Petrominerales – An Overview of This Beaten Down Oil Small-Cap

Description

It has been a bad year for Colombia's third largest oil producer, Canadian based small-cap oil explorer and producer **Petrominerales** (TSX:PMG). Its share price has taken a bath, falling by 23% for the year to date. This has occurred on the back of investors shying away from small-cap energy producers operating in what are perceived to be high risk economic environments such as Colombia, along with falling crude prices. This has also impacted the share prices of other Canadian small to mid-cap energy companies operating in Colombia, including **Pacific Rubiales** (TSX:PRE) Colombia's largest independent oil producer and **Gran Tierra Energy** (TSX:GTE) the fourth largest.

Why Petrominerales' Share Price Has Collapsed

However, Petrominerales has had its own pressing issues ranging from declining reserves and production to pressing short-term liquidity problems. The company's exploration program has been particularly disappointing with no credible proven finds to date, seeing its proven reserves at the end of 2012 fall by 15% year over year to be almost 27 million barrels of oil. Production has also been poor, having fallen for eight straight quarters to a low of 22,000 barrels of oil per day, a 35% fall year over year.

The company has also been grappling with significant short-term liquidity issues, primarily a $200 million bond payment due in August 2013 as well as a royalty dispute with the Colombian petroleum industry regulator the National Hydrocarbons Agency. All of which has created a perfect storm, destroying investor confidence and wiping out half of its enterprise-value. But while Petrominerales outlook is particularly ugly at this time, there are a range of catalysts that have the potential to drive its share price higher.

Key Emerging Catalysts

At a recent bondholders meeting, Petrominerales was able to secure an extension of six months for the $200 million bond payment. This gives it sufficient time to arrange for an orderly sale of its interest in the OCENSA oil pipeline in Colombia, valued at around $300 million. Petrominerales also has an almost ten percent interest in the Bicentario pipeline , which is a particularly lucrative asset to hold in a country where poor infrastructure prevents the cost efficient transportation of oil by any other means than oil pipelines.

Pacific Rubiales also holds an interest in this pipeline of almost 34%, while Gran Tierra, which does not have any pipeline interests, is solely dependent on Colombian government controlled Ecopetrol to transport its oil. This has added to Gran Tierra's cost base with it unable to realize the same savings that Petrominerales or Pacific Rubiales can through pipeline ownership.

Another catalyst is Petrominerales expansion of its exploration acreage through the acquisition of an additional 62,000 onshore acres in Brazil as well expanding its acreage in Colombia's key oil producing location the Llanos basin. This over the long-term should boost the success rate of its exploration activities and diversify production away from Colombia's Llanos basin.

Finally, on the basis of its enterprise value to earnings before income tax, depreciation and amortization , which is a key metric which is used to provide an apples-to-apples indication of the comparative valuation of oil companies, Petrominerales appears exceptionally cheap. Its enterprise value is currently around 1.7 times its EBITDA, which is significantly lower than the average for oil producing small caps of seven times. It is also lower than either Pacific Rubiales' or Gran Tierra's enterprise value of 3.5 times EBITDA.

This makes Petrominerales a potential takeover target, with the Colombian oil industry ripe for another round of consolidation. This need for consolidation is being driven by Colombia's low proven reserves, which were confirmed by Colombia's Finance Minister Mauricio Cardena, who stated in February 2013 that the country only has sufficient proven reserves for another eight years of production. This has seen the larger oil companies operating in Colombia come under increasing pressure to secure further reserves, which is occurring primarily through acquisition rather than exploration.

This pressure can be seen in the case of Colombian government controlled Ecopetrol, which is coming under increasing pressure, both from its majority owner and investors alike, to grow its reserves and boost production. In addition, Pacific Rubiales is facing increasing pressure to expand its operations, with growing speculation that it will lose its flagship Rubiales field to Ecopetrol, when the lease expires in 2016.

Foolish Bottom Line

It's clear that Petrominerales is a company beset by problems. A disappointing exploration program, declining production, short-term liquidity issues and a royalties dispute have damaged investor confidence. But despite these issues there are a range of catalysts that have the potential to reduce these risks and drive improved financial performance. In addition, the company is now trading at particularly cheap multiples, even in comparison to the depressed share prices of its Colombian peers. All of these factors make it an intriguing but high risk play for the contrarian investor seeking exposure to a sector of the oil industry that has fallen out of favour with mainstream investors.

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