



This Natural Gas Stock Is on Sale: Now Is the Time to Buy

Description

Despite it appearing that natural gas is caught in a long-term slump, many drillers continue to attract the attention of investors because of claims that the fossil fuel is poised to surge. While there are signs that the slump [won't end](#) anytime soon, Colombian-focused natural gas producer **Canacol Energy** ([TSX:CNE](#)) appears heavily undervalued by the market, providing the opportunity for investors to access outsized returns.

Growing reserves

Canacol recently reported that it had increased its proven and probable petroleum reserves to 98 million barrels of oil equivalent, which is 11% greater than at the end of 2017. A key driver of this increase was the driller's outstanding reserve-replacement ratio of 232%. Those reserves are 95% weighted to conventional natural gas and have been determined to have an after-tax net present value of US\$1.1 billion, or \$6 per share, which is 30% greater than Canacol's current market value.

This illustrates that the driller's share price is heavily discounted by the market in comparison to the value of its primary asset: its oil natural gas reserves. It also highlights that there is considerable upside available for investors seeking to bolster their exposure to fossil fuels and attain outsized returns on their investment capital.

Nonetheless, it is easy to understand why the market continues to mark down Canacol's stock.

Heightened geopolitical risk

Because the driller operates solely in Colombia, there is a perception that it is exposed to considerable operational as well as geopolitical risk. Recent events in the Andean nation, including attacks on the operations of gold miners and vital energy infrastructure, have made investors nervous. This hasn't been assisted by the economic woes of the administration of President Duque, which has found itself battling a widening fiscal deficit and weak current account.

Those fiscal issues, which have been predominantly caused by weaker oil prices because crude is Colombia's single largest export, have worsened since the failure of his tax reform. This has sparked speculation that the Andean nation is facing a ratings downgrade by international ratings agencies, as Bogota battles to balance its budget and generate additional sources of revenue.

However, much of the market's trepidation appears overbaked. Canacol has not experienced any significant security issues at its operations, and the government has stepped up efforts to ensure the safety of Colombia's vital energy infrastructure, including oil and natural gas producers operating in the country.

The perceived degree of risk regarding Colombia's internal security environment is dated. The ground-breaking 2016 peace deal between the largest armed leftist guerilla group, the FARC, along with their subsequent demobilization, has substantially [ratcheted down](#) the degree of risk facing the petroleum industry.

Energy shortage leads to favourable pricing

Canacol is also uniquely positioned to benefit from Colombia's emerging energy crisis. A lack of major natural gas discoveries combined with aging fields and growing demand means that the Andean nation is experiencing a natural gas shortage.

In fact, demand for the fuel has grown so significantly in recent years that it now makes up over a fifth of Colombia's total energy basket, and Bogota anticipates that unless there are some major finds soon, it will be running a notable supply deficit in less than five years. There is no sign of the shortage ending anytime soon.

Colombia has had to start liquified natural gas (LPG) imports to meet the growing shortfall in supply. This is being worsened by the crisis in neighbouring Venezuela, which, according to some sources, is responsible for 78% of Colombia's total natural gas imports.

Why buy Canacol?

For those reasons, Canacol has been able to contractually lock in favourable terms for the natural gas it produces. This includes take-or-pay fixed well-head pricing of US\$4.75 per thousand cubic feet (Mcf) sold, which is almost double the North American spot price of US\$2.84 per million British thermal units. This gives Canacol a distinct financial advantage over its peers operating solely in North America.

As a result, those higher contracted prices combined with low operating expenses sees Canacol generating industry-leading operating netbacks. For 2019, it is forecasting a netback of US\$3.75 per Mcf, which is more than a US\$1 greater than many North American upstream natural gas producers. That — along with growing production, which is expected to expand by 65% in 2019 to 215 million cubic feet daily — will give earnings a solid lift, acting as a powerful tailwind for its stock.

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