Can This Natural Gas Producer Ever Bounce Back?

Description

It has been a tough start to 2018 for natural gas producers. The price of natural gas has tumbled 25% for the year to date, and despite falling inventories, there are signs that an upturn may be some time off. This has driven the price of natural gas producers lower. Driller **Painted Pony Energy Ltd.** (TSX:PONY) has plummeted 14%, while Canada's largest natural gas producer by volume, **Encana Corp.** (TSX:ECA)(NYSE:ECA), saw its stock fall by the same amount.

Nevertheless, there are signs that natural gas will eventually rebound, and the latest dip in Painted Pony's shares leaves it attractively valued.

Now what?

Painted Pony is focused the Montney in northern British Columbia, which is rated by many analysts as Canada's premier natural gas play. The company's properties have been assessed to have natural gas reserves of 1.1 billion barrels of oil equivalent, which have an after-tax value of $2.6 billion, or just under $16 per share. That valuation was independently determined using an average natural gas price of US$1.73 per million British thermal units (mmBtu) for 2018 and US$2 per mmBtu for 2019, which are both well below the current spot price of US$2.75 per mmBtu.

This highlights just how tremendously undervalued Painted Pony is by the market and the considerable potential upside that is on offer when natural gas rebounds.

Impressively, Painted Pony has been able to significantly grow production.

For 2017, the company's output almost doubled to 42,882 barrels daily. The driller was able to do this while reducing operating expenses, which, for 2017, were 6% lower year over year. That, along with higher natural gas prices during 2017, saw Painted Pony report a netback of $2.01 per thousand cubic feet (mcf) of natural gas produced, which was 16% higher than a year earlier.

General and administrative expenses for 2017 were also lower, dropping by 14% year over year; thatin conjunction with a higher netback, Painted Pony reported a 2017 net profit of $122 million comparedto a $52 million net loss in 2016.

Based on Painted Pony's 2018 guidance, the company's bottom line should continue to grow. At the bottom end of its guidance, production is forecast to grow by at least 42% year over year, which, coupled with Paint Pony's ongoing focus on reducing costs and higher natural gas prices, will give its earnings a solid lift.

Remarkably, that growth is expected to be achieved with a significant decrease in capital expenditures because of significantly improving efficiencies associated with drilling and well completions.

So what?

Painted Pony is an attractively valued natural gas producer which offers investors considerable potential gains because of the quality of its assets and the fact that the value of its reserves is significantly higher than its current price. Because of the improved outlook for natural gas, along with Painted Pony's ability to materially expand production, its cash flow and earnings will grow further in 2018, which should give its shares a healthy boost.

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