3 Undervalued Canadian Oil Juniors With Solid Growth Prospects

Description

Since the start of the year, investors have witnessed a particularly volatile outlook for the price of crude oil. Much of this has been generated by mixed economic data coming from the two key economies driving the international economy, China and the U.S., along with growing political and economic instability in key oil-producing regions. This has caused many investors to shun Canada's oil exploration and production industry in preference for less risky investments.

Of late, however, the outlook for crude has brightened considerably on the back of better-than-expected employment and manufacturing data from the U.S. and China. This has created an opportunity for investors in Canada's diverse small-cap energy space with many companies trading at particularly cheap valuation ratios.

Three stand out: **Gran Tierra Energy** (TSX:GTE), **Canacol Energy** (TSX:CNE), and **Whitecap Resources** (TSX:WCP).

All three of these companies have low levels of debt, solid proved oil reserves, and consistently growing production — factors that make them appear undervalued, especially when their promising outlooks are taken into account. Let's take a closer look at each.

Gran Tierra Energy

Gran Tierra is a Canada-domiciled small-cap oil explorer and producer focused on South America. The majority of its production comes from Colombia's Putumayo basin, located in the south of the country. It also has a diverse portfolio of exploration properties across Colombia, Peru, and Brazil, with a recently completed exploration well in Peru testing positive for oil.

The company has been reporting particularly strong production results. For the first quarter of 2013, it reported record production of 21,860 barrels of oil per day and it is expected that production will continue to increase through 2013.

A key driver of this significant increase in oil production is the improving security environment in Colombia, with the Colombian government and largest belligerent group the FARC engaged in peace talks. Production disruptions and outright attacks on oil infrastructure — such as all important oil transportation pipelines — have fallen significantly.

The increase in production led to particularly pleasing financial results for the same period. Earnings per share exceeded the analyst consensus forecast by 25%for the first quarter of 2013. With production set to increase, Gran Tierra is expected to be able to continue growing both its revenue and profitability through the remainder of the year.

A particularly appealing aspect of Gran Tierra is that the company is debt-free, which reduces its vulnerability to any unexpected or sustained fall in crude prices. It also has proved reserves of 41 billion barrels of oil — the third-largest producer in Colombia on the basis of proved reserves.

Despite all these positives, Gran Tierra is trading with an enterprise value of just over three times EBITDA, making it appear particularly cheap.

Canacol Energy

Canacol is another Canada-domiciled oil explorer and producer; its oil production and exploration is focused primarily on Colombia and Ecuador. The company has proved oil reserves of almost 11 billion barrels of oil, making it the fifth largest operator in Colombia by proved reserves (behind Gran Tierra).

It has also taken the lead on unconventional oil and gas exploration in Colombia, establishing partnerships with **ConocoPhillips**, **Exxon**, and **Royal Dutch Shell**. This should prove to be a lucrative endeavor for Canacol — at its current rate of production, Colombia only has sufficient proved oil reserves for another seven years.

Canacol has also has been able to steadily increase production over the past three quarters, helping to boost sales and margins despite softening oil prices. This bodes well for increased profitability and should see its current enterprise value (11x EBITDA) improve. It also has a low level of debt — its debt-to-equity ratio is 0.31 — indicating that it is less vulnerable to a sustained downturn in the price of crude.

Whitecap Resources

Whitecap is focused exclusively on western Canada. For the first quarter of 2013, Whitecap was able to boost average daily production by almost 80% year over year to 17,592 barrels of oil.

Production growth should continue, boosted by the company's June 2013 acquisition of light oil assets in Alberta. This acquisition has added additional average daily production of 2,900 barrels, which will ultimately flow through to the company's bottom line.

Like Canacol, Whitecap has a low level of debt, with a debt-to-equity ratio of 0.37, leaving it well-positioned to weather any unexpected and sustained fall in the price of crude. It is also trading with an enterprise value of nine times EBITDA — which I'd call moderately undervalued. I expect this ratio to fall in value as EBITDA increases on the back of increased production.

Foolish final thoughts

While investing in junior oil companies carries no guarantee of success — even if they come with low debt and growing production — those companies are less vulnerable to any sustained downturn in crude prices, and they are well-positioned to take advantage of any spike in demand for crude.

With record production, a low enterprise value-to-EBITDA multiple, no debt, and solid proved reserves, Gran Tierra is the most appealing of the bunch. But for those investors averse to investing in companies operating in higher-risk emerging economies, Whitecap, which operates in a lower-risk environment (Canada) and has growing production with a low level of debt, provides a solid alternative.

This post was created by Fool contributor Matt Smith.

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1. Investing

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1. TSX:CNE (Canacol Energy Ltd)
2. TSX:GTE (Gran Tierra Energy Inc.)
3. TSX:WCP (Whitecap Resources Inc.)

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