

Cash In on Colombia's Next Oil Boom With Canacol

Description

A few years ago, South America's largest to-date unconventional shale oil and gas play was identified. This play is the Vaca Muerta in Argentina, which has been estimated to hold around 22 billion barrels of oil, making it the third-largest shale oil and gas reserve in the world.

There are even more exciting events afoot in the north of the continent. Colombia, once regarded as a failed state wracked by civil war, narco-terrorism, and corruption, is fast shaping up as one of the most exciting unconventional opportunities in the oil industry. Not only has the country been able to shake off its reputation of instability and violence, but it is now the fifth-largest oil producer in Latin America, and the fourth-largest in South America.

Unconventional oil and gas key to growing Colombia's oil reserves

Investors are already familiar with the story, where a number of Canadian junior oil explorers and producers spearheaded the charge in Colombia over the last eight years. This has seen TSX-listed **Pacific Rubiales** (TSX: PRE) become the largest independent oil producer in the country.

However, fears that Colombia has sufficient conventional oil reserves for only another seven years of production are seeing the government and the ANH, the country's hydrocarbon regulator, working hard to promote investment in unconventional oil and gas exploration. As a result, the government has introduced environmental regulations governing the hydraulic fracturing of shale formations and promoted the sale of unconventional oil and gas acreage.

The U.S. Energy Information Administration estimates that Colombia's recoverable shale reserves are as much as 6.8 billion barrels of oil and 55 trillion cubic feet of shale gas, making it a viable play for energy majors.

Colombian state-controlled oil company **Ecopetrol** (TSX: ECP)([NYSE: EC](#)) has rapidly expanded its operations into shale oil exploration and production in order to offset its own dwindling oil reserves of around 1.8 billion barrels of crude. Integrated global energy majors **Exxon Mobil** ([NYSE: XOM](#)) and **Royal Dutch Shell** (NYSE: RDS.A) have also joined the fray, purchasing acreage and partnering with existing players.

This Canadian oil producer offers exciting prospects

But one of the most exciting opportunities for investors is Canadian intermediate oil producer **Canacol Energy** ([TSX: CNE](#)). The company has a history of successful risk-taking, having been one of the pioneering explorers in Colombia's southern Putumayo department, which suffers from a chronic lack of infrastructure and is a hotbed of insurgent activity.

This was where Canacol discovered Colombian heavy crude, which many industry insiders claimed at the time was unsellable. This heavy crude forms a key part of the company's growth plans, and

generates a considerable portion of its revenue.

Canacol has now established itself as the leading player in Colombia's shale oil and gas industry, holding the second-largest shale acreage in Colombia behind Ecopetrol. This property, consisting of 250,000 acres, sits across what are believed to be the two shale formations holding the most potential: the La Luna and Rosablanca. It is estimated this acreage holds over 8 billion barrels of crude. The company has engaged a range of experienced world-class partners to exploit these assets, including **ConocoPhillips** ([NYSE: COP](#)), Exxon, and Shell.

Solid operational and financial results

More impressively, Canacol has established itself as a major player in conventional oil production in Colombia. It is now the fourth-largest oil producer after Ecopetrol, Pacific Rubiales, and **Gran Tierra Energy** ([TSX: GTE](#))(NYSE: GTE). It is this success that makes Canacol stand out, with oil production and margins continuing to grow.

For example, in the first quarter of 2014, crude production shot up a healthy 8% compared to the previous quarter and a whopping 73% compared to the equivalent quarter in the previous year. The company's operating netback, a key measure of the profitability of its oil production, is also growing. For the same period it shot up 13% quarter over quarter and a massive 23% year over year to \$43.57 per barrel of crude sold.

This netback is higher than many of its peers operating in North America, but still below those of its peers operating in Colombia. For the same period, Pacific Rubiales reported a netback of \$63.80 while Gran Tierra's netback was an incredible \$71.41 per barrel.

A key drag on Canacol's netback is that around 29% of its crude production is made up of what is known as tariff production. Under these tariff contracts Canacol receives a flat price for the crude it produces, which is typically significantly lower than the spot, or market, price. But with the company focused on implementing cost-saving initiatives and boosting non-tariff production, its netback is set to grow.

High potential with good value

Despite its share price surging 109% over the last year, Canacol remains attractively valued when its enterprise value of 19 times its oil reserves is considered. This is lower than Pacific Rubiales' EV of 20 times, but higher than Gran Tierra's 15 times.

Canacol's price-per-flowing barrel of \$78,408 is also quite attractive. This is significantly lower than many of its peers solely operating in North America, where the industry average is around \$122,000 per barrel. It's also lower than Gran Tierra's \$90,000 per barrel but marginally higher than Pacific Rubiales' \$70,480 per barrel.

Canacol has tremendous potential, and with the company focused on aggressively growing oil reserves and production, its financial performance can only continue to grow. When coupled with its leading position in Colombia's shale oil and gas industry and some attractive valuation metrics, it's a compelling play for risk-tolerant investors.

CATEGORY

1. Investing

TICKERS GLOBAL

1. NYSE:COP (ConocoPhillips)
2. NYSE:XOM (Exxon Mobil Corporation)
3. TSX:CNE (Canacol Energy Ltd)
4. TSX:FEC (Frontera Energy Corporation)
5. TSX:GTE (Gran Tierra Energy Inc.)

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