This Hidden Gem Will Perform Strongly as Oil Rallies

Description

Despite the claims of naysayers that a new oil crunch is on the way, oil remains at over US$50 per barrel, and the recent rally triggered by the OPEC production cuts has been a powerful tailwind for beaten-down energy stocks. While the big names remain attractive means of playing the rebound in crude because of their solid balance sheets and diversified operations, it is the smaller intermediate plays that offer the most bang for the dollar.

One small cap that stands out as a solid opportunity is **Canacol Energy Ltd.** (TSX:CNE); because it is trading at less than half of its 2014 peak, it now appears attractively priced. The company has also made significant gains in recent months that leave it well positioned to take full advantage of the recovery in crude.

Now what?

A crucial strength that Canacol possesses is that it is uniquely positioned to take full advantage of the booming demand for natural gas in South America, particularly in Colombia, where the majority of its operations are located.

Canacol has an enviable history of growth.

Over the last four years, it has made a number of significant dry natural gas discoveries in Colombia; its exploration activities have an impressive 86% success rate. This is far higher than many other upstream oil and gas producers and attests to the competency of management and the quality of its oil and gas assets. These discoveries have boosted Canacol's natural gas reserves to a notable 73 million barrels of oil equivalent, effectively underpinning its existing gas sales contracts until at least 2020.

As a result of the inability of existing natural gas production to meet demand, Canacol has been able to lock in very favourable terms for its sales contracts. Among the most crucial has been the ability to secure US$5 for every million British thermal units (MMbtu) sold. This is almost double the market price and has significantly bolstered Canacol's profitability in an industry beset by low margins.

The company is generating operating margins of about 80% from its natural gas production. This is far higher than those of North American–focused natural gas producers such as **Encana Corp.** (TSX:ECA)(NYSE:ECA)**,** which, for the final quarter of 2016, produced an operating margin of about 30%.

These impressive margins coupled with an ongoing focus on reducing costs caused net earnings for the nine months ending September 2016 to spike to US$3.3 million compared to a loss of US$93 million a year earlier.

I expect Canacol's performance to continue improving.

You see, the demand for natural gas in Colombia has outstripped supply, forcing the Andean nation to start importing natural gas in 2016 after years of self-sufficiency to fill the shortfall. For this reason, the Colombian government has moved to boost production through tax breaks and reduced capital requirements among other things.

Furthermore, demand for energy, particularly natural gas, is expected to grow strongly in coming years as the country's economy expands at a rapid clip.

So what?

Canacol has boosted the tempo of operations, including exploration and production, to meet this growing demand. It expects natural gas production by December 2017 to have increased by roughly 44% compared to 2016, and further sales growth will be facilitated by two new gas pipelines that it is currently constructing.

Along with rising oil prices, and because crude makes up almost 30% of its total production, these factors will give Canacol's bottom line a healthy bump in coming years. This should translate into a higher share price, especially with Canacol currently trading at less than half of the net value of its oil and gas reserves.

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