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

Description

The latest oil price crash is harshly impacting energy companies around the globe. While oil has recovered, there will be bankruptcies across the industry with oil well below the breakeven price for many drillers. One oil stock that has been hit hard is **Gran Tierra Energy** (TSX:GTE)(NYSE:GTE). There are signs the stock market is pricing Gran Tierra for bankruptcy.

Oil price crash impacts operations

The Colombian-based driller is down by 64% since the start of 2020, which is far greater than the international Brent oil price, which plunged 49%. It is feared that sharply weaker oil and the measures taken to contain the coronavirus will see Gran Tierra pumping crude at a loss. This is being magnified by farmers' blockades in southern Colombia, which have forced Gran Tierra to shutter additional production at two blocks in the Putumayo Basin.

As a result, first-quarter 2020 production fell by 23% year over year to 29,527 barrels of crude daily. This, along with significantly weaker oil, caused Gran Tierra's earnings collapse.

The driller's operating netback, which is a key measure of operational profitability, plunged to US$16.56 per barrel, which was 54% lower than a year earlier. Quarterly EBITDA of US$34.5 million was 63% lower year over year.

Consequently, Gran Tierra reported a US$252 million net loss compared to a US$2 million profit a year earlier.

Gran Tierra's second-quarter 2020 numbers will worsen, because oil fell even further during April, and additional fields with zero or negative netbacks were shut in.

Reducing the impact of the oil price crash

To protect is balance sheet, Gran Tierra has suspended capital spending and deferred its well workover program. The driller has also bought more oil price hedges to mitigate the impact of sharply weaker oil. Gran Tierra's ability to survive is supported by its US$39 million of cash at the end of the first quarter. One of the key reasons for the market pummeling is that Gran Tierra's debt since 2016 has ballooned out to US$787 million, which is a worrying three times trailing 12-month EBITDA.

That highlights there is considerable pressure in the current harsh operating environment on Gran Tierra to strengthen its balance sheet. The driller recently announced that it had successfully redetermined its credit facility. That saw the base limit reduced to US$225 million from US$300 million. The syndicate of lenders also waived the debt to EBITDAX covenant until October 2021, reducing the risk of Gran Tierra breaching its financial obligations.

Gran Tierra acquired additional oil price hedges to offset sharply weaker crude. As a result, 11,000 barrels of daily oil production is hedged for the second quarter, and 9,000 barrels are hedged during the second half 2020. This will mitigate the worst of the marked impact of sharply weaker oil prices on Gran Tierra's earnings.

The driller's second-quarter oil production has averaged around 21,000 barrels daily. This is 29% lower than Gran Tierra's first-quarter oil output. That — along with weaker oil prices — will impact Gran Tierra's second-quarter earnings.

Foolish takeaway

Gran Tierra appears well positioned to survive the current difficult operating environment. The driller has sufficient liquidity to survive until the end of 2020. It will also experience a lift in cash flow, as oil prices rebound. Gran Tierra is a speculative and risky play on higher oil prices, but it is attractively valued and will survive until Brent recovers.

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