Will Canadian Natural Gas Prices Rebound?

Description

There are claims that natural gas is due to rally, and the prolonged slump which has existed for nearly a decade will come to an end. After spiking to over US$4.60 per million British thermal units (MBTU) in early December 2018, because of unseasonably cold weather triggering a massive surge in consumption, natural gas has pulled back sharply to just over US$3.40 per MBTU.

Despite this recent decline, the fossil fuel is still trading well above the lows witnessed in 2016 during the last great commodity slump. That — along with a massive uptick in demand from Asia, notably China, as well as the push to replace coal-fired electricity with natural gas fired power plants — has prompted claims by analysts that natural gas producers are poised to soar.

Canadian drillers under pressure

This has had little positive effect on Canadian natural gas producers. Many, like **Peyto Exploration & Development** (TSX:PEY), have been heavily marked down by the market regardless of the increasing optimism surrounding the outlook for natural gas. Peyto alone has lost 40% over the last year, and there are signs that a recovery is a long way off in spite of rising demand for the low-carbon-emission fossil fuel.

Among the biggest drivers of the ever-growing optimism surrounding natural gas is the surge in consumption by China. There is no sign in sight that China's voracious demand for the fuel will end anytime soon.

Beijing has implemented a range of strategies aimed at aggressively arresting air pollution in the east Asian nation's cities. Central to this plan is the elimination of coal as a heating and cooking fuel. Beijing is also attempting to rein in the construction of coal-fired power plants and replace them with gas-fired installations. This, according to local industry sources, will cause natural gas consumption to grow by up to 8% annually between now and 2020, with some tipping that it will accelerate to even higher levels.

Domestic natural gas production, however, has not grown quickly enough to keep pace with demand, which — along with China's voracious appetite for the fuel — makes it heavily reliant on imports.

During 2018, the Asian nation received record natural gas imports, and there are signs that this could continue to grow if Beijing implements further fiscal stimulus to kindle manufacturing activity and economic growth.

This has sparked a massive effort to expand Canada's LNG export capabilities and is the reason for the $40 billion LNG Canada project in British Columbia being led by **Royal Dutch Shell**. That facility is forecast to produce first gas in 2025 and will go some way to alleviating the pressure on Canadian natural gas prices caused by a range of severe infrastructure bottlenecks. It is deficient transportation capacity created by a lack of natural gas pipelines which is primarily to blame for the discount applied to Canadian natural gas prices.

Those transportation constraints are very similar to the phenomena which caused the price of Canadian heavy crude to plummet, as localized supply gluts in Western Canada emerged due to a lack of pipeline exit capacity. For that reason, the current Canadian AECO spot price of US$1.38 per MBTU is almost a third of the Henry Hub price of US$3.48 per MBTU.

The emerging supply glut weighing on domestic natural gas prices is being exacerbated by Canadian natural gas production expanding at a rapid clip, including the booming Duvernay formation, where 2017 gas output shot up by 25% compared to a year earlier. The prolific Montney is also experiencing a similar boom.

Unattractive investments

Sharply weaker AECO prices have forced Peyto to shutter uneconomic production, causing its third-quarter 2018 natural gas output fall by 16% compared to a year earlier.

The wider AECO differential to Henry Hub pricing saw Peyto's realized price per thousand cubic feet (mcf) of gas sold before hedging fall by 51% year over year to $1.27 per thousand cubic feet of gas sold. That price was also 54% lower than the average Henry Hub price for the period, highlighting the financial disadvantage that the deep discount applied to Canadian natural gas is creating for local producers.

As a result of weaker AECO pricing, Peyto's third-quarter netback fell by 3% year over year to $2.63 per mcf, and it reported a worrying 34% decrease in net earnings, which totalled $29.5 million for the quarter.

Until the severe transportation and storage bottlenecks are dealt with the wide differential between domestic natural gas pricing and the benchmark Henry Hub price will continue. That makes Canadian natural gas producers like Peyto unattractive investments.

CATEGORY

1. Energy Stocks
2. Investing

TICKERS GLOBAL

1. TSX:PEY (Peyto Exploration & Development Corp)

PARTNER-FEEDS

1. Msn
2. Newscred
3. Sharewise
4. Yahoo CA

Category

1. Energy Stocks
2. Investing

Date
2025/08/24
Date Created
2019/01/22
Author
mattdsmith