Contrarian Investors: Get Ready for This Small-Cap Driller to Soar in 2018

Description

Crude's recent rally, which now sees the North American benchmark West Texas Intermediate trading at over US$60 per barrel, has been a boon for energy stocks. With breakeven costs of US$60 per barrel or lower for many energy companies, there will be a surge in profitability in coming months if prices remain firm.

Yet surprisingly, many energy stocks have failed to appreciate significantly, and that has created considerable opportunities for investors seeking exposure to oil.

One Canadian driller that remains relatively unknown but stands out for all the right reasons is **Canacol Energy Ltd.** (TSX:CNE). Despite firmer oil, Canacol's stock has only added 17% over the last year, leaving it attractively priced.

Now what?

Canacol's operations are focused on the Andean nation of Colombia, where it has 2.1 million net acres and reserves of eight million barrels of oil as well as 410 billion cubic feet of natural gas. Normally, when investing in energy companies it is preferable to invest in those where the reserves are heavily weighted to oil because of the higher margins that can be earned.

Nonetheless, the characteristics of Colombia's natural gas market will be extremely positive for Canacol.

You see, the Latin American country was forced to import natural gas for the first time in 2016 after decades of self sufficiency because of dwindling domestic supplies and growing demand. This has sparked a shortage of natural gas, which has allowed Canacol to lock in very favourable terms. That includes earning an average of ~US$4.75 per million of cubic feet of natural gas sold in Colombia, which is more than 40% higher than the spot price.

As a result, Canacol is receiving some very juicy netbacks, a key measure of profitability, for its natural gas production, which, for the third quarter 2017, were as high as US$23.46 for every barrel of oil equivalent produced. That is well above the netback being received by many companies operating in

North America. This includes **Peyto Exploration and Development Corp.** (TSX:PEY), which is considered to be one of the lowest-cost operators in Canada; it reported a netback of US$16.32 per barrel for the same period.

Canacol also continues to experience considerable success with its drilling program, making its 10th consecutive Colombian natural gas discovery in December 2017.

On an important note, Canacol divested itself of its Ecuadorean oil assets in December 2017 for US$36.4 million, bolstering its balance sheet and raising capital to be directed to expanding its Colombian natural gas business. This was a particularly positive move, because as those assets were producing what is known as tariff oil, which has a fixed price, there was little upside available once oil had rallied significantly.

The outlook for Canacol is quite positive.

The driller expects 2018 natural gas production to grow by up to 61% to 129 million cubic feet daily and fund its US$80 million capital budget from existing cash on hand and cash flow. That investment will fund the drilling of four exploration and appraisal wells as well as three development wells, which should see further discoveries and higher production.

So what?

Canacol is among the most appealing contrarian plays on natural gas and higher crude. The driller is well positioned to unlock considerable value for investors as it further cements its position as a leading player in Colombia’s natural gas market.

CATEGORY

1. Energy Stocks
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TICKERS GLOBAL

1. TSX:CNE (Canacol Energy Ltd)
2. TSX:PEY (Peyto Exploration & Development Corp)

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