



## Why Canadian Investors Should Care About the Election Controversy in Colombia

### Description

There has been considerable controversy surrounding the latest Colombian presidential elections with claims of bribery, corruption, and under-handed behavior. This has done nothing to change the negative image surrounding the country. After decades of civil conflict, narco-terrorism, kidnappings, and government sanctioned-paramilitary actions, the country has a tarnished image in the eyes of investors.

But what has Colombia got to do with Canadian investors? Well, it was Canadian oil and gas explorers that spearheaded the development of Colombia's oil industry, making it the fifth-largest petroleum producer in Latin America.

This now means a number of micro- to mid-cap oil and gas producers listed on the Toronto Stock Exchange have a significant portion, or even all, of their core oil production located in Colombia. These companies include Colombia's largest independent oil producer, **Pacific Rubiales** (TSX: PRE), **Gran Tierra Energy** (TSX: GTE)(NYSE: GTE), **Canacol Energy** (TSX: CNE), **Parex Resources** (TSX: PXT), **Petroamerica** (TSX: PTA), and **Petronova** (TSX: PNA).

Because of Colombia's tarnished image and investor uncertainty over the degree of political risk, the shares of these companies continue to trade at discounts to their fair value.

### What are the geopolitical risks?

Now with incumbent Juan Manuel Santos and key challenger Oscar Ivan Zuluaga headed to a runoff on June 15, 2014, to determine who will be Colombia's next president, there is growing uncertainty as to the political direction of the country. Zuluaga won 29% of the vote in Sunday's election, while Santos came a close second with 26%.

Zuluaga, like his political mentor, former president Alvaro Uribe, has been a harsh critic of Santos. This criticism in particular has focused on Santos' desire to reach a negotiated peace with the Fuerzas Armadas Revolucionarias de Colombia, or FARC, Colombia's largest insurgent movement, as well as attacking Santos' more moderate and inclusive economic and social policies. This includes Santos' desire to promote more even economic growth, while continuing to attract investment in the oil industry

and providing greater opportunities to the Colombian population.

Santos was also heavily criticized for his policy of land restitution to those dispossessed by state-sponsored paramilitaries in the 80s and 90s, and his prosecution of members of the military for involvement in a range of scandals.

The campaign has been hotly contested, with accusations that Santos' 2010 presidential campaign was funded in part by the proceeds of narco-trafficking, while Zuluaga has been accused of espionage and attempting to disrupt the peace negotiations. A political consultant associated with Zuluaga is accused of hacking into the email accounts of government officials involved in peace talks with the FARC, as well as those of journalists monitoring the negotiations.

Unfortunately, the growing political tensions have created considerable uncertainty in Colombia, particularly with Zuluaga taking a hard-line stance on security and peace negotiations with the FARC.

It is even speculated that if Zuluaga comes to power, the peace negotiations will cease, with Zuluaga preferring to pursue a military campaign against the FARC and defeat them on the battlefield. This would certainly see a resurgence of civil conflict and terrorism acts, with Colombia's energy infrastructure a favorite target.

### **How does this affect Canadian investors?**

Any return to the conflict of old would be particularly bad for oil producers operating in Colombia, with oil pipeline bombings, insurgent attacks on wellheads, and kidnappings of key staff set to escalate, leading to significant production disruptions. These disruptions would certainly impact the financial performance of those companies and cause bottom lines to soften.

This is evident from the run-up to the commencement of peace negotiations during 2011 and 2012, where there were a range of pitched battles between the Colombian military and the FARC in the oil-rich provinces of Cauca, Putumayo, and Caqueta.

Furthermore, the FARC at that time stepped up its campaign of attacking oil infrastructure, in particular putting oil pipelines out of action by bombing them. This was particularly disruptive to the infrastructure-poor country, where pipelines are the only economical means of transporting crude.

This significantly affected the profitability of Pacific Rubiales, Gran Tierra Energy, and Canacol Energy by forcing them to use more costly road transportation to get their crude to key shipping points and markets. As a result, their margins fell significantly, with operating netbacks plunging as increased transportation costs ate into their bottom lines.

While many hope not to see a resurgence in the civil conflict, it is a definite risk should Zuluaga win the presidency, because of his desire for a battlefield victory and exclusionary economic policies set to further provoke conflict in Colombian society.

Any significant breakdown in Colombia's internal security will drastically impact the bottom lines of Canadian oil explorers and producers operating in the country. Investors in those companies must keep a close watch on the internal security situation and level of geopolitical risk in Colombia.

### **CATEGORY**

1. Investing

## **TICKERS GLOBAL**

1. TSX:CNE (Canacol Energy Ltd)
2. TSX:FEC (Frontera Energy Corporation)
3. TSX:GTE (Gran Tierra Energy Inc.)
4. TSX:PXT (PAREX RESOURCES INC)

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