My Top Oil Stock for 2019 and Beyond

Description

It's been a tumultuous year for energy investors, with oil whipsawing wildly since January, climbing to a multiyear high only to collapse once again to see West Texas Intermediate (WTI) down by 11% and Brent 7% for the year to date. The latest price collapse is weighing heavily on oil stocks, with many being heavily marked down by the market. Among them is **Gran Tierra Energy Inc.** (TSX:GTE)(NYSEMKT:GTE), which has fallen by 4% since the start of 2018, thereby creating an opportunity for investors to acquire a high-quality driller with considerable potential upside.

Now what?

Gran Tierra is focused on the exploration and production of oil in the Latin American nation of Colombia, where it has oil reserves of 137 million barrels composed entirely of higher margin light and medium crude. Those reserves have a net present value before taxes of US$2.5 billion, or over $1 million greater than the driller's enterprise value.

That is equivalent to around $8.62 per share, more than double Gran Tierra's market price, indicating the considerable potential upside available once oil recovers.

There is every likelihood that crude will firm in coming months. OPEC and Russia have indicated that they are willing to consider further production cuts to buoy prices, while the latest sell-off in energy markets appears overdone. Not only are there a range of emerging risks that could constrain global supplies, notably Venezuela's declining production and the possibility of further outages in the Middle East, but demand growth may not slow as significantly as expected, as the likelihood of a full-blown trade war between the U.S. and China is diminishing, which means that 2019 global economic growth may be stronger than many pundits are expecting.

The quality of Gran Tierra's assets and operations is underscored by its strong third quarter 2018 results, where it reported record production of 36,170 barrels daily, 11% higher than a year earlier. The profitability of the driller's operations is underscored by the solid quarterly operating netback of US$37.52 per barrel produced, which was a healthy 59% higher year over year.

That can be attributed to firmer crude and the fact that Gran Tierra unlike many of its North American peers hasn't hedged its oil production allowing to fully enjoy the benefits of firmer oil prices. It is also able access international Brent pricing giving it a financial advantage over those peers because Brent trades at a premium of around US$8 per barrel to WTI.

As a result of these solid operational results, Gran Tierra reported that third quarter net earnings soared to US$75 million, roughly 25-times greater than the equivalent period in 2017.

Gran Tierra's production should continue to grow. The company has an enviable drilling success rate, which has led to new oil discoveries as well as the expansion of existing reservoirs. The company is also focused on consolidating its existing operations, which saw it acquire the remaining 45% interest in the PUT-1 Block located in its core operating area in Colombia's southern Putumayo Basin. That deal, which after price adjustments cost US$45 million, gave Gran Tierra 100% ownership of the block allowing it to better control operations and leverage off its existing infrastructure.

For the reasons discussed earlier, it is likely that Brent will recover to around US$70 a barrel in coming months, thereby boosting the value of Gran Tierra's oil reserves and production which will give its earnings as well as market value a solid lift.

So what?

Gran Tierra, because of its high-quality assets and long-life reserves, is an appealing play on higher oil. Its solid balance sheet, including only US$280 million in net debt, is a very manageable 0.6 times EBITDA, combined with low costs significantly reduces the risks associated with weaker oil should prices remain soft for a sustained period.

For these reasons Gran Tierra ranks as a very attractively valued energy stock that will soar once oil rebounds.

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