The Only Natural Gas Stock I Would Ever Buy

Description

Natural gas remains caught in a prolonged slump with the North American Henry Hub price falling to just over US$2.20 per MMBtu. Despite growing consumption of natural gas, as it replaces coal as the fossil fuel of choice due to its low emissions and claims by some pundits that it is poised to bounce back because of falling supply growth, the outlook remains poor.

While that makes North American natural gas stocks unappealing investments, there is one producer, **Canacol Energy** (TSX:CNE), that is poised to soar, even if natural gas remains weak.

Favourable market conditions

Canacol operates in the Latin American nation of Colombia, where an emerging energy crisis caused by diminishing natural gas supplies and rapidly growing demand has created a favourable local environment for natural gas producers.

In 2017, after imports from Venezuela virtually came to a halt and production continued to decline at Colombia's main offshore gas fields, the Andean nation was forced to commence LNG imports. There are signs that those supply constraints will continue for the foreseeable future and could even worsen.

Some analysts are speculating that a worsening supply shortage coupled with greater demand for the fossil fuel will trigger a sharp increase in LNG imports.

Those considerable supply constraints, combined with rising decline rates at Colombia's aging offshore fields and lack of new major natural gas discoveries, have allowed Canacol to lock in a price net of transportation costs of around US$4.97 per MMBtu sold. That is significantly higher than the market price received by natural gas producers in North America — more than double the Henry Hub benchmark.

Using that forecast price and projected average 2020 natural gas sales volumes of 205 million cubic feet daily, which is roughly 37% greater than forecast 2019 sales, Canacol expects to generate EBITDA of US$205 million for the year. Such a significant increase in earnings will give Canacol's market value a solid lift, and there are signs that it could even double from its current share price based on the driller trading with an enterprise value of over seven times EBITDA.

By having secured take-and-pay contracts with a price that represents a significant premium for the natural gas sold, Canacol has been able to eliminate much of the uncertainty surrounding its operations. This is because it has virtually eliminated the unpredictability and volatility associated with natural gas prices, which form a key risk for upstream natural gas explorers and producers.

That means Canacol should be trading at a considerable premium to many of its peers, which continue to be impacted by the uncertain and poor outlook for natural gas.

Growing natural gas reserves and sales

Canacol's proven and probable natural gas reserves will continue to expand with it having made multiple natural gas discoveries during 2019 and completing a range of well-development activities.

The driller's ability to grow its reserves is highlighted by its 2018 proven and probable reserves-replacement ratio of 232%, illustrating that Canacol is adding hydrocarbon reserves at a greater rate than they are being depleted by its production.

For 2020, Canacol has forecast capital spending of US$114 million with US$72 million being directed to exploration drilling and another US$19 to well development and maintenance activities.

That, combined with an exploration success rate, will ensure that Canacol's natural gas reserves continue to grow. This will allow Canacol to meet the considerable leap in demand for the fuel anticipated once the Promigas pipeline between its gas fields in the Middle and Lower Magdalena Basins and Colombia's second-largest city, Medellin, is completed in 2023.

Canacol is expecting to double its natural gas sales to over 300 million cubic feet daily. That would give its EBITDA a solid lift, to potentially as high as US$398 million, lifting its market value and adding further weight to the belief that Canacol stock will double.

Foolish takeaway

Canacol is a very attractively play on the unique market conditions that exist in Colombia, creating the opportunity to sell natural gas at a contracted price, which is significantly higher than the North American benchmark. There is every indication that as Canacol's access to local energy markets improves and sales volumes increase, the driller's EBITDA will expand significantly, potentially causing its market price to double.

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Author
mattdsmith