Will the Oil Price Collapse Bankrupt Gran Tierra (TSX:GTE)?

Description

The latest oil price collapse has hit Canadian oil stocks particularly hard. A sharp demand shock triggered by the coronavirus pandemic is weighing heavily on energy prices.

Among the worst affected is Colombian-based driller **Gran Tierra** (TSX:GTE)(NYSE:GTE). Its stock has plunged by a massive 89% since the start of 2020. This is significantly higher than Brent's 63% loss, which sees it trading at around US$22 per barrel.

Gran Tierra is trading at almost a ninth of its 52-week high. That coupled with the latest sell-off indicate the market is pricing the intermediate oil producer for bankruptcy. For some time, I have been bullish on Gran Tierra, because it has been trading at a deep discount to the net asset value of its proven and probable oil reserves.

Let's take a closer look at what the future potentially holds for the beaten-down driller.

Surviving weaker oil

In response to the coronavirus pandemic and oil price collapse Gran Tierra slashed its 2020 capital spending by over 60%. That sees the driller expecting to spend a maximum of US$80 million on drilling and well-development activities.

Gran Tierra is also suspending uneconomic production to reduce expenses. By mid-April 2020, Gran Tierra had shuttered around 11,300 barrels daily of oil production. This includes 4,000 barrels from Gran Tierra's Suroriente and PUT-7 Blocks in the Putumayo basin, where operations ceased because of a local farmer blockade.

That reduction in oil output, while reducing costs, will magnify the impact of sharply weaker oil prices on Gran Tierra's earnings.

Oil price collapse

A key headwind being faced by Gran Tierra in the current harsh operating environment is its weak financial position. The driller finished 2019 with a paltry US$8 million in cash compared to over US$803 million of long-term liabilities, including US$700 million of long-term debt. Gran Tierra's long-term debt was a conservative 1.9 times its 2019 EBITDA, indicating that prior to the oil price collapses it was very manageable.

The most pressing issue for Gran Tierra is its lack of cash in what is shaping up to be an especially harsh operating environment that no one predicted.

Other than its revolving credit facility, Gran Tierra has no near-term debt maturities. Its convertible notes totaling US$600 million don't mature until 2025 when US$300 million falls due, with a further US$300 million in 2027. Gran Tierra also has a US$300 million credit facility, which matures during November 2022. Currently, there is US$118 million drawn on the facility and US$182 million available, boosting Gran Tierra's liquidity.

Despite the lack of cash on hand, Gran Tierra's overall financial position appears sound.

Is bankruptcy imminent?

Nonetheless, at $0.39 per share, the market is pricing Gran Tierra for bankruptcy. That price is a mere 15th of the after-tax net asset value of Gran Tierra's proven and probable oil reserves.

Gran Tierra is in a superior position compared to its peers operating solely in North America. It can access international Brent oil prices, giving it a handy financial advantage. This is because Brent trades at a US$5-per-barrel premium to the North American West Texas Intermediate (WTI) benchmark.

This — along with low operating and transportation expenses, which for 2020 were originally estimated to be US$10.50 per barrel pumped — means Gran Tierra's operations should be cash flow positive in the current difficult operating environment.

Looking ahead

Gran Tierra appears extremely attractively valued, despite the oil price collapse. Even Gran Tierra's low liquidity is not a serious issue when its well-laddered debt profile and manageable level debt are considered.

Other than rising geopolitical risk in Colombia and operational outages caused by farmer blockades, there is no reasonable explanation as to why Gran Tierra has been heavily marked down by the market. For these reasons, Gran Tierra should emerge from the coronavirus-induced oil price collapse as a going concern.

Neveretheless, despite Gran Tierra's appealing valuation, it should be treated as speculative, high-risk, contrarian play on higher oil.

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