Is Canacol Energy Headed for $9 a Share?

Description

Canadian-listed small-cap oil explorer and producer **Canacol Energy** (TSX:CNE), which operates in Colombia and Ecuador, has been on a tear over the last year with its share price soaring by almost 115%. But the big question for investors is does the company have sufficient momentum to hit $9 per share in 2014?

Solid operational results
Over the last two years Canacol has grown from being a speculative oil and gas explorer in Colombia to one of the country's largest producers of crude and natural gas. This success has been achieved on the back of extraordinary growth of its oil reserves, which by the end of the fiscal second quarter (calendar fourth quarter) had jumped 32% to almost 41 million barrels of crude.

It also reported significant growth in oil and natural gas production, which for the same period jumped 89% in comparison to the second quarter 2012, to just over 10,000 barrels of crude per day. As a result, cash flow – a key measure of a junior oil explorer and producer's operational strength — has spiked significantly, more than quadrupling for the same period.

Plenty of catalysts to generate additional momentum
For calendar year 2014, Canacol's forecast production is quite conservative with average daily production expected to be between 11,500 to 12,500 barrels of crude. This represents a significant increase in production of between 30% to 40% in comparison to calendar year 2013 where daily production averaged 8,796 barrels of crude.

In conjunction with this significant increase in production, operating costs have continued to fall. They're down by more than half for the quarter ended 31 December 2013, in comparison to the same quarter in the previous year. This has seen the company's profitability — as represented by its netback per barrel of crude produced — grow significantly more than doubling for the same period.

When this is coupled with higher average crude prices, with West Texas Intermediate trading at well over $100 per barrel I expect Canacol's 2014 revenue and cash flow to continue to grow.

Exploration success is enviable

Further, Canacol continues to experience an enviable oil and gas exploration success rate, with a 100% drilling success rate across its Rancho Hermoso, Labrador and Leono fields in Colombia. This success rate is higher than many of its Colombian-based peers, including **Pacific Rubiales'** (TSX:PRE) success rate of 80% and **Parex Resource's** (TSX:PXT) 50%.

This historical trend, coupled with an aggressive 2014 exploration and development plan targeting 36 development and 11 exploration wells, bodes well for further discoveries. As a result I expect to see Canacol grow its oil reserves further throughout 2014, boosting its underlying asset value.

Finally, one of the most exciting aspects of the company, is that it has taken the lead in what is shaping up as one of the most exciting unconventional oil and natural gas plays in South America. The play is the Middle Magdalena Valley in Colombia, which is estimated by some pundits to be the next biggest unconventional oil (shale) play in South America, after Argentina's Vaca Muerta.

Canacol has amassed significant exploration acreage in the valley totaling 545,000 net acres, giving it the second largest shale land position in Colombia after state-controlled Ecopetrol. It is estimated this acreage alone contains around 3 billion barrels of crude.

Even more exciting is that Canacol has brought a number of experienced and cashed up major partners in to help it realize the potential of those assets. These partners include **Exxon Mobil**, **Royal Dutch Shell** and **Conoco Phillips**.

With the assistance of those partners, Canacol expects to drill 30 shale oil and gas exploration wells on this exploration acreage in the Middle Magdalena through 2014 and 2015. All of this bodes well for success in what is shaping up as one of the hottest unconventional oil plays in South America.

Colombian in-country security situation is improving
It wasn't long ago that Colombia was considered a failed state, with one of the world's longest running insurgencies seeing vast sections of the country made too dangerous for oil exploration. There were also a significant number of attacks by insurgents from the FARC and ELN on energy infrastructure, including the overwhelmingly important oil pipelines.

These attacks, particularly on the pipelines, caused significant production disruptions. Poor transportation infrastructure coupled with mountainous terrain makes pipelines the only cost-effective means of transporting crude. But with the Santos government commencing peace negotiations with the FARC in 2012, coupled with the increasingly positive outlook for those negotiations, the security situation has stabilized considerably.

This bodes well for Canacol to be able to boost oil sales with fewer and less significant outages to transportation infrastructure. And it also bodes well for it to continue growing revenue and cash flow from increased sales of crude and natural gas.

Foolish bottom line
Only eight months ago, Canacol was trading at less than $3 per share, but since then because of its solid operational results, growing reserves and considerable exploration success, the company's share price has exploded.

But it is clear a solid exploration base and enviable drilling success rate, coupled with its leadership in shale oil exploration in Colombia, leave it well positioned to continue creating considerable value for investors. Barring any significant crisis, I expect to see Canacol hit $9 per share before the year is out.

CATEGORY

1. Investing

TICKERS GLOBAL

1. TSX:CNE (Canacol Energy Ltd)
2. TSX:FEC (Frontera Energy Corporation)

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