This Chart Should Scare Canadian Energy Investors

Description

There's a common belief that oil prices will rebound sooner or later. After all, with prices so low, producers are sure to lose money, and will be forced to cut output.

But if you look at what oil companies are actually doing, the story is very different. Below we take a look at a couple of big examples, then take a look at what you should do.

Continental Resources provides some clues

Continental Resources Inc. is the quintessential American oil producer. The company focuses mainly on the Bakken play in North Dakota, but also owns some property in Oklahoma. It has grown production dramatically in recent years, nearly quadrupling output from 2010 to 3Q2014. And of course, the recent oil slump has battered the company's share price, which is down by nearly 50% since late August.

In late December, Continental announced a US$2.7 billion budget for 2015, down more than 30% from 2014. But output is expected to increase by 16% to 20%! What's going on?

The one chart that should worry Canadian oil producers the most

So how is Continental coping with such low oil prices? The chart below speaks volumes.

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Continental Resources Rate or Return Projections - Investor Presentation
Continental Resources Rate or Return Projections.
Source: Investor Presentation

As you can see, the company is able to make roughly 8% return on investment in the Bakken with oil at US$45 per barrel. This isn't a great return, but is not low enough to make the company stop drilling. But Continental also expects Completed Well Costs (CWC) to drop by 15% in today's oil price environment. As a result, that rate of return goes up to nearly 15%.

What's the point? Well, with oil prices at US$45, Continental has no reason to stop drilling. And the story is similar for other American producers. For instance, **EOG Resources Inc.** claims it only needs US$40 oil to earn a 10% return at its prime locations, including the Bakken and Eagle Ford.

Meanwhile, Canadian oil producers are facing higher costs, and thus banking on a price rebound. For example, **Suncor Energy Inc.** is forging ahead with its Fort Hills oil sands project, even though it requires US$90+ oil prices to earn a sufficient return.

So what should you do?

First of all, you can be forgiven for not owning any energy companies. Producers are clearly digging in for a war of attrition, and as a result the price slump may last a lot longer than anyone expects.

But if you do want to own an oil company, you should choose one with low-cost production of its own. One strong candidate is **Crescent Point Energy Corp.** (TSX:CPG)(NYSE:CPG), the largest player in the Canadian Bakken. Crescent Point has very strong economics, in some cases needing only US$40 to break even on new production.

That said, there's one other energy company that should be on your watchlist. It's also The Motley Fool's top stock pick for 2015. You can read all about it in the free report below.

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