My Top Natural Gas Play for 2019

Description

Natural gas has been on the nose for investors for some time, having been caught in a near-decade-long slump. Despite claims that demand will soar because of the transition from coal-fired electricity to natural gas-fired power plants and growing demand in Asia, where Beijing is trying to eradicate coal as a source of energy, the fossil fuel has failed to perform. Even a sudden sharp spike in prices because of particularly cold weather, which saw natural gas almost reach US$5 per million British thermal units (MBTU), was unsustainable. The fuel has recently pulled back sharply to be US$2.98 per MBTU, well below its one-year peak of US$4.70 hit in late November 2018.

Weaker gas prices in Canada

The situation is even worse for Canadian natural gas producers where infrastructure bottlenecks are suppressing domestic gas prices fomenting a localized natural gas crisis. At the start of this week, the Henry Hub spot price was US$2.94 per MBTU, whereas the local Canadian AECO price was less than half, trading at US$1.21 per MBTU. This is having a sharp impact on the financial performance of natural gas producers operating in Canada.

There is one natural gas driller that is not only avoiding the impact of the deep discount applied to Canadian natural gas, but has minimal exposure to the ongoing natural gas slump. That energy company is **Canacol Energy** (TSX:CNE), which is focused on the exploration and production of natural gas in the Latin American nation of Colombia. The driller has gained almost 3% over the last month, despite the U.S. Natural Gas Fund losing a whopping 31% because of the sharp decline natural gas prices. This illustrates just how insulated Canacol is from the North American market price for natural gas.

Leading gas producer in Colombia

Canacol has amassed almost 1.3 million net acres in Colombia with the majority focused on natural gas exploration and production in the Lower Magdalena Valley in northern Colombia. It has reserves of 103 million barrels of oil equivalent, which are 86% weighted to natural gas. Those reserves are expected to grow by over 10 million barrels of oil equivalent because of additional discoveries made during 2018.

Colombia is suffering from an ever-worsening natural gas crisis. The nation, which was once self-sufficient, was forced to commence liquefied natural gas (LNG) imports in late 2017 to meet a growing supply shortfall, which has triggered an energy crisis in the Andean nation. Aging gas fields operated by **Chevron** and state-controlled **Ecopetrol S.A.** are suffering from marked declines in production, while there have been no major natural gas discoveries in Colombia for over a decade. This combined with rapidly expanding household and industrial demand for the fuel has led to an acute shortage, which will worsen over the course of 2019. Canacol is well positioned to benefit from this because its gas-producing fields are located near the Caribbean coast, which is among the worst-affected regions.

As a result, Canacol has been able to lock in some very favourable pricing for the natural gas it produces and sells domestically. The driller estimates that based on its current portfolio of 2019 natural gas sales contracts, it has locked in an average sale price, net of transportation costs, of around US$4.87 per MBTU sold. That represents a premium of US$1.89 per MBTU over the current Henry Hub price, giving Canacol a significant financial advantage over is peers operating solely in North America.

Why buy Canacol?

Because there is no sign of Colombia's natural gas crisis ending anytime soon, Canacol will continue to be able to lock in higher-than-market prices for the natural gas it produces and sells. That — along with a focus on expanding 2019 gas sales by a notable 65% compared to 2018 — will give its earnings a solid lift, which — along with an ongoing share buyback — will boost its market value.

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