Why Pacific Rubiales Energy Corp. Is a Better Growth Play

Description

When hunting for companies with solid growth prospects in the energy patch that are attractively valued, it is hard to pass up Colombia's largest privately owned oil producer **Pacific Rubiales Energy Corp.** (TSX: PRE).

It has been a roller coaster for the company's share price, having hit a new 52-week low in March of this year before bouncing back up 12% year to date. But as I will highlight, Pacific Rubiales continues to perform strongly, offering investors seeking growth and income a superior option to many of its Canadian-based peers.

Production has grown to record levels

Despite a range of relatively minor issues triggering some consternation in the market, Pacific Rubiales continues to deliver solid operational performances, with crude production hitting record levels during the second quarter of 2014. When coupled with higher average realized crude prices for the quarter, Pacific Rubiales beat consensus analyst earnings estimates by a massive 83%, reporting earnings of $0.75 per share.

I expect these strong performances to continue, with it having built up a portfolio of high-quality oil assets across Latin America, with a specific focus on Colombia and Peru.

Generates an operating margin that's the envy of many North American oil companies

Pacific Rubiales continues to generate a solid margin or netback per barrel of crude produced. For the same period, it reported a netback of $62.76 per barrel, well above the netbacks its Canadian peers were are able to generate.

For its last reported quarter **Crescent Point Energy Inc.** had a netback of $54.75, **Lightstream Resources Ltd.**'s (TSX: LTS) was $57.49, while **Penn West Petroleum Ltd.**'s (TSX: PWT)(NYSE: PWE) was almost half of Pacific Rubiales at $36.67, and **Whitecap Resources Inc.**'s (TSX: WCP) was $46.09 per barrel.

This can be explained by a number of factors, the most critical being the lower cost and royalty structure associated with operating in Colombia compared to Canada. In addition, Colombian crude blends trade at a far lower discount to West Texas Intermediate than Canadian crude. For the second quarter, Pacific Rubiales oil received an average realized price per barrel of $99.76, which is only a 3% discount to the average WTI price over the quarter, whereas Canadian light crude or Edmonton par for the same period traded at an average discount of 9% to WTI.

I also expect Pacific Rubiales to continue to deliver a solid margin per barrel of crude produced primarily because management have affirmed focus on controlling costs coupled with the lower price differential between Colombian crude and WTI.

It is also important to note that for the second quarter of 2014, transportation costs spiked 13% compared to the first quarter 2013, because greater volumes of crude were trucked to points of sale due to the extended outage of Colombia's Bicentario oil pipeline. These costs will drop as and when the pipeline comes back online at full capacity through late 2014 and 2015, offsetting any further softening of crude prices.

Remains attractively valued

Despite all of its strengths and solid second-quarter earnings, Pacific Rubiales remains attractively priced based on a range of key industry specific valuation metrics. At this time, Pacific Rubiales is trading with an enterprise value of a mere four times EBITDA, compared to Crescent Point's nine times, Lightstream's five, Penn West's nine, and Whitecap's 12. More impressively, Pacific Rubiales has a price per flowing barrel of $69,000 compared to Crescent Point's $181,000, Lightstream's $99,000, Penn West's $72,000, and Whitecap's $182,000.

All this highlights how undervalued Pacific Rubiales is, particularly when you consider that it has a relatively low degree of leverage and is not struggling to rebuild its balance sheet, conserve capital, or divest itself of low-quality assets like Lightstream and Penn West.

Pays a steadily growing dividend

Pacific Rubiales while offering solid growth prospects also pays a quarterly dividend with a tasty yield of 3.5%. While this is lower than many of its Canadian peers, it appears far more sustainable with a conservative payout ratio of 35%.

This leaves plenty of room to sustain dividend payments should earnings be disrupted by further pipeline outages and softer crude price, while giving management a free hand to hike the dividend. More impressively, since inception in 2010 the dividend has been increased three times, giving it a compound annual growth rate of 15%, which, given the Pacific Rubiales solid fundamentals, should continue.

Pacific Rubiales is an oil explorer and producer with an enviable track record. It continues to trade at a significant discount to its correct indicative value because of an overblown perception of risk within the market. It also operates with significantly superior margins and production growth compared to its Canadian peers, making it a must-have growth stock for risk-tolerant investors seeking exposure to the energy sector.

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2. TSX:FEC (Frontera Energy Corporation)
3. TSX:VRN (Veren Inc.)
4. TSX:WCP (Whitecap Resources Inc.)

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