1 Top Oil Stock for Every Portfolio

Description

Oil's latest pullback, which sees the international benchmark Brent trading at almost US$72 per barrel or over US$24 less than its recent multi-year high of over US$86 a barrel has triggered considerable pessimism over the outlook for crude. While weaker crude makes many upstream oil producers' unattractive investments one that stands out for its long history of unlocking value for investors is **Parex Resources Inc.** (TSX:PXT).

Now what?

Parex which is focused on oil exploration and production in Colombia pulled through the worst moments of the protracted slump in oil in relatively good shape compared to many of its peers. Since the start of 2018, Parex has kept pace with Brent rising in value by 11% and there are signs of further gains ahead.

Parex reported some solid third quarter 2018 results. Oil production soared by 24% to 45,020 barrels daily, and it was 99% weighted to oil and other petroleum liquids, meaning that it won't be impacted by the poor long-term outlook for natural gas.

The profitability of Parex's high-quality Colombian oil assets is underscored by its impressive operating netback, an important measure of profitability because it shows the margin that an upstream oil producer can generate for each barrel of oil pumped. Parex's third-quarter operating netback was US$44.41 per barrel produced, which was 59% greater than the comparable period in 2017. Sharply lower operating and transportation expenses along with higher oil prices contributed to the notable improvement in Parex's netback.

The driller's netback is significantly higher than those of its Canadian peers such as **Whitecap Resources Inc.** and **Surge Energy Inc.,** which reported before hedging netbacks of US$29.24 and US$30.66 per barrel, respectively. A reason for this is that operating expenses in Colombia are lower than Canada because of noticeably lower salaries and other overheads.

Nonetheless, the primary reason is that Parex can access international Brent pricing, giving it a distinct financial advantage over drillers operating solely in North America because Brent is trading at a US$10 per barrel premium to the North American benchmark West Texas Intermediate (WTI). According to analysts that premium will continue for the foreseeable future.

Such strong production growth and profitability caused Parex's earnings to surge. It reported that net income shot up by a remarkable 60% year over year to US$89 million, while cash flow from operating activities more than doubled to almost US$119 million.

More important for a company operating in a capital-intensive industry, free cash flow surged to US$38 million, a significant improvement over the negative US$7 million reported a year earlier. That has bolstered Parex's cash holdings, seeing it finish the period with US$361 million in cash. This means the driller is capable of funding exploration and development program activities from operating cash flows leaving its pristine balance sheet intact.

Because of those solid results, Parex is on track to meet its 2018 annual production guidance that it revised upwards earlier this year to 48,000 barrels daily, an impressive 35% increase over 2017. In an operating environment that sees Brent is trading at over US$70 per barrel, this will give Parex's full-year earnings a healthy lift, which should cause its stock to appreciate.

Parex is currently undertaking a strategic review aimed at determining the company's future direction and maximizing value for shareholders. It is focused on the potential sale of Parex's established Southern Casanare assets in Colombia's prolific, but mature Llanos Basin while retaining its exploration properties and returning the net proceeds of any sale to shareholders.

The two blocks that make up those assets contain the majority of Parex's oil reserves and are responsible for most of its oil production. Such a move would reposition the driller as an exploration play which because of the quality of its exploration assets and enviable drilling success rate would position it to unlock considerable value for shareholders.

So what?

Parex is an attractively valued means of gaining exposure to higher crude. As Brent firms further, Parex's stock will appreciate. Higher oil appears likely given the range of emerging supply constraints that has seen investment bank **Goldman Sachs** predict that Brent will reach US$80 a barrel by the end of 2018. The company's strategic review increases the likelihood that it can maximize shareholder value by shifting the focus away from mature producing assets to those with significant exploration upside.

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