2 Top Energy Stocks to Buy and 1 to Avoid

Description

Oil's epic rally since the start of 2019 continues to gain momentum, seeing the international benchmark Brent up by a whopping 41% to be trading at over US$71 a barrel. While this has been a boon for upstream oil producers, it has failed to spark a notable uptick in investment in the oil industry, creating a disconnect between the value of many drillers and their growing profitability.

Let's take a closer look at three upstream oil and natural gas producers: two are attractively valued as well as uniquely positioned to unlock significant value for investors, and one investors should avoid.

Gran Tierra Energy (TSX:GTE)(NYSE:GTE) is an upstream oil producer I have been bullish on for some time. It has lost 11% over the last year, despite Brent gaining almost 4%, and it has failed to keep pace with the latest oil rally, creating an opportunity for investors seeking to bolster their exposure to crude.

Growing production, which is forecast to expand during 2019 by up to 19% year over year, low operating expenses, and the ability to access premium Brent pricing support Gran Tierra's considerable profitability per barrel pumped. When combined with higher oil and estimates that Brent could reach as high as US$75 per barrel before the end of 2019, Gran Tierra's earnings will expand at a solid clip.

The driller has also been steadily increasing its oil reserves, which, for 2018, grew by 15% year over year to 142 million barrels. The considerable potential upside available to investors is highlighted by those reserves having a before-tax net asset value of $7.95 per share, which is more than double Gran Tierra's market value.

Canacol Energy (TSX:CNL) has pivoted its operations away from crude to become a leading onshore producer of natural gas in Colombia. It has amassed natural gas reserves of 559 billion cubic feet and reported an extraordinary reserve-replacement ratio of 232% for 2018. That can be attributed to the substantial exploration success being enjoyed by Canacol on its quality Colombian acreage, which is in excess of one million net acres and has 140 drilling prospects and leads. The driller has an enviable 81% natural gas exploration success rate and its mineral concessions hold up to 2.6 trillion cubic feet of the fossil fuel.

A combination of growing natural gas consumption in Colombia, emerging supply constraints including aging Caribbean gas fields and a lack of major discoveries have created a favourable operating environment. Those conditions mean that Canacol has been able to establish take-or-pay wellhead contracts of US$4.75 per thousand cubic feet, which is 86% greater than the North American spot price. This gives Canacol a significant financial advantage over its peers operating solely in North America.

There is every sign that those unique market conditions will continue for some time. Decline rates at Colombia's aging Caribbean gas fields continue to accelerate impacting supply; along with a dearth of major discoveries and growing demand, that forced the Andean nation to start importing liquefied natural gas. Those premium prices combined with 2019 gas sales expected to reach 215 million cubic feet daily by June, which is 80% greater than the average contracted sales for the fourth quarter 20189, point to a substantial lift in earnings.

For these reasons, Canacol is a top play on growing demand for energy.

Fontera Energy (TSX:FEC) is the latest incarnation of the failed Colombian oil producer known as Pacific Rubiales. Since emerging from bankruptcy in 2016 with a clean balance sheet and considerable quality oil assets in Colombia and Peru, it has struggled to unlock value for investors.

A key issue has been that its Peruvian properties have failed to perform as expected and production has been declining. First-quarter 2019 oil production only expanded by just under 3% year over year because of ongoing outages at its acreage in Peru. That can be attributed to a range of factors, including higher-than-anticipated decline rates and civil disturbances. While Frontera has acquired mineral concessions in Ecuador and is in the process of finalizing a joint venture in Guyana, these could very well act as distractions from resolving the issues impacting its core Colombian and Peruvian operations.

Furthermore, Frontera is still dealing with the overhang of issues relating to its pre-bankruptcy operations. This includes having to shell out US$85 million for Pacific Midstream's interest in the Bicentenario pipeline, which was non-operational for six consecutive months.

Production outages remain a constant threat, not only because of operational hazards but ongoing civil unrest in Colombia and Peru as well as oil pipeline bombings in Colombia. While these are risks that impact all drillers operating in Colombia, it is Frontera which appears the most vulnerable.

For the reasons discussed, investors seeking to boost their exposure to crude should avoid Frontera.

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2. TSX:CNE (Canacol Energy Ltd)

3. TSX:FEC (Frontera Energy Corporation)
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