Why These Oil Companies Will Survive While Their Shareholders Suffer

Description

Now that oil is trading for close to US$60 per barrel, stocks like **Suncor Energy Inc.** (TSX:SU)(NYSE:SU) and **Canadian Natural Resources Ltd.** (TSX:CNQ)(NYSE:CNQ) are as popular as ever.

So, are these stocks right for your portfolio?

Why these companies will survive

Oil prices fell close to US$40 per barrel back in January and again in March. When that happened, the very survival of all Canadian energy companies came into question. After all, the Canadian oil sands are well known to be a high-cost region.

These concerns were completely overblown. Both Suncor and CNRL are known to be very efficient producers, and are excellent at minimizing costs. Better yet, input costs (like labour and equipment) fell with the oil price. Providing yet another boost, the low Canadian dollar has made Canadian oil more competitive. Tellingly, both companies actually increased production in the first quarter, despite the depressed oil price.

Meanwhile, U.S. producers have been cutting back dramatically. According to **Baker Hughes**, oil rig counts have fallen for 22 straight weeks, and are at their lowest levels since September 2010. And the profitability of U.S. shale oil drillers has been called into question, most notably by hedge fund manager David Einhorn.

So, even if oil prices fall again, U.S. drillers will cut back again simply because they have to. This creates a nice price floor for companies like Suncor and CNRL, who have proven they can survive through such conditions.

Why these stocks are expensive

Amazingly, even as oil prices have fallen so far, these companies' stock prices have held relatively steady. To illustrate, since the beginning of 2014 Suncor shares have fallen by only 1.3%. CNRL shares have actually risen by 6%. Meanwhile, the price of oil has fallen by 38% over this time. As a result, both companies trade as if oil sells for more than US$90, according to **BMO**.

Clearly these two companies are popular, and for good reason. They are large, strong, low-cost producers. They have strong balance sheets and stable management. They're very capable of surviving low oil prices. This is precisely why they're so expensive.

Why you should avoid these stocks

While oil prices have had a nice run in the past month, there are signs that this won't last. **EOG Resources**, the biggest U.S. shale oil producer, has plans to resume some drilling. Other producers have indicated similar plans.

Industry figures back up this story—the Baker Hughes rig count shows that rigs are declining at a slower rate. Bloomberg Intelligence anticipates that if oil reaches US$65, an extra 500,000 barrels could come online. That could keep a ceiling on prices for a long time.

To make a long story short, both Suncor and CNRL should have no trouble surviving. But oil prices are unlikely to rebound enough to justify these high stock prices. So, your best bet is to look elsewhere.

CATEGORY

1. Energy Stocks
2. Investing

POST TAG

1. Editor's Choice

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2. NYSE:SU (Suncor Energy Inc.)
3. TSX:CNQ (Canadian Natural Resources Limited)
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