Canacol Energy Ltd. (TSX:CNE) Is Poised to Soar

Description

Natural gas prices have been depressed for a prolonged period and despite a short period of hope when they spiked sharply at the end of 2017 they have returned to close to their historic lows. This has weighed heavily on many upstream natural gas producers causing their share prices to fall sharply, seeing many down by 10% or more since the start of 2018. While the outlook for natural gas remains depressed despite some signs of growing demand one driller that deserves considerable attention is **Canacol Energy Ltd.** (TSX:CNE).

Now what?

Canacol owns and operates oil as well as natural gas assets located in the South American nation of Colombia. In recent years, Canacol has reduced its focus on oil as it pivots to becoming a leading producer of natural gas in the Andean nation. That has seen Canacol significantly bolster its natural gas reserves and expand its pipeline as well as gas processing infrastructure.

By the end of 2017, Canacol's reserves had grown to 103 million barrels of oil equivalent, composed of 89 million barrels of natural gas and 14 million of oil. This represents a 35% compound annual growth rate (CAGR) for its total petroleum reserves since 2009.

At the same time, production has grown at a healthy clip. For the first quarter 2018, total oil equivalent production was up by 23% year over year despite oil output declining by 29%. This is due to natural gas output surging by 37% because of Canacol's increased focus on boosting its presence in Colombia's natural gas industry.

At face value, this appears somewhat absurd given that the Latin American nation has a long history of being self-sufficient when it comes to natural gas.

However, rapid decline rates at mature fields and a lack of new discoveries in recent years coupled with a surge in demand has triggered a material supply shortfall in a country that has a rapidly developing economy and industrial base. This led the Colombian government energy planning commission to forecast that the nation will be running a significant natural gas supply deficit by 2023.

In response, Bogota initiated natural gas imports in the form of liquified natural gas (LPG) to meet the shortfall. It also saw the government introduce measures to promote natural gas production in Colombia. This includes providing considerable financial incentives to promote private investment in domestic natural gas exploration and production.

As a result, Canacol is receiving extremely favourable pricing for the gas it produces and transport to domestic markets. For 2018, the average contracted price it will receive is US$4.75 per million British thermal units (Mmbtu) net of transport costs which is almost double the North American spot price.

This gives Canacol a substantial financial advantage over its North American peers, helping to ensure that its operations are highly profitable. For the first quarter, the driller reported a netback of US$3.58 per million cubic feet (Mcf) of natural gas produced compared to around US$1.66 for **Painted Pony Energy Ltd.** and US$2.42 for **Peyto Exploration and Development Corp.**

And that, along with the low operating expenses in Colombia and Canacol's ability to expand production at a rapid clip, which sees 2018 natural gas output forecast to be at least 41% greater than 2017, will give its cash flows and earnings a solid lift.

Canacol is also experiencing considerable exploration success, having announced a number of natural gas discoveries since the start of 2018. These will boost the driller's reserves and production in an operating environment that sees it receiving a contracted price for the oil it produces and sells, which is considerable higher than the market price.

So what?

Upstream natural gas producers have been an unappealing investment for some time because of deeply depressed gas prices. However, because of the dynamics of Colombia's domestic market, is well placed to be exceptionally profitable. This makes it an attractive investment in a country where the degree of geopolitical risk has decreased significantly in recent years.

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