Why I'm Not Buying Any Oil Stocks Just Yet

Description

Last week, dozens of oil companies gathered in Toronto for the CAPP Scotiabank Investment Symposium. It was an opportunity for executives to explain how they are coping with such low oil prices.

So, what messages did investors receive at the conference? Below I discuss why I'm not buying any energy stocks right now.

Companies are coping

Let's take a look at **Cenovus Energy Inc.** (TSX:CVE)(NYSE:CVE) and its comments at the conference. Cenovus uses an extraction method called Steam-Assisted Gravity Drainage (SAGD) to produce heavy oil. The process requires drilling two parallel horizontal wells and injecting steam into one of them. The steam heats the bitumen underneath, allowing the second well to scoop it up.

You would think this is a high-cost operation. After all, SAGD requires drilling two wells instead of one. Furthermore, SAGD comes with high decline rates, meaning that a well's production falls off dramatically after just a couple of years. Fortunately for Cenovus, you would be wrong. According to CFO Ivor Ruste, its two main SAGD projects require only US$40-45 oil prices to break even.

So, Cenovus can keep expanding these two projects, even at current prices. To pay for this expansion, it sold an additional $1.5 billion in equity. And once oil prices move beyond US$60, the company plans to ratchet up its growth plans even more.

Cenovus wasn't the only firm able to cope with low oil prices. For example, Nalcor Energy, an offshore driller owned by the Newfoundland & Labrador government, has breakeven prices of US$20-35. Others are coping as well.

Why I'm not buying energy stocks today

Executives have been saying this kind of thing for months. They've been saying something else too: that the oil rout is really just a temporary setback.

This makes no sense to me. If oil prices really are set to recover, that means someone is set to cut production. It means some companies aren't able to cope. Yet everyone seems to be keeping the taps on. So, even after all these months, I still have no idea who the high-cost producers are.

Here's the worst part: stock prices seem to be pricing in a recovery. Even if these companies are making money at US$50 oil, investors will likely lose, unless we really do see a big rebound. It's no wonder companies like Cenovus are selling more of their stock to the public.

At this point, I would wait until there's some blood in the streets before stepping in. Until then, I just don't see how oil prices recover enough for you to make money.

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1. Energy Stocks
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1. Editor's Choice

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