



Latest Results Confirm the Quality of This Oil Company's Operations

Description

Oil's [latest rally](#) has brought the spotlight firmly back on energy stocks. One upstream oil producer that has attracted considerable attention is **Parex Resources** ([TSX:PXT](#)). The driller has gained 23% since the start of 2018, which is almost three times the 8% gain for the international benchmark Brent. Despite this solid rally, there are signs that Parex will continue to appreciate, particularly as oil gets ready for its next leg up.

Now what?

Parex is focused on oil exploration and production in the Andean nation of Colombia, where it owns oil properties totaling 1.6 million gross acres, giving it gross oil reserves of 162 million barrels. The driller reported some strong second-quarter 2018 results — notably, a significant jump in net income, which was US\$189 million compared to US\$3.5 million for the same period in 2017.

This can be attributed to a combination of higher oil, growing production, and a voluntary tax restructuring all boosting Parex's bottom line.

For the second quarter, oil output expanded by 5% year over year to 42,625 barrels daily, while transportation costs fell by an impressive 28%, more than offsetting the 8% increase in production expenses. That in combination with a higher average price per barrel of crude sold saw Parex's netback — a key measure of operational profitability — spike by an impressive 69% to US\$44.97 per barrel. This highlights the quality of Parex's oil assets and their profitability in an operating environment where oil has firmed significantly since the end of 2017.

Those solid results saw Parex restate its 2018 guidance, increasing the forecast top end of its 2018 production to 44,000 barrels daily, which is 24% greater than 2017. This coupled with higher oil will give Parex's cash flow and bottom line a solid boost.

Unlike many of its North American peers, Parex hasn't invested heavily in hedges to mitigate the risk of lower oil prices. While that means it is exposed to greater downside risk if oil prices collapsed, it also means that it is not incurring the same costs to maintain those hedges.

You see, because of oil's unanticipated rally, many upstream oil producers have incurred considerable losses on their risk-management contracts. In the case of Canadian light oil producer **Whitecap Resources**, it reported an almost \$111 million loss on [those contracts](#) for the second quarter, virtually eliminating the gains created by higher oil.

By not incurring significant costs with regards to its oil and currency hedges, Parex is better positioned to benefit from firmer oil prices.

Impressively for an upstream oil producer, Parex remains debt free, which endows it with considerable financial flexibility. Because of this and the quality of its Colombian oil acreage located in the Llanos Basin, management has embarked on a strategic review aimed at enhancing shareholder value.

Management is considering restructuring Parex by selling its long-life southern Casanare assets in the Llanos Basin while retaining its exploration assets so as to re-position it primarily as an oil-exploration company. According to a management announcement, the proceeds of any assets sale would be returned to shareholders. The appeal of implementing such a strategy is that it would enhance Parex's existing growth runway and allow it to focus on realizing the tremendous exploration upside held by its other assets.

So what?

Parex is an appealing play on higher oil, but while it owns a portfolio of quality oil properties and possesses considerable exploration upside, it may not hold the same potential as other oil companies. This is because sharply weaker oil didn't have the impact on its market value, meaning that there may be little upside ahead until oil undergoes another substantial rally.

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