



Buy EnCana Corporation Now Before Natural Gas Prices Heat Up

Description

As we head into the cold winter months, natural gas prices typically heat up. While Moody's recently reduced its forecast for natural gas prices through to 2015, to \$3.75 per million British thermal units (MMBtu) from \$4.25 MMBtu previously, this may be a good time to revisit in preparation for a winter move.

And while natural gas prices have weakened as inventory has been replenished at a faster rate than initially expected due to a cooler-than-normal summer, soon it will shift from injection season to withdrawal season. And natural gas inventories are still 13% below the five-year average, which is a bullish sign for natural gas.

But while the seasons and weather fluctuations certainly affect natural gas prices and stocks, I am even more concerned with the long-term trends, which I view as increasingly bullish. Let's review these long-term secular shifts that are happening in the natural gas market.

- **Switch from coal to natural gas**

It remains clear that natural gas has become the fuel of choice, both politically and economically. Firstly, it is among the more environmentally friendly fuels. As we know, President Obama's environmental and energy policy is aimed at targeting global warming. So we are seeing government regulations that are adversely impacting the coal companies, and benefiting natural gas companies. In addition, natural gas is attractive because it is the cheap(er) energy source.

- **Slower growth of unconventional gas production**

The decline rate (rate at which a well's production declines) on unconventional wells is very steep so their life is shorter than conventional wells. As these wells mature, production increases will slow and be more expensive.

- **LNG as a big source of new demand**

B.C. is finally set to release the long-awaited tax rules for the industry, as players are finalizing plans

for big liquefied natural gas investment in the province. When the LNG market opens up, the market will see a huge boost in demand.

Natural gas stocks have been weak over the last month, in my view, making it a good time to add to positions. Which stocks are leveraged to moves in natural gas prices?

EnCana Corporation (TSX: ECA)(NYSE: ECA)

EnCana's share price has declined over 10.5% in the last three months. While it is working feverishly to diversify away from natural gas toward natural gas liquids, and while this strategy seems to be reactive versus proactive, the fact remains that EnCana's production is currently very heavily weighted toward natural gas (over 80%). Rising netbacks of \$5.75/mcfe in the company's core assets versus \$3.4 /mcfe in its base production means higher-margin barrels. Declining operating costs that are 20% lower in the most recent quarter, and a company target of a 10% cumulative average growth rate in cash flow per share through 2017, show a company that is firing on all cylinders.

NuVista Energy Ltd. ([TSX: NVA](#))

NuVista has declined over 12.8% in the last three months. But the fact remains that it is a stock to own if natural gas rises, as I believe it will. NuVista's focus on natural gas (70% of production is natural gas) is definitely working for the company at this time. It recently announced second-quarter results that were, once again, above expectations. Production was stronger than expected, coming in at 14,493 barrels of equivalent oil per day (boe/d) versus expectations of between 13,000 to 14,000 boe/d. The company's realized natural gas prices were 26% higher in the quarter compared to the same period last year, and accordingly, the operating netback increased over 13%. Furthermore, it has a strong balance sheet with a strong drilling inventory and reserve base.

Birchcliff Energy Ltd. ([TSX: BIR](#))

Birchcliff's stock price has declined over 23% in the last three months. This is no reflection of company-specific performance, however. It is on track to achieve a 32% increase in production in 2014 versus 2013, and in the second quarter of 2014, achieved an 11% decrease in operating costs to \$5.25 per boe, and total cash costs decreased 17%. With natural gas production accounting for 83% of total production in the second quarter, it is also well positioned to benefit from an increase in natural gas prices.

Bottom line

I view natural gas stocks as having a very favorable risk/reward tradeoff currently, and I think this is as good a time as any to add to your portfolio.

CATEGORY

1. Energy Stocks
2. Investing

TICKERS GLOBAL

1. TSX:BIR (Birchcliff Energy Ltd.)
2. TSX:NVA (NuVista Energy Ltd.)

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