# The Plight of Alberta’s Natural Gas Industry in 2 Charts

## Description

Alberta’s energy patch has battled chronic labour shortages and the bitumen bubble. But now the industry faces a new challenge that threatens to cut production and drilling activity: the growing discount for Alberta natural gas.



**The discount for Canadian gas …**
It’s no secret that the natural gas industry is struggling. New technologies like hydraulic fracturing and horizontal drilling have unlocked vast quantities of previously unexploitable shale supplies. Combined with weak demand, North American natural gas prices have remained tepid.

But like the bitumen bubble plaguing the oil industry, the price for Alberta natural gas is trading at a deep discount to other benchmarks. Last week, the Alberta Market Price — a volume-weighted index of all gas prices in the province — settled at $2.39/GJ, down 30% for its high in May. The equivalent amount of gas at Henry Hub closed a $3.75.

first chart
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*Source: NGX and IEA*

Much of the discount can be attributed to recent toll changes along **TransCanada’s** cross-country natural gas mainline. In an effort to encourage more long-term commitments — or firm service in the industry vernacular — TransCanada hiked the rates for short-term contracts. Tolls for interruptible service have been set at premiums of 220% above firm and as much as 1,200% for winter short-term service. But rather than commit to long-term contracts or pay a premium for shipping, producers have chosen to store their gas.

Western Canadian gas is also being muscled out by cheaper shale from the United States. Demand from eastern utilities has been declining as they start to tap cheaper supplies elsewhere.

**… is killing production …**
Alberta’s natural gas production has already fallen 25% since 2005 due in part to the huge increase in competing shale gas. But if the price gap persists, it has the potential to cause an even more severe

drop in the industry’s output.

second chart

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*Source: CADOC*

In Alberta, the total number of gas wells drilled annually has plunged from 16,000 wells in 2006 to 1,187 last year. Industry expert Peter Howard, Chief Executive of the Canadian Energy Institute, told provincial politicians last week that “In 2013, we will be very lucky if we can break the 1,000 well mark.”

**… and hurting shareholders**
Low natural gas prices have had predictable consequences for Canadian natural gas producers. Unhedged operators like **Birchcliff Energy**, **Paramount Resources**, and **Tourmaline Oil** have seen their profits decimated. But natural gas prices have remained so low for so long that even hedged producers are feeling the pinch.



To address this, companies are shifting production from conventional gas to oilier plays. **Talisman** (TSX: TLM, NYSE: TLM) hasn’t abandoned its gas-heavy strategy, but the company is moving to more liquids-rich formations. In 2011, the company announced that it had acquired 347,000 acres of land in Alberta’s Duvernay shale formation. Since that news, the company has drilled nearly a dozen pilot wells to appraise the play’s potential and early results are encouraging.

Other big names in the Canadian energy patch are changing their strategies too. Last week **Encana** (TSX: ECA, NYSE: ECA) announced that it’s planning to sell off its dry-gas assets and shift to an oilier production mix. As part of this strategy, CEO Doug Suttles is looking to exploit liquids-rich plays like the Tuscaloosa Marine Shale in the southern United States.

**Foolish bottom line**
The industry is in store for another two months of ugly prices before the beginning of the winter heating season. In the meantime, there’s a real risk of running out of storage in Western Canada — and that could mean further price declines.

But the real question for investors is whether this price gap is a short-term blip or a long-term issue. Unlike the bitumen bubble hampering the oil industry, any solution to this problem — such as new pipeline capacity or LNG export terminals — is still years away. So unfortunately for shareholders, the only way that this price gap might be erased is through painful production cuts.

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*Disclosure: Robert Baillieul has no positions in any of the stocks mentioned in this post.*

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