This Driller Is on Sale, Making Now the Time to Buy

Description

Intermediate upstream oil explorer and producer **Parex Resources** (TSX:PXT) has plunged sharply in recent days because of crude's latest weakness and fears of a global economic slowdown, which will apply greater pressure to prices. Since the start of 2020, Parex has followed Brent lower, losing 11% compared to the international benchmark's 16% decline. While there are considerable headwinds ahead for crude, it shouldn't stop investors from acquiring market-beating Parex, which was one of the best-performing Canadian oil stocks of 2019, gaining 44%, or more than double the **S&P/TSX Composite Index's** 19%.

Positive outlook

The driller, which is focused on oil exploration and production in the South American nation of Colombia, is trading at a deep 53% discount to its after-tax net asset value (NAV). The value of Parex's oil reserves will grow once oil discoveries made during 2019 are incorporated. This highlights that Parex is very attractively valued and that there is considerable upside available to investors, making now the time to buy.

Parex's appeal as an investment is further enhanced by its rock-solid balance sheet, which is a rarity for an upstream oil producer. The company finished the third quarter 2019 with no long-term debt and cash of US$350 million.

Parex also generated US$94 million of free cash flow for the quarter, despite Brent only averaging US$62 per barrel, highlighting the considerable profitability of Parex's oil assets. This is further illustrated by the driller's netback — a key measure of operational profitability for an upstream oil company — which, for the first nine months of 2019, was US$37.90 per barrel of oil pumped.

That is one of the highest netbacks in the industry and significantly greater than Parex's peers operating solely in North America. Intermediate upstream oil producer **Whitecap**, which produces light and medium oil in Saskatchewan as well as Alberta, reported a netback of US$22.44 per barrel produced, while for **Crescent Point** it was US$26.12. Even **Surge Energy**, which is focused on conventional light and medium oil production in Alberta as well as Saskatchewan and is one of the lowest-cost operators in Canada, reported a netback of a mere US$21.47 per barrel.

A key reason for the considerable profitability of Parex's operations are its low-decline rate conventional oil assets, meaning less capital is required to be invested to sustain production. That coupled with low operating costs in Colombia saw Parex report low production costs of US$5.80 per barrel pumped, which is almost half of its peers operating in Canada.

Then there is Parex's ability to access premium Brent pricing. The international benchmark price trades at a US$5 per barrel premium to the North American West Texas Intermediate price, giving Parex a handy financial advantage over drillers operating Canada. Parex is also not subject to the discounts applied to Canadian crude, which, for the Edmonton light oil benchmark price, is around US$7.65 per barrel, further impacting the operational profitability of Canadian oil producers.

Parex expects its 2020 oil production to expand by 5% year over year to an average of 55,375 barrels daily. After securing three new blocks in the Colombian hydrocarbon regulator's December 2019 bidding round, Parex's exploration upside has expanded considerably, even more so when it is considered that it plans to drill 59 wells in 2020 compared to 43 in 2019.

Foolish takeaway

Even in a difficult operating environment where oil prices are under pressure because of declining demand growth and growing supply, Parex appears undervalued. The company is trading at a deep discount to its NAV, the value of which will expand once 2019 drilling results and oil discoveries are included. Parex's low operating costs and rising production will ensure that its earnings expand during 2020, which, along with growing oil reserves, will give its stock a solid boost, making now the time to buy.

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