What Does the Latest Oil Price Collapse Mean for Frontera Energy Corp. (TSX:FEC)?

Description

Oil's latest sharp decline that sees the international benchmark Brent down by around 7% for the year to date has hit upstream intermediate oil producer **Frontera Energy Corp.** (TSX:FEC) particularly hard, causing it to decline by 32%. The driller, which is focused on Colombia and Peru, has failed to unlock value for investors since emerging from bankruptcy in late 2016. There are fears that Frontera is incapable of making the significant operational improvements required to create value for shareholders.

Now what?

Frontera is the largest independent oil and gas company operating in Colombia, where it has acreage in all the major oil basins as well as assets in Peru. The driller's oil reserves total 154 million barrels and have been assessed to have a before tax value of US$2.5 billion, which equates to around $33 per share or more than double its current market price.

That highlights the considerable potential upside available to investors and how attractively valued the driller is if it can successfully execute its strategy aimed at creating value for shareholders.

The reason for Frontera's latest sell-off is easily explained by its poor third quarter 2018 results. Disappointingly, especially in an operating environment where oil had firmed significantly, Frontera's third-quarter oil production plunged by 18% year over year to 58,558 barrels daily. This can be attributed to pipeline outages in Peru, which prevented Frontera from transporting its crude to crucial shipping points.

The profitability of that production did expand because the driller's netback of US$23.81 per barrel was 2% higher than a year earlier. That netback however is significantly lower than its peers such as **Gran Tierra Energy Inc.** and **Parex Resources Inc.** which reported US$47.41 and US$44.41 per barrel, respectively.

This reveals that Frontera's developed producing assets are not as profitable as its peers, further explaining why the market has heavily marked down its value. That can be blamed on the higher production and transportation expenses associated with Frontera's oil assets including the need for costly diluent to make its heavy oil production sufficiently viscous to be transported by pipeline.

Those higher extraction costs are caused by many of Frontera's wells being located in aging mature fields, which require greater expenditure on workovers and maintenance while being less efficient to operate.

As a result of this poor performance, Frontera was forced to revise its full year 2018 guidance downward. It dialed down forecast production by 5%, compared to its previous guidance, to a maximum of 65,000 barrels daily and increased production costs by 10% to US$14.50 per barrel. This, along with oil's latest weakness, does not bode well for its fourth quarter results, illustrating that Frontera has yet to successfully maximize the performance of its operations.

The only pleasing aspect of its third-quarter results is that Frontera continues to maintain a robust balance sheet. It finished the third quarter with US$587 million in cash and long-term debt of US$350 million, which is less than one times EBITDA, indicating that it is very manageable.

So what?

Frontera remains a difficult company to like. While its solid balance sheet along with initiatives aimed at reducing costs and bolstering operational efficiencies do increase its appeal, as does the fact that Frontera is trading at a steep discount to the value of its oil reserves, operational issues are weighing on its outlook. It is for this reason that other upstream oil producers like Gran Tierra and Parex are more attractive investments.

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