What is Happening at Gran Tierra Energy (TSX:GTE)?

Description

The last year has been a rough one for investors in one of Colombia's largest privately owned oil producers, **Gran Tierra Energy** (TSX:GTE)(NYSEMKT:GTE). The driller has lost a whopping 52% over that period despite crude rallying significantly to see the international benchmark, Brent, up by over 29%.

This initially generated considerable enthusiasm among investors because it indicated that Gran Tierra was attractively valued, with considerable upside ahead.

Nonetheless, Gran Tierra has failed to rally, even after the latest news regarding OPEC production cuts saw considerable optimism return to energy markets and Brent crude rally sharply to over US$65 per barrel.

This indicates that there could be deeper issues impacting Gran Tierra's operations and its ability to unlock value for shareholders.

Rising geopolitical risk

Earlier in 2019, Gran Tierra experienced a range of operational issues leading to production outages. These included equipment failures at its Acordionero oil field in the Middle Magdalena Valley Basin and the shut-in of all production at the Suroriente and PUT-7 blocks in the Putumayo basin because of farmer blockades. Those events saw Gran Tierra lose average production of around 9,000 barrels daily for as long those assets were unable to operate.

Operations were eventually restored, but Gran Tierra's share price has yet to recover to its pre-outage level despite higher oil. In fact, the driller is trading at almost a fifth of its net asset value (NAV) of $6.89 per share, indicating that the market is pricing in considerable downside for the driller regardless of the improved outlook for crude.

A key risk is the deteriorating security situation in Colombia, where major cities have been rocked by protests against the administration of President Duque. There are fears that Colombia's economically vital oil industry and transportation infrastructure will become targets for blockades and attacks, triggering further production outages for Gran Tierra.

Considerable speculation has already emerged that the current crisis could cause Colombia's oil production to fall. This would significantly impact Gran Tierra because it is one of the largest privately owned oil producers operating in the Andean nation. That hazard is magnified by Gran Tierra being the largest landholder in the Putumayo Basin, which is a highly unstable region and responsible for a considerable proportion of its oil reserves and output.

A deteriorating security situation, notably in rural regions, could lead to a greater volume of attacks on critical energy sector infrastructure, particularly vulnerable oil pipelines. This has arisen because of the breakdown of the FARC peace process which has seen a sharp increase in dissident guerilla groups in recent months. The last remaining left-wing guerrilla group, the ELN, has ratcheted up its attacks on critical energy infrastructure to force the Colombian government to the negotiating table.

As at the end of August 2019, it was estimated that there had been 32 strikes against oil pipelines in Colombia, with the Cano Limon-Covenas and Transandino pipelines being favoured targets. Pipelines are the only cost-effective means of transporting crude from oil fields to ports because of Colombia's rugged terrain and lack of infrastructure.

Gran Tierra is particularly dependent on the Transandino pipeline, which connects its petroleum concessions in the Putumayo Basin to the Pacific port of Tumaco. The difficult terrain in that part of Colombia makes it costly and extremely difficult to ship crude if the pipeline isn't in operation.

Foolish takeaway

Rising geopolitical and security risk in Colombia is weighing heavily on Gran Tierra and constitutes a significant hazard to its operations. Any major pipeline outages or regional blockades could cause production to fall sharply and has the potential to substantially impact the driller's 2020 guidance and earnings. It is for this reason that Gran Tierra has been roughly handled by the market and continues to trade at a deep discount to its NAV.

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