Is it Safe to Invest in Colombia?

Description

It was adventurous Canadian energy companies that led the charge into Colombia when the strife-ridden Latin American nation deregulated its oil industry to attract foreign investment. The same is now occurring in Colombia's fledgling mining sector, where Canadian precious metals miners are entering the country to invest in a sector that only five years ago was off-limits to foreign investors.

Nonetheless, the recent tragic attack on the employees of miner **Continental Gold Inc.** in North Western Colombia at the end of September 2018 that saw three employees murdered has cast a pall over the nation. The latest attack has triggered considerable apprehension among foreign investors that Colombia's internal security situation is not as stable as the government has claimed, since the implementation of the ground-breaking 2016 peace agreement with the country's largest guerilla group the FARC.

While there are serious concerns about the stability of Colombia's internal security situation, particularly in rural regions where most miners and oil companies operate, it shouldn't deter investors. Bogota is focused on bolstering foreign investment in Colombia's resources sector and is implementing strategies aimed at making the country an attractive destination for foreign investors.

Now what?

Many of the security incidents in Colombia can be attributed to FARC dissident groups that refused to demobilize once the peace process had been implemented. They are primarily focused on narco-trafficking and extortion as a means of generating income, which sees them view international energy and mining companies as legitimate targets.

According to the Colombian military, the dissidents number around 1,200, although based on informal reports that number could be as high as 2,000. The military and police have stepped up efforts to eradicate those, while the government is focused on stabilizing domestic security and bolstering the police as well as military presence in the affected regions which include some of Colombia's most prolific oil producing basins.

Since the FARC demobilized, there has been a noticeable decline in kidnappings as well as the extortion of companies operating in Colombia. However, these practices remain a problem, as does criminal involvement in illegal gold mining. The last remaining leftist guerilla group the National Liberation Army, known by its Spanish abbreviation ELN, remains active and this year has been responsible for bombing Colombia's oil pipelines.

Nonetheless, the situation is currently more stable and secure than it has been since the 1970s, as is evidenced by the homicide rate falling to be at around its lowest level since 1973. That should reassure investors, especially given that the IMF expects Colombia's economy to expand by 3% this year and GDP growth to increase by 3.5% in 2019.

The business-friendly government of President Ivan Duque is focused on attracting further foreign investment through tax concessions and other favourable dispensations to bolster oil and mining production. This has created considerable opportunities particularly in Colombia's oil industry with the Andean nation ranked as the fourth largest oil producer in Latin America.

So what?

Many drillers operating in Colombia possess attributes that make them more attractive investments than their peers operating in North America; their ability to access international Brent pricing is key. This gives them a notable financial advantage over North American upstream oil producers because that benchmark is trading at a significant premium of over US$9 a barrel to West Texas Intermediate (WTI).

One that stands out is **Parex Resources Inc.** (TSX:PXT). The company has only gained 10% since the start of 2018 compared to Brent's 26%, creating an opportunity for investors. Its failure to keep pace with crude can be blamed on the perceived degree of risk of operating in Colombia because of recent security concerns.

Parex owns 1.6 million acres in Colombia's Llanos and Magdalena basins, which contains oil reserves of 162 million barrels. It possesses a rock-solid balance sheet with no debt, and at the end of the second quarter 2018 had cash of more than US$323 million. The financial advantage afforded by the ability to access Brent pricing is reflected in Parex's second quarter operating netback of US$44.97 per barrel, which is 65% greater that the US$27.28 reported by North American driller **Crescent Point Energy Corp.**

In early September 2018, Parex announced a new oil discovery at the Capachos Block in the Llanos basin in which it has a 50% interest with Colombian national oil company **Ecopetrol S.A**. The newly drilled well recently successfully tested for 2,057 barrels daily of production, and the discovery should give Parex's reserves and production a healthy lift.

The impressive history of reserves and production growth along with Parex's share price failing to keep pace with oil's recent rally makes it an attractive play on higher oil.

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