



The Oil Price Collapse Has Created a Deep Value Opportunity for Investors

Description

Oil prices remain under considerable pressures, as the spread of the coronavirus pandemic has sparked considerable fears that a global recession will occur as China's growth wanes; the East Asian nation and the world's second-largest economy is responsible for around half of oil demand growth, meaning that a marked decline in economic activity will lead to a significant fall in energy consumption.

That's been responsible for the international benchmark, Brent, falling by 24% since the end of 2019, and there are signs that oil will remain under pressure at least for the short term.

The sharp decline in prices coupled with the deflation of the optimism surrounding the outlook for crude at the start of 2020 has hit energy stocks hard.

The largest industry ETF, the **SPDR S&P Oil & Gas Exploration & Production ETF** has lost a whopping 30% since the start of the year, indicating that many oil stocks are now trading at bargain basement valuations.

One that stands out is beaten down **Gran Tierra Energy** ([TSX:GTE](#))([NYSEMKT:GTE](#)) which has lost 29% over that period. This indicates that despite the risks, there's considerable opportunity to acquire a deeply discounted upstream oil producer with considerable upside ahead once crude rebounds.

Trading at a deep discount

A key factor underscoring the attractiveness of Gran Tierra is that it is trading at a massive 203% discount to its net-asset-value (NAV). After allowing for the independently calculated value of its proven and probable oil reserves and deducting all long-term liabilities, Gran Tierra has an after-tax NAV of \$5.38 per share or around three times its current market value.

That highlights that the driller is very attractively valued — and the considerable upside available once oil rebounds, making now the time to buy.

The key reasons that Gran Tierra has been so harshly handled by the market is that it operates in the

strife-torn South American nation of [Colombia](#), where most of its operations are located. Gran Tierra is the single largest landholder in the Andean nation's southern Putumayo Basin.

Toward the end of 2019, Columbia was rocked by civil insurrection as people protested a wide range of issues including corruption, the murder of community and social leaders, economic reforms and the growing disenfranchisement of civil society.

This, along with elements of the FARC electing to recommence their conflict against the government and the largest remaining guerilla group, the ELN, stepping attacks on infrastructure including oil pipelines sparked considerable fears that the [country's oil industry](#) would be disrupted.

Oil pipelines, which remain the only economic means of transporting crude to key ports, have long been a popular target of armed groups in their fight against the Colombian government.

Blockades of major roads also remain a problem and were responsible for production outages caused by Gran Tierra being forced to shutter production at two blocks in the Putumayo Basin in 2019.

For these reasons, Gran Tierra is vulnerable to production outages that will impact its earnings, particularly in an operating environment in which Brent remains soft, making it highly dependent on growing production to bolster revenue.

Nonetheless, the market's perception of risk appears overblown and it's not as severe as anticipated. Gran Tierra expects to generate free cash flow of US\$60 million to US\$80 million during 2020 after funding its well development and exploration program where it expects to drill up to 24 wells during the year.

That free cash flow will be directed to reducing debt, strengthening Gran Tierra's balance sheet and financial flexibility, a positive move in the current difficult operating environment.

Foolish takeaway

The poor outlook for crude coupled with growing economic uncertainty makes the energy sector an unappealing investment.

Nevertheless, those drillers with quality assets, the ability to generate free cash flow and robust balance sheets remain an attractive investment.

With its history of growing oil reserves and production, Gran Tierra is very attractively valued given that it's trading at a third of its after-tax NAV, indicating considerable upside available.

CATEGORY

1. Energy Stocks
2. Investing

TICKERS GLOBAL

1. NYSEMKT:GTE (Gran Tierra Energy Inc.)
2. TSX:GTE (Gran Tierra Energy Inc.)

PARTNER-FEEDS

1. Business Insider
2. Msn
3. Newscred
4. Sharewise
5. Yahoo CA

Category

1. Energy Stocks
2. Investing

Date

2025/08/25

Date Created

2020/02/26

Author

mattdsmith

default watermark

default watermark