



## Is the Fracklog a Genuine Threat to Oil Prices?

### Description

It is becoming increasingly difficult to predict the outlook for crude with any certainty despite some industry insiders being confident of prices rebounding later this year. Now, there is more data from the U.S. that has left the outlook for crude prices even gloomier, with analysts now concerned about the U.S. “fracklog.”

### Now what?

The fracklog is an inventory of all the uncompleted wells in the U.S. that have been drilled, but have yet to be fracked. Essentially, this means they have yet to commence pumping oil. According to Bloomberg, this is keeping daily production of about 332,000 barrels of crude in the ground, which is equivalent to 21% of the current global oversupply.

However, there is a rationale for producers to do this. Crude prices are at their lowest point in six years and storage costs have gone through the roof. In recent months, with the U.S. oil inventory now at its highest point in 80 years, storage costs have gone from a few cents a barrel to over a dollar.

Despite the potential threat this potential production poses to oil prices, I don't believe that it will have any meaningful impact.

This is because with oil companies slashing budgets for drilling and well development, oilfield service companies have been rapidly scrambling to cut costs to survive the downturn. Oil companies have been laying off large numbers of employees, retiring rigs (as well as other equipment) at a rapid rate, and putting off the acquisition of new rigs and other essential equipment.

The end result will be a shortage of rigs and other infrastructure as well as drilling expertise when oil companies scramble to boost production after oil prices finally rebound.

This will push up drilling and fracking costs and limit the rate at which production can grow. In fact, it will take some time for companies to complete those wells to the point where they are producing at full capacity, thereby mitigating the risk these additional barrels of crude pose to oil prices.

## So what?

The carnage in the energy patch and the impact of sharply low crude prices on Canada's economy will continue for at least the remainder of this year.

However, I doubt that the additional production capacity in the fracklog will have any meaningful long-term impact on oil prices. This is good news for investors and supports the view that the collapse in oil prices has created a once-in-a-lifetime buying opportunity. Investors should focus on acquiring those companies with low debt and high-quality assets that are well positioned to weather the current oil rout.

Among those companies **Crescent Point Energy Corp.** (TSX:CPG)(NYSE:CPG) and **Vermilion Energy Inc.** ([TSX:VET](#))([NYSE:VET](#)) stand out as the best opportunities. Both have healthy balance sheets, low degrees of leverage, and portfolios of high-quality oil assets.

Crescent Point has also hedged a considerable portion of its 2015-16 oil production, mitigating much of the impact of sharply low crude prices on its financial performance. And Vermilion is able to access Brent oil pricing, which currently trades at a 14% premium to WTI, giving it a financial edge over many of its North American peers.

## CATEGORY

1. Energy Stocks
2. Investing

## TICKERS GLOBAL

1. NYSE:VET (Vermilion Energy)
2. NYSE:VRN (Veren)
3. TSX:VET (Vermilion Energy Inc.)
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