Cash In on Colombia's Emerging Energy Crisis by Buying This Natural Gas Driller

Description

Colombia's energy crisis is worsening at a rapid rate. A combination of weak oil and natural gas prices, security issues, and tight capital markets have led to a dearth of investment in Colombia's economically crucial energy patch. This has not only caused production to decline but led to a lack of major oil and natural gas discoveries in a country which is heavily dependent on energy exports as a crucial driver of economic growth.

What is causing the crisis?

These conditions have caused an energy crisis, which has become so severe that in 2017 Colombia was forced to start importing liquefied natural gas as a combination of growing demand and constrained supply led to domestic shortages. This is a disappointing outcome for a nation that was once self-sufficient in natural gas and a major regional exporter.

A combination of aging natural gas fields, where a marked uptick in decline rates is impacting production, and an absence of major hydrocarbon discoveries has sparked considerable supply constraints. That is being exacerbated by the escalating political and economic crisis in Venezuela, including U.S. sanctions against the Maduro regime, because that nation was responsible for providing around 78% of all of Colombia's natural gas imports. Then there is a growing domestic demand for natural gas, which is a crucial fuel for many industries and residential use; this has sparked shortages in various domestic markets — notably, on Colombia's Caribbean coast.

While it has been predicted by the Colombian Petroleum Association that 2019 investment by oil companies will increase by 14% year over year to US$5 billion, most of that capital will be directed towards oil rather than natural gas. That is because the fossil fuel is caught in a protracted slump, which means the low margins associated with its production makes oil a more profitable option.

How to benefit

This confluence of events has created favourable market conditions for **Canacol Energy** (TSX:CNE), which pivoted its operations to become one of the largest privately owned onshore producers of natural gas in Colombia. In fact, by the end of 2018, it had become Colombia's premier natural gas producer and explorer second only to state-owned integrated energy major Ecopetrol in terms of natural gas output. Aside from Ecopetrol, Canacol has little to no competition in Colombia, which — along with the emerging natural gas shortage — gives it a competitive advantage that many of its peers operating in North America can't match.

For 2018, Canacol reported that natural gas sales surged by 41% year over year, while funds flow from operations expanded by an impressive 62%. It also announced that its proven and probable natural gas reserves by the end of 2018 had expanded by 11% to 559 billion cubic feet (bcf).

The company has proven that it is capable of expanding production at a healthy clip. Its 2018 hydrocarbon output grew by 19% compared to a year earlier to 20,947 barrels of oil equivalent daily, even after factoring in the sale of its oil assets in Ecuador. This can be attributed to a 40% increase in natural gas production to 116,616 million cubic feet (mmcf) daily.

Canacol anticipates that for 2019, once the Promigas pipeline expansion is completed mid-year, gas sales will increase to 215 mmcf daily, which is a 90% increase over the 113.3 mmcf per day averaged over the course of 2018. This will give Canacol's earnings a healthy lift.

More importantly, Colombia's growing natural gas crisis means that it has been able to secure wellhead sales prices that are well in excess of the North American market price. For January and February 2019, Canacol reported that it had received an average wellhead price of US$4.99 per thousand cubic feet (mcf) sold. This was not only US$0.04 per mcf higher than the average realized price of US$4.95 per mcf for the fourth quarter 2018 but is around 85% greater than the North American Henry Hub benchmark price.

That highlights the considerable profitability of Canacol's operations. It also shields the driller from the impact of the ongoing slump in natural gas and gives it a financial advantage over its peers focused solely on operating in North America, particularly Canada, where the AECO benchmark is less than half of the Henry Hub price. There is every sign that higher domestic natural gas prices will continue for the foreseeable future because of tight supplies of the fossil fuel in Colombia.

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