Canadians: Avoid This 1 Energy Stock at All Costs!

Description

Frontera (TSX:FEC) is an oil and gas company engaged in the exploration, development, and production of crude oil and natural gas in South America. The company's primary production is crude oil followed by natural gas. The largest markets it supplies is the United States and China.

Its share price is down 9.35% since the beginning of the year, and it has a current market capitalization of $1 billion.

An interpretation of the numbers

For the six months ended June 30, 2019, the company reported a poor balance sheet with $3.4 billion in negative retained earnings compared to $2.5 billion of assets. The company reported an increased total asset from $2.3 billion to $2.5 billion driven by an increase in intangible assets of $65 million, and an increase in deferred tax asset of $144 million. Its total liabilities are virtually unchanged with a reduction in accounts payable of $95 million, offset by increases in other liabilities.

Looking at the income statement, the company reported an increase in overall revenues from $689 million to $755 million, driven by an increase in sales of oil and gas for trading of $72 million. The company reported reduced operating expenses, which result in a pre-tax income of $152 million, up from a pre-tax net loss of $173 million the prior year. Overall, the company performed well this quarter with after-tax net income of $287 million, up from a net loss of $196 million in 2018.

Frontera continues to generate strong operating cash flows from $138 million in 2018 to $248 million in 2019. The company paid $31 million in dividends while decreasing capital-expenditure spending slightly from $126 million to $117 million.

But wait, there's more

The company's notes to its financials indicate a couple of important items.

Firstly, the company acquired control of CGX Energy by buying $19 million in shares to increase ownership from 48.2% to 67.8%. CGX is involved in the exploration and development of petroleum and natural gas in Guyana. This strengthens Frontera's presence in another South American country given that it is primarily focused in Columbia and Peru. This acquisition is beneficial for investors, as the company received a net cash inflow of $4 million in addition to future revenues.

Secondly, the company derives the majority of its revenues from its Colombian operations. For the six months ended June 30, 2019, the company recognized $656,000 in net income from Peru compared to $15 million the prior year. Columbia has grown significantly with net income of $124 million compared to a net loss of $43 million in 2018. It's Canada and Other division continues to lag behind with a $9 million net loss in 2019.

Thirdly, the company recognizes a $65 million increase in intangible assets from $0 the prior year. This is due to the termination of pipeline capacity rights held by Transporte Incorporado. The company paid $48.5 million to Transporte plus an additional $20.1 million to settle receivables. This transaction nullifies the need for Frontera to pay monthly premiums to Transporte amounting to $90 million over the life of the contract. Overall, the company benefitted from the deal.

Foolish takeaway

Investors looking to diversify their portfolios and purchase shares of an oil and gas company should not consider buying Frontera. Given its $3.4 billion negative retained earnings, it is very hard for investors to stomach the fact that the company has no real value. Fellow fool Matt Smith begs to differ.

If you are looking to add an energy stock to your portfolio, I would suggest looking here.

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