Does the Latest Natural Gas Price Spike Make it Time to Buy ARC Resources Ltd. (TSX:ARX)?

Description

Unseasonably cold weather has caused natural gas prices to spike once again. Energy companies that are focused on producing the fossil fuel have attracted considerable interest. One Canadian oil and gas producer garnering significant attention is **ARC Resources** (TSX:ARX).

Successfully growing production and reserves

ARC embarked on a difficult transformation, which has seen it become a leading Canadian natural gas producer and report some solid 2018 results. Key to that performance was an impressive reserve-replacement ratio of 245%. During the year, ARC added 118 million barrels of oil equivalent to its reserves to finish 2018 with proven and probable reserves of 879 million barrels, which was 5% higher than a year earlier. Those reserves are 77% weighted to natural gas with the remainder made up of oil, condensate, and natural gas liquids.

ARC's reserves were independently assessed to have an after-tax value $14 per share, which is over 30% higher than the driller's current market price, highlighting the considerable potential upside available to investors.

The company has proven that it can grow production at a steady clip, comfortably meeting its 2018 guidance. For 2018, ARC's total oil equivalent output grew by 8% year over year to 132,724 barrels daily with a significant lift in the volume of condensate and natural gas liquids driving that increase. It also reported an impressive operating netback, which, at $17.12 per barrel of oil equivalent produced before commodity hedges, was a healthy 9% greater than 2017.

Despite those solid operational results, ARC's net income declined by 45% year over year to $214 million primarily because of higher exploration, evaluation, depreciation, and amortization expenses as well as a $64 million foreign exchange loss.

Improved outlook

The recent spike in natural gas as well as oil prices coupled with ARC's upbeat 2019 guidance bodes well for the company's performance. Total forecast production of 135,000-142,000 barrels of oil equivalent daily is between 2% and 7% greater than ARC's reported 2018 production, while operating expenses are expected to fall by up to 11%. Those projections combined with analysts predicting firmer oil and natural gas prices bodes well for ARC's financial performance and should see cash flow as well as earnings grow.

While weaker Canadian natural gas prices remain a risk, with the wide differential between AECO pricing and the Henry Hub benchmark weighing on domestic producers, ARC has mitigated that through a range of strategies. Key is a focus on establishing commodity price hedges combined with selling the oil and gas produced across multiple price hubs. This means ARC anticipates that less than 10% of its 2019 sales revenue generated by natural gas will be exposed to AECO pricing.

Is it time to buy ARC?

The wide differential between Canadian AECO gas prices and the North American Henry Hub benchmark has been weighing on domestic producers for some time, making them unappealing investments. Higher natural gas and a narrower price differential has reduced some of that impact. When that is considered along with ARC's marketing strategy aimed at minimizing its exposure to AECO pricing, its growing reserves, higher forecast production, and solid netbacks, the company shapes up as an interesting contrarian play on natural gas.

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