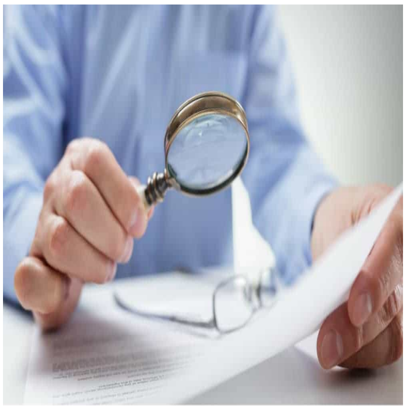

This Is the Only Natural Gas Stock I Would Ever Buy

Description

Natural gas remains weak, despite claims from some analysts that a rally is due because of firmer fundamentals. While demand for the clean fossil fuel grows at a rapid clip, it is highly unlikely that this will be enough to cause prices to recover.

You see, supplies of natural gas are growing at a rate which exceeds demand growth, and it is this which has been responsible for the prolonged price slump, despite a marked uptick in consumption.

Nevertheless, specific characteristics in various regional energy markets mean that natural gas producers are receiving prices that are significantly higher than the North American Henry Hub and Canadian AECO natural gas prices.

Considerable opportunity in Colombia

One such market is Colombia, which is battling an emerging energy shortage. The Andean nation has been facing a chronic shortage of natural gas, which forced it to start importing the fuel in 2017 to meet growing demand, particularly on its Caribbean coast. In April 2019, Bogota announced plans to expand its import capacity, as local supply constraints forced the price ever higher.

A combination of aging offshore natural gas fields, declining production, and dearth of new discoveries is responsible for triggering the crisis. This, according to some sources, is causing natural gas supply to decline by around 12% annually. It has triggered escalating fears of a growing lack of energy security in Colombia, causing Bogota to introduce a range of initiatives aimed at securing greater natural gas supplies.

This has created a significant opportunity for upstream natural gas explorer and producer **Canacol Energy** (TSX:CNE), which has 1.2 million net acres of petroleum concessions in Colombia. The driller, since 2016, has been pivoting its operations to focus on the natural gas it moves to take advantage of the emerging energy crisis and natural gas shortage in the Latin American nation.

Canacol has amassed 59 billion cubic feet of natural gas reserves and boosted production to 130 million cubic feet (MMcf) daily; it's become the leading independent natural gas producer in Colombia.

The existing supply constraints have allowed Canacol to contractually lock in take-or-pay well-head pricing of US$4.97 per thousand cubic feet (Mcf) of natural gas sold, which is roughly double the Henry Hub price. This is also more than five times greater than the AECO benchmark for natural gas produced in Canada.

This gives Canacol a distinct financial advantage over its peers operating solely in North America and especially Canada. There are signs that domestic natural gas prices will continue to trade at a substantial premium to the North American spot prices, because it will be some time before supply shortages and Colombia's emerging energy crisis ease.

In fact, Bogota is seeking to expand the amount of electricity generated by gas-powered turbines, as it battles brownouts and weaknesses in the country's electricity grid. That will only cause demand for the fossil fuel to keep expanding at a solid clip.

This allows Canacol to generate some impressive margins, including an operating netback of US$4.03 per Mcf and an 81% operating margin. For the first quarter 2019, even after reducing operating expenses by $0.55 per Mcf, **Painted Pony Energy** reported an operating netback of US$1.86 per Mcf sold, which is less than half of Canacol's netback. That highlights the financial advantage that Canacol possesses and how the planned 65% increase in daily production to 215 MMcf will give earnings a solid boost.

Foolish takeaway

The long-awaited rally in natural gas is unlikely to occur because production is more than adequately keeping pace with demand. That combined with the wide differential between AECO and Henry Hub prices makes drillers focused on Canada unappealing investments.

Nonetheless, for the reasons discussed, Canacol is an attractive play on natural gas, and it is uniquely positioned to profit from the weaknesses in Colombia's domestic energy market and emerging crisis. When Canacol reports that it has successfully brought the targeted additional production online and boosted its reserves, its stock will rally strongly.

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Date
2025/08/17
Date Created
2019/07/02
Author
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