Why Oil Prices Won’t Be Rebounding Anytime Soon, Part 2

Description

In an article published Monday, I argued that oil prices will remain depressed for quite a while. The reason is quite simple: oil companies are still increasing production, even though they are cutting capital spending. The Monday article highlighted three examples.

Below we highlight two more, and discuss what this means.

1. Canadian Natural Resources

On Monday, I highlighted how **Canadian Natural Resources Ltd.** (TSX:CNQ)(NYSE:CNQ) planned to cut spending by 30% in 2015 while still achieving 9% growth. Then CNRL updated its numbers.

In an update released Monday, CNRL announced more across-the-board spending cuts. The total budget was slashed by another 28%, and now stands at barely 50% of 2014 spending. Yet the company *still* expects oil production growth of 5% this year.

Interestingly, the Horizon oil sands project barely suffered any cuts this time around, and now accounts for nearly half the company’s budget. This is a perfect example of why production growth is still strong — many companies have already spent massive amounts of money on big projects, so cutting them off now would make no sense (CNRL built out Horizon from 2005 to 2008).

2. Cenovus Energy

It should surprise no one that **Cenovus Energy Inc.** (TSX:CVE)(NYSE:CVE) is growing production. The company has some of the most efficient oil sands projects in Canada, at Foster Creek and Christina Lake. These territories come with “competitive supply costs” between $40 and $45 per barrel.

For 2015, the company is targeting production growth of 9%, despite cutting its budget by 15%. And there are other similarities between Cenovus and its peers. Longer term spending is being cut in favour of shorter-term projects. The company is focusing on efficiency improvements and cost reductions. Cenovus also has various hedging programs in place to protect itself.

So what does all this mean?

This shouldn't be all that surprising. Commodity-based companies tend to view production growth as sacrosanct, and any declines usually send a very bad signal. As Judith Dwarkin, director of research at ITG Investment Research, said in *The Globe and Mail*, "No one wants to disappoint their shareholders and say we're cutting production. That's death. So it's a bit of doing what they can to stay afloat during a difficult period and hoping somebody else shuts in." The story is similar in the United States.

As a result, there's really only going to be one way production decreases: some producers will have to go under. And until that happens, you can't count on an oil price rebound. You should be very careful in this sector.

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2. NYSE:CVE (Cenovus Energy Inc.)
3. TSX:CNQ (Canadian Natural Resources Limited)
4. TSX:CVE (Cenovus Energy Inc.)

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