Is This the Top Oil Stock to Play Higher Oil?

Description

I have been bullish on intermediate oil explorer and producer **Gran Tierra Energy** (TSX:GTE)(NYSEMKT:GTE) for quite some time. While its core mineral concessions located in Colombia are of high quality and it has long history of unlocking value from those properties and through accretive acquisitions, the stock has failed to perform.

Despite the international benchmark Brent gaining around 17% since the start of 2019, Gran Tierra's value has declined by 14%. sparking fears that its operational position may not be as solid as some pundits believe.

Trading at a discount to its oil reserves

Among Gran Tierra's key strengths is its copious oil reserves totalling 170 million barrels net after royalties, which are 52% weighted to higher value light and medium crude. Those reserves were calculated to have an after-tax value of US$2 billion, which after deducting Gran Tierra's liabilities and applying a 10% discount rate in accordance with industry methodology give the driller a net-asset-value (NAV) of $5 per share on a diluted basis. This is around double Gran Tierra's current market value, indicating that there is considerable upside available for investors.

Unlike its peers operating in North America, the driller can access Brent pricing, giving it a handy financial advantage because the international benchmark is trading at a significant premium to West Texas Intermediate (WTI). That premium is currently over US$9 per barrel, and there is every expectation that it will remain at around that level for the foreseeable future.

Gran Tierra is also focused on reducing costs and deploying its capital profitably. For the first quarter 2019, operating and transportation expenses rose sharply compared to a year earlier, but this can be attributed to a marked increase in work over, well development and higher equipment costs associated with the rapid production growth at the Acordionero field. Gran Tierra's return on average capital employed has grown significantly in recent years to be over 13% for 2018 compared to roughly 8% in 2017.

The driller also has low finding and development costs of US$10 to US$15 per barrel of crude, highlighting its cost effectiveness for Gran Tierra to continue investing in expanding its oil reserves and production.

The company also recently entered Ecuador, where it has been awarded three blocks in the Oriente Basin, which forms part of the same geological basin containing Colombia's Putumayo Basin, where Gran Tierra is a primary landholder. Those blocks are contiguous with Gran Tierra's Southern Colombian acreage, meaning that it should be able to leverage off existing infrastructure and expertise when developing its Ecuadorean concessions. The company expects to commence its drilling program in 2020, targeting the completion of 14 wells over the next four years.

Gran Tierra expects its operations to be self-funding and cash flow positive at an average Brent price of US$65 per barrel, which is only marginally higher than the current price of US$62 a barrel. The company also has a solid balance sheet with long-term debt of US$517 million, which is expected to be a manageable 1.4 times 2019 operating cash flow, if Brent averages US$65 a barrel.

Foolish takeaway

For the myriad reasons discussed, it's difficult to understand why Gran Tierra's stock has remained depressed and trading at around the same level since 2015. While that has been a disappointing outcome for investors, it does create an opportunity to acquire a high -quality driller offering considerable upside.

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