Cash in on This Undervalued Oil Producer

Description

Canadian oil producer **Gran Tierra Energy** (TSX: GTE)(NYSE: GTE) is going from strength to strength, yet its share price continues to languish. All of the company's operations and oil reserves are based in South America, with the majority located in troubled Colombia.

For the year to date, Gran Tierra's share price has remained flat despite the company continuing to report some impressive results and remaining debt-free. In contrast, many of its peers have seen their shares prices appreciate over the same period.

The patch's king of light crude, **Crescent Point Energy** (TSX: CPG)(NYSE: CPG), has seen its share price appreciate by almost 8% over that period, while troubled **Lightstream Resources** (TSX: LTS)(NYSE: LTS) has jumped an impressive 26%. Even relatively recent newcomer **Whitecap Resources'** (TSX:WCP) share price has shot up 19% over that period.

So what is placing downward pressure on Gran Tierra's share price? Is the market's perceived degree of investment risk overblown?

Colombian presidential election contributes to investors' fears

While companies such as Crescent Point and Lightstream are operating in the relatively low-risk jurisdiction of Canada, Gran Tierra has the majority of its oil reserves located in the higher-risk jurisdictions of Colombia and Peru, with the majority of its oil production derived from Colombia.

This higher degree of geopolitical risk sees Gran Tierra trading at a discount, and this will more than likely continue with the uncertainty now surrounding the outcome of the Colombian presidential election.

This is particularly true in light of fears that the peace negotiations with the country's largest rebel group (the FARC) will end if the incumbent, Juan Manuel Santos, loses the run-off against Oscar Ivan Zuluaga. A result in favour of Zuluaga would certainly see a return to civil conflict, and an increase in attacks on the country's oil infrastructure.

Gran Tierra still performing strongly

But despite these risks, Gran Tierra continues to perform strongly and has already proven its mettle, generating solid operational and financial performances in 2011 and 2012, which was when the FARC stepped up its terrorist campaign. In late 2013, the company made a significant oil discovery in Peru that effectively doubled its oil reserves, yet its share price has not reflected this significant growth in Gran Tierra's core assets.

The company is trading at a share price that is virtually equal to the net asset value of its oil reserves of $7.51 per share, and does not take into account any potential upside. This includes higher realized oil prices — with the price of crude now well over $100 per barrel — as well as lower transportation and operational costs, and the potential for further oil discoveries.

Furthermore, unlike the majority of its peers operating in Canada, a significant portion of Gran Tierra's petroleum production is higher-margin crude, which makes up almost 96% of the company's total production. Like its Canadian peer **Parex Resources** (TSX: PXT), which also operates in Colombia, Gran Tierra is able to access Brent pricing for the majority of its production. In contrast, the majority of its Canadian-based peers are only able to access realized crude prices benchmarked to West Texas Intermediate.

With Brent continuing to trade at a premium of around 7% to WTI, which is expected to grow over the short-term, Gran Tierra receives a tremendous revenue boost. This is coupled with the ability to generate higher margins than its Canadian-based peers, which can be seen when we examine its operating netback per barrel.

For the first quarter of 2014, Gran Tierra reported an operating netback of $71.41 per barrel, primarily due to lower operating costs. These dropped a massive 30% compared to the previous quarter and a healthy 26% compared to the first quarter of 2013.

This netback is also significantly higher than the reported first quarter 2014 netbacks for its peers operating in Canada. Gran Tierra's netback is 27% higher than Lightstream's $56.11, 36% higher than Crescent Point's $52.65, and 56% higher than Whitecap's $45.80 per barrel.

Such a healthy netback illustrates the higher margins that Gran Tierra is able to generate per barrel produced, and gives it essentially a bigger bang for its buck for the capital it invests in developing that production.

Finally, another particularly appealing aspect of Gran Tierra is that the company has no debt and limited liabilities. This is in stark contrast to companies like Lightstream, which gorged itself on debt to fund acquisitions, development of oil properties, and dividend payments.

Even after slashing its dividend by 50% and making over $250 million in asset dispositions since the start of 2014, Lightstream still has an unhealthy net debt of almost four times its operating cash flow ratio. Contrast that with Gran Tierra, whose cash on hand exceeds its key liabilities.

Clearly, the perceived high degree of risk associated with Colombia is hurting Gran Tierra's share price. But with the company able to access Brent oil pricing, generate an incredible operating netback of over $70 per barrel, and remain debt-free, now might just be the time for savvy risk-tolerant investors to take advantage of this undervaluation.

CATEGORY

1. Investing

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1. NYSE:VRN (Veren)
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3. TSX:VRN (Veren Inc.)
4. TSX:WCP (Whitecap Resources Inc.)

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