3 Ways to Bet on the Future of Natural Gas

Description

The news media can always be counted on to make exaggerated claims, hoping that attention-grabbing headlines will draw a bigger audience.

So it's easy to be skeptical when hearing the phrase "game changer" used to describe increased natural gas production. But in this case, that is no overstatement at all. Increased production has led to lower natural gas prices – as low as $1.82 (USD) in April 2012 – reducing the cost of heating, manufacturing, transportation, and electricity.

So what are the different ways to play this trend? Below are three strategies.

The producers

Betting on a natural gas producer can be a dangerous game. Gas prices can swing wildly, and can fall to levels where profits are practically impossible, as we all witnessed in April 2012. There are also risks with cost inflation, especially in Alberta, where there are persistent labour shortages.

One way to minimize this risk is by betting on a low-cost producer such as **Peyto Exploration & Development Corp** (TSX: PEY). Just last year, it cost Peyto only $0.82 per Thousand Cubic Feet Equivalent (mcfe) to extract the gas, transport it, pay government royalties, and cover overhead costs. Peyto also hedges part of its production, allowing the company to remain profitable even when gas prices reach new lows.

The servicers

We've all heard the saying, "The only ones to make real money in a gold rush are the ones selling the picks and shovels." There's a simple reason for this: If there are too many people chasing gold, that drives up mining costs and drives down gold prices.

The same could be said for the boom in natural gas. So for example, one way to play the boom in natural gas production is by investing in **Black Diamond Group** (TSX: BDI). Black Diamond makes money primarily from remote workforce accommodations, but also provides other field services. With companies like that, you don't have to worry so much about increased gas production driving down prices; increased production simply equals more business for the servicers.

The end users

It's often said that whenever there's a new ground-breaking technology, it's more of a benefit to those that use the technology rather than those that supply it. And when it comes to natural gas, certainly its end users have benefited greatly from low input costs as suppliers have struggled to make money.

One example is methanol supplier **Methanex** (TSX: MX). Natural gas is the primary input cost when producing methanol, allowing companies like Methanex to benefit from low gas prices. As could be expected, the shares have done very well, having more than quadrupled in the last five years. But this company is still a great way to bet that natural gas will continue to be produced at will.

Foolish bottom line

When investing in any sector, it is always important to know what kind of bets you are making. Because in an industry like natural gas, "playing the sector" can have more than one meaning.

CATEGORY

1. Investing

TICKERS GLOBAL

1. TSX:BDI (Black Diamond Group Limited)
2. TSX:MX (Methanex Corporation)
3. TSX:PEY (Peyto Exploration & Development Corp)

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