What to Expect When Pacific Rubiales Reports Next Week

Description

Canadian-domiciled Colombian based independent oil explorer and producer **Pacific Rubiales** (TSX: PRE) continues to see its share price hammered, down by 15% over the last year, despite continuing to report solid operational results.

The market has taken a dislike to the company because of the uncertainty surrounding the expiry of its lease over its flagship Piri-Rubiales field in Colombia. This is likely to continue for the short-term, with the company expected to report flat results for the first quarter 2014. But as we will see, this will continue to create a buying opportunity for investors seeking exposure to the Latin America's burgeoning energy sector.

What will Pacific Rubiales deliver for the first quarter 2014?
While Pacific Rubiales management expects to report stronger operational results compared to previous quarters, it is likely financial results will at best remain flat both quarter over quarter and year over year.

Oil and gas production for the first quarter 2014 is expected to have shot up a healthy 11% to 15% quarter over quarter and 17% year over year, to between 147,000 and 149,000 barrels of crude daily. Sales volumes also grew for the third consecutive quarter, by between 5% and 6% over the same period to between 151,000 and 153,000 barrels of crude daily.

But when Pacific Rubiales' operating netback per barrel – a key measure of profitability – is considered, it has remained flat when compared to the previous four quarters. For the first quarter 2014, management expects to report an operating netback of $59 to $61 per barrel, which is roughly the same as the previous quarters $59.43 per barrel and first quarter 2013's $60.88 per barrel.

The decline in operating netback was primarily driven by increased production costs per barrel because of lower production from the Rubiales field, coupled with higher transportation costs resulting from outages to the Bicentario pipeline caused by terrorist attacks.

The volatility of the Colombian peso over the last year has also had an impact on Pacific Rubiales' financial performance and this will continue for the first quarter 2014. For the year to date, the value of the peso against the U.S. dollar has dropped by around half a percent and over the last year by 6%. This volatility is set to continue with outlook for emerging markets over the short to medium-term uncertain.

Share price continues to underperform despite strong operating results
Pacific Rubiales' share price continues to perform poorly over recent years, particularly in comparison to its peers, because of uncertainty surrounding oil production and reserves volumes. It is expected the company will lose its concession to the Piri-Rubiales field in Colombia's Llanos basin when the concession ends in June 2016. This field contributed 67% of the company's total crude production for 2013 and its loss would be a significant blow to Pacific Rubiales.

But it would appear the market continues to focus solely on the worst case scenario and has not taken into account the considerable benefits derived from Pacific Rubiales' acquisition of Petrominerales in late 2013. This acquisition allowed the company to establish a firm roadmap to replacing both the oil reserves and production lost when this concession expires.

What does it all mean for investors?
Any further dips in Pacific Rubiales' share price on the back of its first quarter 2014 results would create a buying opportunity for investors, with the company already trading with some particularly attractive valuation ratios.

At this time Pacific Rubiales has an enterprise value a mere 3 times EBITDA and 12 times its crude reserves. This makes it appear far cheaper than many of its peers operating in Colombia, with **Gran Tierra Energy** (TSX: GTE)(NYSE: GTE) trading with an enterprise value of 4 times EBITDA and 13 times its oil reserves.

These valuation ratios are also considerably lower than many of its similar sized peers operating in Canada, with **Penn West Petroleum** (TSX: PWT)(NYSE: PWE) trading with an enterprise value of 12 times EBITDA and 15 times its oil reserves. Pacific Rubiales also continues to generate a superior netback to many of its Canadian peers, underscoring the profitability of its operations in Colombia and Peru.

Foolish bottom line
Pacific Rubiales is not out of the woods yet, with a number of operational uncertainties continuing to impact both its operational and financial performance. But what is increasingly clear is the market has significantly undervalued the company by solely taking into account the worst case scenario, which is appearing increasingly unlikely.

CATEGORY

1. Investing

TICKERS GLOBAL

1. TSX:FEC (Frontera Energy Corporation)
2. TSX:GTE (Gran Tierra Energy Inc.)

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