Will There Be Further Carnage in the Energy Patch in 2015?

Description

The ongoing rout in crude prices has brought the spotlight firmly back on Canada's energy patch with West Texas Intermediate or WTI — the key benchmark price for the majority of Canada's oil producers — now hitting $49 per barrel, its lowest price in over five years. This has already forced a number of operators to slash dividends and capital expenditures, and is a key catalyst for the frenzied sell-off of energy stocks.

But despite some analysts claiming softer crude prices may only be for the short-term, there are two worrying trends already emerging in the patch that investors need to be wary of.

First, significantly softer crude prices look they are here to stay for the foreseeable future.

While there is a distinct lack of clarity around how long it will be before crude prices rebound, they certainly appear here to stay for the short-to-medium term.

On the demand side, two of the key drivers of declining global demand for crude are the economic crisis faced by the Eurozone and China's slowing economy. And it is unlikely for a variety of structural reasons there will be any improvement on this front any time soon.

On the supply side, it is rapidly growing U.S. oil production from the shale oil boom coupled with Saudi Arabia's unwillingness to cut production which is creating as supply glut.

While the significantly lower crude prices being experienced are well below the breakeven price for many shale oil wells, with the majority ranging between $60 and $90 per barrel, it will take some time for operators to wind down uncommercial production. This is in part attributable to the logistics involved as well as many of the operators having established hedges that allow them to offset lower crude prices.

Meanwhile, the Saudis appear determined to continue driving crude prices lower as a means of regaining market share and it is uncertain how long they will continue to do so. Already, there is considerable confusion as to the oil price being used for the national budget with estimations ranging from $55 to $80 per barrel. There are also signs the Saudis will relentlessly pursue this policy despite the pain this is causing other OPEC members such as Venezuela.

This makes the outlook for crude prices over the short to medium term difficult to forecast, with 2015 WTI futures ranging between $48 and $55 per barrel.

Secondly, financial estimates in the patch are predicated on substantially higher oil prices.

This is a particularly worrying trend, with a number of energy companies having based their 2015 guidance — including cash flows, capex and dividend forecasts — on significantly higher oil prices than we are currently seeing.

Among these companies, the most concerning is **Canadian Oil Sands Ltd**. (TSX:COS), which has used WTI of $75 per barrel for its 2015 guidance. But even at this price it lacks sufficient free cash flow to cover its dividend, which it has already slashed by 43%, clearly indicating that with crude prices continuing to fall another cut is on the way.

Other intermediate oil producers including **Penn West Petroleum Ltd.** (TSX: PWT)(NYSE: PWE) and **Lightstream Resources Ltd.** (TSX LTS) have assumed an average price for WTI in 2015 of $65 per barrel. But even this may not be low enough when the prices of 2015 WTI futures are accounted for.

This indicates there will be further dividend and capex cuts in the patch as oil companies struggle to adjust their operations to the current difficult operating environment.

But one company that stands out as being well positioned to cope with the current operating environment is **Crescent Point Energy Corp.** (TSX:CPG)(NYSE:CPG). Already it has boosted its hedging position with over 50% of its 2015 crude production hedged at prices above $90 per barrel, while reducing capex by 28% and services costs by 10%.

But more importantly, Crescent Point has a solid balance sheet with one of the lowest levels of leverage among its peers with net debt of a mere 1.2 times operating cash flow. This endows it with considerable financial flexibility and in conjunction with its hedges bodes well for the sustainability of the dividend.

CATEGORY

1. Dividend Stocks
2. Energy Stocks
3. Investing

TICKERS GLOBAL

1. NYSE:VRN (Veren)
2. TSX:VRN (Veren Inc.)

Category

1. Dividend Stocks
2. Energy Stocks
3. Investing

Date

2025/09/10
Date Created
2015/01/09
Author
mattdsmith