter in 2017. The driller reported total operating costs of US$29.94 per barrel, a worrisome 15% greater than the US$25.97 reported a year earlier. That sharp increase in operating expenses can be attributed to higher production costs caused by increased field maintenance and higher diluent costs because of firmer oil prices.

Nonetheless, because of oil's sustained rally that saw Frontera realize an average quarterly sale price of US$10 a barrel greater than a year earlier, it reported a netback of US$26.76, a healthy 32% increase year over year.

Frontera also reported that by terminating a range of pipeline agreements, it had generated US$377 million in savings for transportation costs while retaining sufficient capacity through other agreements to meet its transportation needs.

For these reasons, amid an operating environment in which Brent remains firm and will likely trade in a band between US$70 to US$80 a barrel for the remainder of the year, Frontera should see a solid lift in profitability.

The sharp decline in second quarter profitability can also be attributed to Frontera recognizing impairment charges totalling US$109 million for the quarter, primarily related to its investment in the Bicentenario pipeline. The fact that the driller is working hard to maintain a clean balance sheet and wind down its exposure to liabilities from non-core assets bodes well for its future outlook.

So what?

Frontera's results overall were a mixed bag. While deteriorating production, rising costs, and large impairment charges are worrisome, the company's ongoing investment in developing its assets as well as realizing efficiencies will eventually deliver operational improvements. The key problem is that Frontera can't shake the negative view held by the market because of its bankruptcy in 2016 and subsequent restructuring, which essentially wiped out equity holders.

While Frontera does appear attractively valued and its stock has failed to keep pace with the crude, there are better investment opportunities among oil stocks, which are also relatively less risky.

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