Can This Beaten-Down Oil Stock Ever Bounce Back?

Description

The last year has been a tough time for investors in oil explorer and producer **Gran Tierra Energy** (TSX:GTE)(NYSEMKT:GTE). The driller, which is focused on oil production in Colombia, has lost a whopping 53% over that period despite the international benchmark Brent rising by around 15%.

This has led to considerable conjecture regrading Gran Tierra's outlook and performance during 2020, particularly given that peer **Parex Resources** has returned a notable 23%.

Rising geopolitical risk

A key issue that has been weighing on Gran Tierra's performance has been heightened security and political risk in Colombia, particularly in the nation's southern Putumayo Basin, where its core operations are located.

In mid-2019, farmers blockades in Southern Colombia forced Gran Tierra to shutter production at two blocks in Putumayo, which saw it lose 4,500 barrels daily of oil output for a period of almost two months.

Since then, protects have worsened to see a series of national stoppages and marches occurring since November 2019 as tensions rise over proposed economic, taxation and pensions reforms.

Heavy-handed tactics by the police, growing corruption and a deep-seated sense of disenfranchisement among the populace are further fueling the protests. This has sparked considerable disquiet that it could spill over into Colombia's energy sector, which dissident FARC combatants and ELN guerillas already consider to be a legitimate target.

That has triggered considerable speculation that further production outages, notably in Southern Colombia, where the core of Gran Tierra's oil acreage is located, will occur. This would have a sharp impact on Gran Tierra's oil output and ultimately earnings, which explain why the market has heavily marked down its stock.

Another security issue is the vulnerability of Colombia's oil pipelines to bombing and other attacks. A combination of harsh terrain and a lack of transport infrastructure means that the pipelines are the only cost-effective means of transporting crude.

When a pipeline is shuttered because of sabotage, companies like Gran Tierra are either forced to use very costly and limited road transportation, shutter operations in the affected region or store the oil produced, incurring additional costs.

A related issue weighing on Gran Tierra's market value is its 2020 guidance, where its upper estimate is an average oil production of 37,500 barrels daily which is 11% lower than for 2019.

More worrisome still is that the driller's estimates are based upon an average 2020 Brent price of US$60 per barrel. While that is lower than the current spot price of US$63 per barrel, there are emerging indicators that oil could plunge lower during 2020, seeing the international benchmark average a lower price over the course of the year.

And that, along with supply disruptions, would have a material impact on Gran Tierra's projected free cash flow of US$60 to US$80 million and EBITDA US$330 to US$380 million.

Those concerns are amplified by Gran Tierra's growing debt pile. It finished the third quarter 2019 with long-term debt of just under US$638 million, a hefty 60% higher than the US$399 million reported at the end of 2018. If Gran Tierra's free cash flow declines for the aforementioned reasons, it will struggle to repay that debt and strengthen its balance sheet.

Foolish takeaway

It's easy to see why Gran Tierra has been so roughly handled by the market. While risks abound, there are signs that the risk reward equation is in favour of risk tolerant investors.

Gran Tierra is now trading at a deep 254% discount to its after-tax net asset value (NAV), meaning there is considerable upside on offer, though it will be a bumpy ride for investors.

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