1 Energy Stock Selling at a Deep-Discount to the Value of its Oil Reserves

Description

Investors seeking a contrarian play on higher oil with the potential to deliver significant returns should look no further than **Frontera Energy Corp.** (TSX:FEC). The intermediate oil producer, which emerged from the bankruptcy of **Pacific Exploration and Production** (formerly Pacific Rubiales), has been roughly handled by the market. It has lost a whopping 45% over the last year despite the Brent international oil benchmark gaining 3%. While Frontera is still battling operational issues, it appears exceptionally attractively valued after such a significant decline.

Trading a discount to the value of its oil reserves

Frontera owns a diversified portfolio of oil assets across Colombia's major oil producing basins and the Marañon basin in Peru. That acreage has been determined to hold oil reserves net of royalties of 154 million barrels, which have a net present value after tax of $26 per share, more than double Frontera's market price of $12. This indicates that the driller is heavily undervalued by the market and that there is considerable upside available. That valuation was independently determined by industry consultants using an average Brent price of US$64 a barrel in 2019 and US$66 for 2020.

Already, the international benchmark is trading at over US$66 per barrel and analysts are tipping that it reach US$75 before the end of the year and average around US$70 per barrel. If oil moves significantly higher over the course of 2019, it would cause the value of Frontera's reserves to expand, although any considerable gains during this year and the next are unlikely, according to analysts.

Frontera's deeply-discounted value is further highlighted by its enterprise value being a mere six times its proven and probable oil reserves, significantly lower than comparable peers such as **Gran Tierra Energy Inc.** and **Parex Resources Inc.**

Solid balance sheet

Another characteristic that stands out is that Frontera has an almost spotless balance sheet. It finished the third quarter 2018 with US$348 million in long-term debt, a very manageable 0.85 times trailing 12 months adjusted EBITDA. The company's debt profile is well-laddered, with no debt maturities falling due until 2023 providing substantial time for oil to firm and Frontera to grow its cash holdings. It also finished that period with considerable liquidity, having amassed a notable US$587 million in cash.

Those characteristics give the driller considerable financial flexibility, including the ability to weather another oil price collapse and continue funding the ongoing development of its assets to ensure that production keeps growing.

Focused on long-term growth

Frontera estimates that 2019 oil production will remain flat, announcing guidance of 60,000 to 65,000 barrels daily after royalties, which at its upper end is only 3% greater than 2018.

Nonetheless, the driller has implemented a strategy aimed at expanding its oil reserves and production. Central to this has been Frontera's extensive investment in developing its core Colombian acreage. It is also expanding its productive capacity in the Andean nation, having recently entered into a farm in arrangement with Parex obtaining a 50% working interest in the VIM-1 Block in the Lower Magdalena Valley basin. Frontera obtained this in exchange for funding the first US$10 million required for initial drilling and testing of the La Belleza-1 exploration well, after which the costs will be split 50/50 with Parex.

The Peruvian properties owned by Frontera have a disappointing history. In a blow to its 2018 guidance, Frontera was forced to shutter operations at block 192, which is its largest producing concession in Peru, after the state owned NorPeruano pipeline ceased operating in December 2018 because of a rupture. Ongoing community disputes regarding the pipeline means it remains offline preventing Frontera from recommencing operations at block 192 forcing it to shave over 9,000 net barrels daily off its projections.

However, the driller has embarked on an exciting joint venture with **CGX Energy Inc**., where it has obtained a 33% interest in that company's Corentyne and Demerara Blocks in offshore Guyana. Discoveries by global oil giant **ExxonMobil** indicate that the Guyana-Suriname basin could be the site of the next big oil boom in South America, with similar potential to Brazil's Atlantic oil basins.

Is it time to buy Frontera?

A long history of poor operational performances plus the negative perception created by the company's 2016 bankruptcy are all weighing heavily on Frontera's market value. Much of this now appears unjustified, however, with Frontera well positioned to start unlocking value for investors and benefit from higher crude. The driller is also extremely attractively valued, trading at less than half of the net present value of its oil reserves. This highlights the considerable upside available once the market recognizes that the perceived degree of risk associated with Frontera is overbaked.

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Date
2025/08/18
Date Created
2019/02/18
Author
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