

Pacific Rubiales Energy Corp. Was Upgraded: Is Now the Time to Buy?

Description

Troubled energy company **Pacific Rubiales Energy Corp.** (TSX:PRE) continues to disappoint investors with its share price down a massive 84% over the last year. Despite concerns among analysts over its debt burden, analysts seem to be warming to the company. One analyst recently upgrading it from “sell” to “neutral.”

Now what?

Pacific Rubiales is the largest independent oil producer in Colombia and has a globally diversified portfolio of oil assets. However, it has been rocked by a series of issues relating to its operations, which have caused the market to virtually price it for failure.

The most pressing issues are its mountain of debt and the impending loss of its 42% share of the Piri Rubiales field to Colombian government controlled **Ecopetrol S.A.** The loss of the Piri Rubiales oil field is of considerable concern because it currently contributes 41% of its total oil production, and while Pacific Rubiales has worked hard to replace this with production from other oil assets, it is a big chunk to lose.

There are also growing concerns among analysts that Pacific Rubiales will breach its debt covenants by the second half of 2015, with cash flow and EBITDA set to decline significantly because of lower oil prices.

Despite these red flags and the risks they represent, Pacific Rubiales' considerable oil reserves, midstream, and pipeline assets help to offset these risks.

The company has considerable oil reserves totaling 511 million barrels net of royalties, which are valued at almost \$19 per share after tax, or more than six times its current share price. The majority of those reserves are undeveloped, and while there are considerable costs and risks associated with bringing them to commercially viable production, it does highlight just how heavily undervalued the company is.

Furthermore, Pacific Rubiales has implemented a number of measures to reduce debt and prevent a breach of its debt covenants. Management suspended the dividend, creating annual cost savings of \$200 million. The syndicate of lenders have relaxed the debt covenants at the behest of Pacific Rubiales. Pacific Rubiales has also flagged that almost half of its midstream assets are up for sale and it has already received an indicative offer of \$200 million for 30% of those total assets.

Pacific Rubiales has implemented an aggressive hedging strategy that sees 60% of its 2015 oil production hedged at prices well in excess of current prices. This will help to protect its cash flow and reduce the risk of its debt covenants being breached.

So what?

Clearly, there is considerable value locked into Pacific Rubiales existing assets. The gap between the value of those assets and its share price highlights that there is considerable potential upside on offer, especially when the strategies it has implemented to reduce its debt to a manageable level are taken into account. This investment is certainly not without risk, as there is potential for considerable downside if the oil rout persists. I believe this makes it too risky for the average investor.

CATEGORY

1. Energy Stocks
2. Investing

TICKERS GLOBAL

1. TSX:FEC (Frontera Energy Corporation)

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