Why Oil Production Won’t Fall for Awhile

Description

With oil prices having fallen so far, producers are having to grapple with a new reality. But surprisingly few companies are producing less than they did last year. Why is that the case? And with budgets cut so much, does that mean we will see shrinking production down the road? Most importantly, what does this mean for oil prices, the producers, and stock prices? Below we take a look.

You can’t ignore debt

There are plenty of reasons why producers are not cutting output. One big factor is the stigma that goes with production cuts — remember, no one wants to work for a shrinking company, in any industry. Furthermore, some big projects are so close to completion that canceling them would be pointless. And as these projects come online, production grows. Meanwhile, many companies are finding ways to increase efficiency, and are now producing more at lower cost.

All of these factors likely play some role. But there’s another big one: debt. According to a report from the Bank for International Settlements (BIS), energy companies’ outstanding debt grew to $800 billion this year from less than $200 billion in 2003. And in order to service this debt, producers must keep the spigots going.

OPEC numbers back this up

On Monday of last week, OPEC gave a nice boost to oil prices by trimming its supply outlook, while boosting its demand outlook.

But if you think the industry is actually cutting output, think again. According to the report, production in the United States is set to increase by 6.4% in 2015, to 13.6 million barrels per day. Up in Canada, where costs are typically higher, production is still expected to increase by 3.3%. In a market that’s oversupplied by at least a million barrels per day, we really need those production numbers to go *down* , not up. But that won’t be happening any time soon.

So what does this mean for investors?

As an investor, there's one thing about the energy sector you must remember above all else: this is a war of attrition.

In other words, producers will not cut output until they absolutely have to. And that probably means some companies will have to go bust before oil prices go up. So if you're thinking of investing in energy, make sure it's in a company that can withstand some pain for at least a year.

One company in particular should stand out: **Suncor Energy Inc.** (TSX:SU)(NYSE:SU). Suncor has an incredibly strong balance sheet, low-cost operations, and a big refining/marketing business, which should shield the company from lower oil prices. The company has also made tremendous strides in improving efficiency.

For these reasons, Suncor is a great way to bet on energy. But before you do, make sure you have plenty of patience. Because if the BIS and OPEC reports are right, this will take a while.

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1. Editor's Choice

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