How Climate Change Benefits Painted Pony Petroleum Ltd.

Description

As a long-time investor, at times I have read some ridiculous claims. One of the latest is that Ottawa's planned carbon tax will significantly hurt natural gas producers such as **Painted Pony Petroleum Ltd.** (TSX:PPY). According to some pundits, this is the reason behind a string of analyst downgrades and the 39% fall in the company's value over the last three months.

This couldn't be further from the truth. The deep decline in Painted Pony's share price can be attributed to an array of other reasons, the most significant being weaker natural gas prices. If anything, the planned carbon tax will lead to higher demand for natural gas**,** benefiting Painted Pony, along with other natural gas producers.

Now what?

Undeniably, the overall impact on Canada's energy patch will be significant, but the brunt will be borne by oil sands operators rather than natural gas producers.

The extraction of crude from Canada's oil sands is roughly 6% more greenhouse gas intensive than U.S. oil production. It has been estimated that to produce one barrel of crude from bitumen emits up to 20% more greenhouse gases than when producing a barrel of oil from conventional sources.

Natural gas production has a far lower carbon footprint.

The reason the carbon tax will benefit Painted Pony is quite simple.

Coal-fired power generation is the third-largest emitter by economic sector in Canada and the largest producer of greenhouse gases globally. This is because coal is the dirtiest and largest carbon-emitting fossil fuel. Consequently, Ottawa's carbon tax will significantly increase the costs associated with coal-fired electricity.

This is also the reason for a considerable number of governments across the world seeking to remove coal-fired power generation from their energy mix.

An example is the provincial government of Alberta, which mandated that all coal-fired electricity generation must cease by 2030 or that coal-fired plants must have eliminated all emissions. To meet this directive, the operators of coal-fired plants have decided to transition to natural gas.

This is because natural gas has far higher energy content than coal because it burns cleaner, emitting roughly half the volume of carbon dioxide.

When coupled with the sharp decline in natural gas prices in recent years, natural gas has emerged as less environmentally damaging and a cost-effective replacement for coal. Natural gas is considered to be a transitional fuel that will replace coal until other renewable energy sources become more effective and cheaper.

For these reasons, there is a dash to gas underway for electricity generation, and it is forecast that roughly 40 gigawatts of natural gas–fired capacity will come online in North America by the end of 2018.

Consequently, demand for natural gas will grow strongly as coal-fired plants are retired or converted, new gas-fired plants are brought online, and demand for electricity rises.

This will be of considerable benefit to Painted Pony, which has natural gas reserves of a trillion cubic feet and has substantially ramped up production during 2016 by an impressive 49% year over year. The company is forecasting even greater growth for 2017 with production expected to surge by 85%.

More impressively, Painted Pony has been able to significantly increase its netback — a key measure of profitability. It reported a 2016 netback of $1.73 per thousand cubic feet of natural gas produced — a remarkable 41% higher than a year earlier — and it can only continue growing as operating costs are further reduced.

So what?

The transition to natural gas–fired electricity, which has been accelerated by global climate change, carbon pricing, and increasing regulatory barriers for coal-fired plants, will act as a powerful tailwind for Painted Pony. Along with a massive expansion in production, lower costs, and higher prices, this will give its earnings a healthy lift, causing its share price to appreciate.

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