3 Reasons to Bet on Canadian Energy Producers Like Suncor Energy Inc.

Description

In recent weeks, much has been written about the decline in oil prices. Many observers believe these low prices are here to stay. This could be particularly bad news for Canadian producers – after all, Canada is a high-cost jurisdiction, meaning that as oil prices decline, foreign producers can survive a lot longer.

But there are reasons not to be so pessimistic, and below we demonstrate why, using **Suncor Energy Inc.** (TSX: SU)(NYSE: SU) as an example.

1. Some financial relief

Suncor has just recently reported financial results for the third quarter of 2013, and the numbers show what kind of headwinds the company is facing. American oil prices are down 8% year over year, and Canadian heavy oil prices are down 13%. But there are two sources of financial relief.

One is lower royalty payments, which come as a result of lower pricing. On a consolidated basis, lower royalties saved Suncor roughly $200 million relative to the third quarter of last year.

Also, the Canadian dollar has gotten a lot weaker, which benefits Canadian producers like Suncor. Last year, the Canadian dollar traded for US$0.96 (average for Q3). This year, that number dropped to $0.92 for the quarter, and today is around $0.88. So this helps mitigate Canada's cost disadvantage.

2. Problems in the United States

There is no other way to put it: American oil production is booming. Last year alone, production increased by more than 11%, driven by production from shale oil. But there are problems with this story.

The main issue is shale oil's rapid decline rate. According to one estimate, production from the average shale oil well declines by 50%-78% after the first year. As a result, producers must keep drilling just to stand still. And if these wells are economic, that sinks companies into a even bigger financial hole.

A perfect example is **Linn Energy LLC** (Nasdaq: LINE), which since 2010 has spent $6.3 billion more than it has made, while paying out a fat dividend. As a result, it has built up $9.6 billion in debt, which exceeds the company's market capitalization. Meanwhile, Suncor has been relatively conservative. Its debt only stands at about $6.6 billion — not much for a company valued at nearly $60 billion.

3. Problems elsewhere

Saudi Arabia made a big splash recently by saying that it can deal with low oil prices for a while. And it can, because it saved much of its oil revenue. Other countries, such as Iran, Venezuela, and Russia, have not been as responsible, and cannot afford such a price drop.

As a result, one of two things could happen. Lower oil prices could lead to chaos in these countries, as well as decreased investment and declining production. Or more likely, these countries will pledge to cut production if Saudi Arabia agrees to do the same. That would be good news for Canadian producers like Suncor.

Besides Suncor, there is another energy company in Canada that should sail through the current environment. It is featured in the free report below.

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