The Hidden Factor That Could Hurt Canada’s Energy Producers

Description

The price of oil has continued to climb in July due to escalating tensions in both Iraq and Israel. West Texas Intermediate has surpassed the $100 per barrel mark, settling in at around the $103 level. Brent crude, which measures the price of oil in Europe, is even higher, recently flirting with $115 per barrel before pulling back slightly to the $108 range.

Obviously, this is good news for U.S.-based producers. Thanks mostly to new fracking technology, the U.S. has significantly increased its domestic production, with North Dakota, Colorado, and Texas leading the way. The U.S. has cut down the amount of oil it imports dramatically, from 64% of all consumption to under 35%. Certain analysts are predicting the nation may become energy independent in just a few years.

On the surface, the strong price of crude would appear to be positive for Canadian producers as well. Most companies in the space rose when the market first got wind of tension in the Middle East, but now many have fallen back down again. If the long-term outlook on crude prices is still bullish, why aren’t investors piling in?

It’s simple. The Canadian dollar is rising, which acts as a huge headwind for producers who have input costs in Canadian dollars and a product that’s sold in U.S. dollars.

Since the end of March, when the Canadian dollar bottomed out below 89 cents compared to the U.S. dollar, our currency has risen to almost 94 cents. A 6% gain doesn’t seem like much on the surface, but when it largely cancels out the recent price increase in crude, producers who export are going to have a problem.

If investors are looking to minimize this damage, they should look at oil companies that have large gas station networks inside Canada. If this trend continues, companies who sell the majority of their production to Canadian consumers will end up outperforming.

Suncor (TSX: SU)(NYSE: SU) is the obvious choice. The company merged with **Petro-Canada** back in 2009, giving it a network of more than 1,300 convenience stores that are hungry for its gasoline. This type of vertical integration ensures there’s always a customer for all of Suncor’s businesses, from its oil production to its refineries, and minimizes its exposure to the U.S. dollar.

Imperial Oil (TSX: IMO)(NYSE: IMO) is another terrific choice. The company is a diversified oil producer with facilities across the country, the majority of which are located in Alberta. It also has a network of gas stations under the Esso brand, totaling more than 1,850 from coast to coast. One in five vehicles on the road are powered by Esso gasoline.

Husky Energy (TSX: HSE) is good play for investors looking to minimize currency fluctuations. The company has a network of more than 500 service stations, all of which are located west of Toronto. It is also diversifying away from its Alberta roots, by starting production in Asia. Considering the higher price for crude in Asia, this could end up being a terrific move by the company.

CATEGORY

1. Investing

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2. NYSEMKT:IMO (Imperial Oil Limited)
3. TSX:IMO (Imperial Oil Limited)
4. TSX:SU (Suncor Energy Inc.)

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