

Is This Canadian Driller Operating in Colombia Poised to Soar?

Description

Oil continues to whipsaw wildly rising and falling sharply on good as well as bad news relating to key fundamentals including supply, demand and inventories. Bullish sentiment recently drove crude to a new multi-year high causing the international benchmark Brent to trade over US\$86 per barrel, although it has pulled back sharply in recent days, falling to under US\$80 a barrel. However, this latest shouldn't deter investors from boosting their exposure to oil.

One contrarian option for risk tolerant investors is **Frontera Energy Corp.** ([TSX:FEC](#)). Its market value has plummeted by over 16% since the start of 2018 despite Brent soaring by over 24%, leaving it attractively valued with latest news indicating that it is poised to rally.

Now what?

Frontera emerged from the bankruptcy of Pacific Exploration and Production Corp., which was one of the highest profile Canadian casualties of the protracted slump in crude, which at its height saw Brent drop below US\$30 a barrel. Since successfully completing its restructuring, which essentially wiped out existing equity holders, and emerging from bankruptcy the driller has struggled to unlock value for investors. That can essentially be blamed on the questionable quality of many of its oil assets located in Colombia and Peru.

Frontera is the largest independent oil and gas producer operating in Colombia, and latest news indicates that it is in the midst of turning its operations around. A renewed focus on exploration and the development of existing assets is starting to produce results for the beaten down driller.

In September 2018, it announced a new oil discovery on its 100% owned and operated Llanos-25 block located in Colombia's prolific Llanos basin, which was successfully tested with an oil flowrate of 427 barrels daily. That comes on the back of Frontera's discoveries earlier this year at its Guatiqua and Quifa blocks.

The driller also announced in September that it had successfully recommenced production at Block 192 in Peru, which is now pumping over 10,000 barrels of oil daily. That saw Frontera announce that production net of royalties had reached 65,000 barrels daily, which is expected to grow to 70,000 barrels during the fourth quarter 2018. Those latest developments leave the driller positioned to meet its annual 2018 forecast average production despite outages caused by pipeline issues in Peru and a blockade at the Cubiro block in Colombia.

While these events amount to particularly good news for investors Frontera has struggled with profitability for some time. It has reported a net loss for every quarter since the second quarter 2017 with several financial overhangs sharply impacting its performance. Key among these for the second quarter 2018 was a US\$69 million loss on Frontera's currency and commodity hedging contracts, a US\$110 million impairment charge and a US\$51 million non-cash loss associated with its sale of **Petroelectrica de los Llanos Ltd.**

It's important to note that Frontera's oil price hedging contracts unwind at the end of October 2018, which means that for the remainder of 2018 and into 2019, it will enjoy the full benefit of higher oil. There is very likelihood that crude will remain firm for the foreseeable future.

Frontera's production is also 93% weighted to oil, which significantly minimizes its exposure to weaker natural gas prices and because it is benchmarked to Brent allows the driller to enjoy a financial advantage over its North American peers. Brent is trading at a notable premium to the North American benchmark West Texas Intermediate (WTI), which is over US\$10 a barrel and expected to widen further.

So what?

Frontera is a difficult oil company to like. Its struggle with profitability caused a by a range of operational issues and financial overhangs as well as the damage caused by its 2016 bankruptcy have severely tarnished its reputation in the eyes of the market.

Nevertheless, the latest series of events indicate that Frontera is on-track to unlock value for investors, while many of those financial issues are concluding. This along with some extremely attractive valuation metrics including an enterprise value of a mere 3.7 times estimated 2018 EBITDA, a stronger balance sheet, considerable liquidity and growing production make it a risky but appealing contrarian play on higher oil.

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