Get Ready for This Natural Gas Producer to Soar

Description

It has been a tough year for natural gas producers with prices whipsawing wildly since the start of 2018. After soaring to over US$4.60 per million British thermal units (MMBtu) due to [unseasonably cold weather] triggering a surge in demand, they have pulled back to US$3.69 per MMBtu because of growing supply.

This has hit natural gas stocks hard with many North American producers, like **Encana**, pulling back sharply over the last month. While the uncertainty and volatility surrounding natural gas makes many producers unappealing investments, **Canacol Energy** (TSX:CNE) has not been as sharply impacted, only losing 9% over that period. This is because Canacol is relatively immune to the considerable ambiguity surrounding the outlook for natural gas.

Local market dynamics give Canacol an advantage

Canacol owns and operates a range of natural gas assets across 1.3 million net acres in the Latin American nation of Colombia, where it has reserves of 113 million barrels of oil equivalent 88% weighted to natural gas. Because of specific local market dynamics, it is essentially not affected by the ongoing volatility impacting natural gas.

You see, Colombia is facing a significant natural gas shortage. The Andean nation, which was once self-sufficient, possessing considerable reserves of natural gas, had to start importing the fossil fuel in late 2017 because of a sharp decline in reserves and a notable uptick in demand. There is every sign that the supply shortage will continue for the foreseeable future. Colombia has not reported a significant natural gas or oil discovery since 1992, according to the Colombian Petroleum Association, while natural declines are causing production at existing aging fields to deteriorate.

Then there is the growing demand for the low-emission fossil fuel. A significant uptick in industrial and household demand is straining already limited supplies, while the government sees natural gas-fired power generation as a solution to addressing the growing shortfall of electricity production.

Even with Colombia allowing fracking, weaker oil and natural gas prices — along with security issues and other geopolitical risks — have deterred foreign investment in its petroleum industry. That — along with fears that there may be no new substantial natural gas discoveries — means that the current supply constraints will exist for the foreseeable future.

Profiting from inadequate supply and growing demand

Canacol, because of its successful efforts to re-position itself as a leading natural gas producer in Colombia, can take full advantage of these local market inefficiencies.

As a result, the driller has been able to secure pricing for the natural gas it produces, which is well above the spot price in North America. Currently, it has locked in take-or-pay contracted wellhead pricing of $4.80 per thousand cubic feet (Mcf) of natural gas sold, which is 33% greater than the spot price for natural gas.

This gives Canacol a significant financial advantage over those gas producers operating in North America. That becomes apparent when reviewing the driller's third-quarter 2018 results; it realized around US$5.05 per Mcf sold, which was more than double the $1.99 per Mcf received by Encana before gains from hedging contracts.

That means Canacol's operations are for more profitable than North American gas producers, as evidenced by its third-quarter netback of US$3.60 per Mcf sold, which is superior to those being reported by gas producers operating in Canada.

Why buy Canacol?

While Canacol's quality natural gas and oil assets, rising production, and solid profitability make it an appealing investment, it is its ability to contractually lock in gas prices that are higher than market which makes it particularly attractive. Because there is no sign that Colombia's domestic natural gas supply shortfall will ease any time soon, Canacol will continue to profit from these unique dynamics. This will not only boost earnings but also eventually its market value, making now the time to invest.

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