Top Canadian Natural Gas Stocks of 2023

Description

Natural gas is a non-renewable mixture of methane and other hydrocarbons that forms naturally underground and is often used as fuel. In Canada, natural gas is used for generating heat and electricity. Compared to other hydrocarbons, it burns cleaner and is easier to export globally.

But are natural gas companies good investment opportunities? Let's take a look.

What are natural gas stocks?

Natural gas stocks are those companies involved in the production, processing, and sale of natural gas. Also included are companies that produce natural gas machinery and equipment, and those that provide support services like logistics and staffing.

Natural gas stocks fall under the umbrella of the energy sector given the close relationship between natural gas and other petroleum products.

Companies involved in natural gas can be classified broadly as either:

1. **Upstream**: Deal primarily with exploration and initial production of natural gas.
2. **Midstream**: Deal primarily with transportation of natural gas.
3. **Downstream**: Deal primarily with refining and distribution of natural gas.

As a commodity, the price of natural gas is elastic, meaning that it is heavily influenced by supply and demand, which can be cyclical. As a result, natural gas companies have a higher beta, a measure of market volatility. Other risks to note include political/regulatory risk for mining sites and geological/environmental risks from operations.

The natural gas industry often experiences large tailwinds during times of inflation due to rising commodity prices. As energy prices soar, natural gas companies can enjoy higher revenues, better margins, and improved earnings, which can translate to a higher valuation and share price.

Top natural gas stocks in Canada

Here are some of the top natural gas stocks on the Toronto Stock Exchange (TSX), in order of highest market cap.

Company	Description
Suncor Energy (TSX:SU)	Suncor is an integrated oil and gas company with interests in oil sands, natural gas, and renewable energy exploration, production, refining, supply, and trading.
Cenovus Energy (TSX:CVE)	Cenovus is an integrated oil and gas company with crude oil and natural gas operations in Canada and the U.S.
Tourmaline Oil (TSX:TOU)	Tourmaline is a crude oil and natural gas exploration and production firm operating primarily in Western Canada.

Suncor Energy Inc.

Suncor is one of Canada's larger integrated energy companies. The company's operations include oil sands development, production, and upgrading; offshore oil and gas exploration; petroleum refining, and distribution and sales, both to wholesale and retail markets through its PetroCanada label. Suncor has also expanded into low-emission and renewable sources of energy like hydrogen, ethanol, wind, and solar.

Suncor's natural gas segments include supply, trading, load management, transportation, storage, and producer services. Most of Suncor's natural gas is extracted at basins located in Western Canada, Colorado, and offshore drilling in Eastern Canada.

Although Suncor sold off the majority of its natural gas assets in 2013, in 2018 it became a 37% owner of Canbriam Energy, an exploration and production company of liquids rich natural gas with vast natural gas reserves.

Cenovus Energy Inc.

Cenovus is an integrated oil company, currently engaged in the production of crude oil and natural gas, with production and extraction operations in Alberta and refining operations in the U.S. The company operates through oil sands, conventional, offshore, manufacturing, and retail segments. Refined petroleum products exported by Cenovus include diesel, gasoline, asphalt, and natural gas liquids.

Cenovus' natural gas assets are held under its conventional segment, which holds interests in various natural gas processing and electricity generation facilities. The company's natural gas operations are located in Western Canada, within the Elm worth-Wapiti, Kaybob-Edson, Clearwater and Rainbow Lake operating areas in Alberta and British Columbia.

Tourmaline Oil Corp.

Tourmaline engages in natural gas and crude oil exploration, development, and production in Western Canada's Sedimentary Basin. Compared to the previous companies, Tourmaline is more of a "pure-play" natural gas stock and ranks as Canada's largest natural gas producer, and the fifth largest in North America. Eighty percent of Tourmaline's current production is natural gas.

The company's Canadian exploration and production operations span three core areas: the Alberta Deep Basin, NEBC Montney, and Peace River Triassic Oil. The company is highly active in the natural gas export market, delivering to numerous U.S. and international gas importers, including participation in the Gulf Coast liquefied natural gas (LNG) export market.

Investing in Canadian natural gas stocks

Globally, Canada ranks high in terms of the production (4th) and export (6th) of natural gas, with a small number of integrated oil & gas companies accounting for the majority of output.

Canadian's looking to buy domestic natural gas stocks should begin their search in the energy sector of the TSX. From there, it is important to determine if the company under consideration is involved primarily in natural gas as a pure-play or operates as an integrated oil and gas company.

The former derives most of its revenues from natural gas, whereas the latter deals with a broad range of petroleum products, such as crude oil. This is important to note if you only want exposure to natural gas stocks instead of the broader energy sector.

When considering Canadian natural gas stocks, many of the same considerations for fundamental analysis and valuation that apply to the energy sector should be considered:

1. Is the company's balance sheet healthy? What is the current ratio and long-term debt to equity ratio? Is there negative shareholder equity?
2. Has the company consistently grown quarterly revenues and earnings year over year? If so, at what rate?
3. Are the company's gross and operating margins positive and ample?
4. How does the company's enterprise value-to-EBIDTA ratio compare with that of peers in its sector?
5. What are the company's price-to-book, price-to-sales, price-to-free-cash-flow, and price-to-earnings ratios, and how do these compare to peers in its sector?
6. What does the company's return on assets, return on equity, and return on invested capital ratios look like?
7. Does the company have a decent cash runway and sufficient cash flow for long-term operations?
8. Has the company run afoul of any environmental regulations recently and historically?
9. Does the company attempt to hedge its exposure to commodity price fluctuations?
10. Does the company pay a dividend? If so, how many years of consecutive dividend payments has it made? Is the current payout ratio sustainable and not excessively high?
11. Has the company grown dividends consistently? What is the five-year dividend growth?

Are Canadian natural gas stocks right for you?

Investing in Canadian natural gas stocks is higher on the risk-reward spectrum compared with more “boring” sectors like consumer staples or industrials. Natural gas stocks also tend to have higher betas, which makes them more volatile compared with the overall market. Because they are energy stocks, natural gas stocks form a substantial portion of the TSX already, so investors should be cautious to not overweight them if they already hold Canadian index funds.

Like most energy sector stocks, natural gas stocks may also prove to be a good defensive holding against high inflation. One of the main drivers of inflation is a rise in the price of energy commodities, including natural gas. When prices rise, companies that produce, process, and sell natural gas can generate stronger revenues, as the value of stored inventory on their balance sheets improves.

A risk of investing in natural gas stocks is their susceptibility to commodity prices, especially if they take a downturn (like when crude oil hit negative prices during the COVID-19 crash). Drastic swings in the cost of energy commodities can affect the balance sheets and future earnings of natural gas companies. While these companies can hedge these risks via the use of futures and forward derivatives, there is no guarantee that this is 100% effective.

TICKERS GLOBAL

1. TSX:CVE (Cenovus Energy Inc.)
2. TSX:SU (Suncor Energy Inc.)
3. TSX:TOU (Tourmaline Oil Corp.)

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Date
2025/08/11
Date Created
2022/09/27
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