Could a Bitter Cold Forecast Heat up Natural Gas Stocks?

Description

We have yet to see the first day of winter (on the calendar at least), but a recent cold snap drove electricity demand to new records in Alberta. According to the Alberta Electric System Operator, Alberta's electricity demand hit an all-time high of 10,677 MW on November 20 as temperatures reached levels nearing -25C.   The weather has moderated since that record setting day, but another deep freeze is in the forecast for early December which could push the lows back down to the levels seen on that record setting day.

In Alberta, coal and natural gas account for the majority of the installed electricity producing capacity, supplying approximately 82% split evenly between the two. However, that differs greatly from the country as a whole, which generates the majority of its power through hydroelectricity. On the other hand, just to the south is the energy thirsty United States whose sources of electricity are much more in line with that of frosty Alberta.

A sign of more to come?

The early cold snap may just be the beginning. Many parts of the United States and Canada stand to have below normal temperatures from now until the thaw of Spring. According to the trusty Farmers' Almanac, much of Canada is expected to endure below-normal temperatures.

The weather prospects for the United States do not look much better. While the coldest temperatures will occur in the less populated states in the Northern Plains, the cold air will stretch into the more populated Great Lakes region and the densely populated areas of the Northeast are also expected to have very cold and wet weather this winter.

Just what the doctor ordered

Natural gas prices have been in a state of depression for more than five years now forcing many predominantly natural gas companies to shut in wells and sell assets in search of a more liquids rich portfolio. This along with the prospects for abundant supplies has also taken its toll on the shares of natural gas companies, many of which continue to trade near historic lows. However, there is nothing like frigid winter with below average temperatures to spark higher demand in natural gas.

A loss for coal is a gain for natural gas

The cold winter may cause a short-term spike in natural gas prices, but before investing in natural gas stocks the longer-term prospects must be considered. Thanks primarily to China and India, the use of coal as a primary energy source will continue to grow for the next several years. However, the use of coal in heavy energy consuming countries such as the United States has come under a great deal of scrutiny and natural gas has proven to be a popular and economic alternative. The U.S. Energy Information Administration expects natural gas-fired plants to account for 63% of capacity additions from 2012 to 2040 within the U.S.

Down, but not out

As previously mentioned, many natural gas stocks have taken a beating, but may be ready to come out of the corner fighting. The cold winter could certainly provide a jolt and the longer term prospects of natural gas becoming a primary source of power production may keep them in the fight.

Five years ago, shares of **Encana Corporation** (TSX: ECA, NYSE:ECA) were flying high, only to come crashing down to now trade below $20 per share. Like many, Encana is employing strategies to reduce its dependence on natural gas. The company expects to finish 2013 with natural gas supplying roughly two-thirds of operating cash flow. In contrast, the company expects 75% of operating cash flows to come from liquids in 2017 while maintaining its options on gas. The strategy is already bearing fruit as liquids production increased 92% in the third quarter of this year as natural gas production slipped 10%.

Just like Encana, **Talisman Energy Inc.** (TSX: TLM, NYSE:TLM) is focusing its capital expenditures on oil and liquids rich gas plays. Liquids production is on the rise going from an expected 35% of total production in 2013 to 45-50% next year and 55-60% in 2015. Earlier this month, the company agreed to sell of part of its Montney natural gas assets located in British Columbia for $1.5 billion furthering its push towards liquids. Even with this divestiture, the company still holds promising natural gas prospects in the Montney as well as a solid position in the Marcellus Shale located in the United States. Coming with an investment in Talisman is famed investor Carl Icahn who recently announced an agreement with the company to add two of his own board members.

ARC Resources Ltd. (TSX: ARX) is also allocating the majority of its capital spending to oil and liquid rich gas development. The company is currently pegging 2014 capital expenditures at $915 millionwith close to 80% targeting oil and natural gas liquids. Despite the focus on liquids, production ofnatural gas is currently 62% of the total and represents 60% of total reserves. The company holds asizable land position in the Montney Shale located in northeast British Columbia and northern Alberta. The company believes the Montney assets will be a driver of future growth and is committingapproximately 65% of 2014 capital expenditures to these assets.   Despite the shift in spending, ARCshares should respond positively to long-term increases in the price of natural gas.

Final thoughts

Much of Western Canada is expected to be in a deep freeze for the remainder of this week. The bitter temperatures from Canada are then expected to push south into United States bringing considerably colder air to much of the western two-thirds of the country which should provide near-term support for natural gas. An unseasonably cold winter and the prospect of new generating capacity overwhelmingly being powered by natural gas may warm investors to stocks leveraged to the commodity giving shares a much needed boost.

CATEGORY

1. Investing

TICKERS GLOBAL

1. TSX:ARX (ARC Resources Ltd.)

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