2 Risks Energy Investors Should Be Worried About in 2014

Description

From American energy independence to Canada's looming condensate boom, 2014 is shaping up to be another exciting chapter for the North American energy industry. However, two trends could be a hidden risk for investors this year.

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1) America is declaring its energy independence
The United States is in the midst of a quiet revolution.

Thanks to new technologies like hydraulic fracturing and horizontal drilling, millions of barrels of previously unrecoverable oil and gas are now being pulled out of the ground across the country. And according to estimates provided by the International Energy Agency, U.S. oil production could surpass OPEC member Saudi Arabia by the end of 2015.

But American energy independence is bad news for Canada's oil and gas sector. Every extra barrel of oil that the U.S. pulls out of the ground it doesn't important from abroad. And this is displacing Canadian production.

Already this surging output is wreaking havoc on energy prices. In Alberta, the price of AECO natural gas is trading at less than $4.50 per mmBTU – the lowest in the world. And Canadian oil prices trade at a steep discount to other North American benchmarks. This will all impact the industry's top-line.

This will force investors to dial back their growth expectations. **Suncor** (TSX:SU, NYSE:SU) is leading the way in this regard. Since taking the helm over a year ago, new Chief Executive Steve Williams has abandoned his predecessor's growth targets, scrapped the Voyageur upgrader megaproject, and vowed to return more cash to shareholders.

Natural gas giant **Encana** (TSX:ECA, NYSE:ECA) has taking similar measures. Low commodity prices have forced the company to slash capital spending, cut its dividends, and sell off assets. Expect this theme to continue throughout the rest of the oil patch.

2) The 'Achilles' heel' of North American energy revolution
The main challenge for energy producers will be actually moving all of this production to market. As

economist and bestselling author Jeff Rubin told *The Motley Fool Canada* last summer, 'The Achilles' heel of North American energy independence, whether it's trying to double oil sand production in Alberta or double shale oil production in the Bakken, is that we don't have the infrastructure to move that increased production.'

Oil sands production is expected to grow 10% next year further straining takeaway capacity. And while this was a big story in 2013, expect the situation to only get more dire in the new year.

The export route south is blocked for now. **TransCanada's** (TSX:TRP, NYSE:TRP) proposed Keystone XL pipeline, would ship 830,000 barrels per day, or bpd, of Alberta bitumen to refineries on the U.S. Gulf coast. However, the project is still in regulatory limbo waiting for approval from the Obama Administration. And as Foolish contributor Nelson Smith pointed out earlier this month, approval is far from a sure thing.

The contentious **Enbridge** (TSX:ENB, NYSE:ENB) Northern Gateway pipeline received a big boost last month when the project received a conditional recommendation for approval from regulators. If approved the pipeline will cost $6.5 billion to construct and ship 525,000 bpd of bitumen from Edmonton, Alberta to Kitimat, British Columbia for export to Asia. But this project is still far from getting the go-ahead.

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In lieu of pipeline, rail has become a major player in the energy industry for the first time since the days of the Rockefellers. According to Statistics Canada, the amount of oil shipped by rail has increased three fold over the past two years. But recent derailments, most notably the disaster at Lac Megantic, Quebec last summer, has put the industry into the public spotlight.

If one or two pipeline proposals are rejected, then new production growth could outstrip takeaway capacity by 2017. This would be a further discount on oil sands bitumen taking a bite out of the industry's top-line.

Foolish bottom line
The key to investment success in 2014 may be to avoid the upstream producers. Rather, it will be the downstream – the companies that move and refine all of this new production – that are poised to make a fortune next year.

CATEGORY

1. Investing

TICKERS GLOBAL

1. TSX:ENB (Enbridge Inc.)
2. TSX:SU (Suncor Energy Inc.)
3. TSX:TRP (TC Energy Corporation)

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Author
rbaillieul

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