



This South American Driller Will Profit From Venezuela's Collapsing Oil Industry

Description

Venezuela's oil production is caught in [terminal decline](#) despite efforts by Caracas to arrest falling production. Latest data from OPEC show's that the deeply troubled South American nation's oil production is deteriorating at a rapid clip. For November 2018, Venezuela's daily oil output had fallen to 1.1 million barrels, which is almost half of its daily production average for 2016, and there are signs that it will plummet below one million barrels during 2019.

The latest announcement by the Trump Administration that it is considering establishing an oil embargo against the Maduro regime will likely lead to a significant decline in U.S. heavy oil imports. This has already sparked a scramble among refiners to secure supplies of heavy crude, which has helped to buoy Canadian heavy oil, causing Western Canadian Select (WCS) to gain almost 3%.

Heavy oil prices will rise

The reasons for this are quite simple. Many U.S. Gulf coast refineries are configured to only process heavy crude because of an improved crack spread, which makes it more profitable to refine heavier oil blends, despite the higher processing costs. Most of Venezuela's production is comprised of heavy oil and a large proportion is exported to the U.S., where it is processed by Gulf coast refineries. Analysts estimate that an embargo would trigger a medium oil shortfall of up to 500,000 barrels daily.

While Trump's talk of a total oil embargo is a [boon](#) for Canada's energy patch, it will also be beneficial for upstream producers operating in Venezuela's neighbour Colombia. The Andean nation has suffered substantially since the price of crude collapsed in late 2014 and remained in a protracted slump. This is because Colombia is heavily reliant on oil exports as a driver of economic growth and as a means of earning government revenue. A rocky start to 2019 for Colombia's energy patch because of weaker than expected production as well as oil prices has ratcheted up the fiscal and economic pressures on Bogota.

As South America's third-largest oil producer with a notable portion of its oil output comprised of heavy crude, it stands to benefit considerably as Trump pushes ahead with an oil embargo against Venezuela. That would trigger greater demand for Colombian heavy crude known as Castilla to firm,

causing the differential to Brent narrow.

While this will aid most oil producers operating in Colombia, it is **Frontera Energy** ([TSX:FEC](#)) which could benefit the most. The driller has lost 45% over the last year, being heavily marked down by the market because of a range of production and legacy issues.

You see, over half of Frontera's reserves and 40% of its production is comprised of Colombian heavy oil. As the price of Colombian heavy oil firm, its earnings will expand helping to offset higher forecast production costs and weaker oil prices. This would help to mitigate the impact associated with the potential loss of block 192 in Peru, where indigenous protests and pipeline ruptures saw production suspended during 2018.

It would also boost market confidence in the driller, which has been battling a range of legacy issues since it emerged from bankruptcy in 2016. Those include the inability to effectively monetize its interests in a range of critical oil infrastructure, including its indirect interests in the ODL pipeline and Puerto Bahia.

Frontera is also struggling to grow oil production. For 2018, oil output before royalties reached 71,000 barrels daily, which was 1% greater than a year earlier.

Nonetheless, 2019 average daily production is expected to fall by up to 8% year over year to somewhere between 65,000 and 70,000 barrels daily, primarily because of the problems associated with Frontera's operations in Peru.

Frontera has moved to bolster its long-term prospects by acquiring a one-third interest in 1.8 million acres in the Guyana offshore basin, which has an estimated resource potential of almost 14 billion barrels of crude.

Is it time to buy Frontera?

Because the driller has been unable to shed the negative reputation associated with its bankruptcy and ongoing operational obstacles, Frontera's stock remains under considerable pressure. There are signs, however, that its performance will improve over the course of 2018; when combined with the financial leg-up provided by being able to access Brent pricing and growing demand for heavy oil, Frontera is an intriguing investment.

Its appeal is magnified by its portfolio of quality Colombian oil assets and strong balance sheet where long-term debt of US\$350 million amounts to a very manageable 0.9 times EBITDA. Despite weaker oil, Frontera recently commenced dividend payments paying a \$0.33 dividend on January 17, 2019. Those dividends will only be paid where Brent averages US\$60 a barrel or higher over the requisite quarter but, if maintained at the current level, represent a stunning yield of almost 11%.

CATEGORY

1. Energy Stocks
2. Investing

TICKERS GLOBAL

1. TSX:FEC (Frontera Energy Corporation)

PARTNER-FEEDS

1. Msn
2. Newscred
3. Sharewise
4. Yahoo CA

Category

1. Energy Stocks
2. Investing

Date

2025/08/16

Date Created

2019/01/21

Author

matttdsmith

default watermark

default watermark