



## This Driller Remains a Risky Investment

### Description

Since the start of 2019, oil has [rallied sharply](#) to see the North American benchmark West Texas Intermediate (WTI) trading at around US\$60 a barrel and up by a stunning 30% for the year to date. The international Brent price has made similar gains to be trading at over US\$67 per barrel. While this has been a boon for many energy stocks, **Frontera Energy Corp.** ([TSX:FEC](#)) has failed to rally, losing 12% over the same period. This is because the market remains unconvinced that the driller, which emerged from [the bankruptcy](#) of Pacific Exploration and Production preciously known as Pacific Rubiales is capable of unlocking value for investors.

### Why is it failing to perform?

Not only is Frontera's past weighing on its stock, but ongoing concerns regarding its assets and operational issues are also impacting sentiment toward the driller. Key among these is that 2018 production declined by almost 7% year over year to 71,032 barrels daily, although that was within Frontera's 2018 guidance of 70,000 to 72,000 barrels of oil equivalent daily.

The drivers of this sharp decline in oil and natural gas output were operational issues including greater than expected production declines and temporary regulatory restrictions at Frontera's Colombian Guatiquia, La Creciente and Casimena blocks. A community blockade also forced Frontera to shutter operations at its Cubiro block located in Colombia's Llanos Basin. While those issues are typical of the risks faced by many drillers globally, they do appear to have been only temporary in nature.

Another factor weighing on Frontera's stock has been its inability to capitalize on being able to access Brent pricing and generate solid operating netbacks. This is an important measure of operational profitability, and for 2018 the driller announced a netback of US\$25.98, which while 14% greater than 2017 was lower than its peers operating in Colombia.

[Parex Resources](#) and **Gran Tierra Energy**, which are also operating in South America's third largest oil producing nation, reported 2018 netbacks of US\$41.44 and US\$33.51, respectively. This is considerably higher than Frontera's netback, indicating that their oil acreage is higher quality and possesses greater profitability. The low margins generated by Frontera's developed producing oil

acreage can be attributed to substantially higher production and transportation expenses.

Disappointingly for 2019, the driller expects its oil production to average 65,000 to 70,000 barrels daily, which at its upper end represents a 1.5% decline compared to 2018. It is also forecast that Frontera's 2019 production as well as transportation expenses will remain the same as 2018. When coupled with Brent expected to average US\$65 per barrel over the course of the year, which is lower than the US\$71.69 for 2018, Frontera's earnings 2019 will fall. That doesn't bode well for its market value, particularly when the operational issues experienced during 2018 are considered.

## Is Frontera a worthwhile investment?

It should be noted, however, that Frontera's net proven and probable oil reserves of 155 million barrels are valued at US\$2.5 billion after tax and the application of a 10% discount rate in accordance with industry methodology. After deducting Frontera's debt, they have a net present value of around \$34 per share, which is more than double the driller's market value, indicating considerable upside available to investors.

Nonetheless, given that only around a fifth of Frontera's proven and probable reserves are proved developed and producing, there is no guarantee that the undeveloped proportion can be successfully and economically recovered. That risk is magnified by the operational issues that have impacted Frontera's production.

Despite the driller's solid balance sheet, considerable exploration upside which has been enhanced by it acquiring interests in offshore Guyana as well as onshore Ecuador and ability to access premium Brent pricing Frontera remains a risky play on higher oil.

### CATEGORY

1. Energy Stocks
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1. TSX:FEC (Frontera Energy Corporation)

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