Where Are the Production Cuts From Canada's Oil Producers?

Description

When oil prices went into free-fall late last year, most analysts expected a recovery by the second half of 2015. As the thesis went, low oil prices would force producers to cut back on output, especially in the high-cost oil sands. This would inevitably lead to a price rebound. But of course that hasn't happened at all. Despite severely depressed oil prices, Canada's top producers have kept the spigots open.

	Oil Production (bbl/d)		
	2014	2015 guidance	Growth
Suncor Energy Inc. (TSX:SU)(NYSE:SU)	534,900	572,500	7.0%
Canadian Natural Resources Ltd. (TSX:CNQ)(NYSE:CNQ)	531,000	582,000	9.6%
Cenovus Energy Inc. (TSX:CVE)(NYSE:CVE)	203,493	203,500	0.0%
Crescent Point Energy Corp. (TSX:CPG)(NYSE:CPG)	128,458	149,750	16.6%

There are a few reasons why production numbers continue to defy the odds. We take a closer look below.

Reduced costs

As would be expected, energy companies have cut costs dramatically in this environment. This is partly due to falling prices for equipment and labour. Energy companies are also making cuts that could have been made in years past, but simply weren't necessary at the time.

Suncor has been especially proficient at reducing costs. In its most recent quarter, cash costs per barrel in the oil sands decreased by 18% year over year. Meanwhile, CNRL decreased per-barrel operating costs by 12%. American producers have seen similar results.

Sunk costs

If you look at the annual cash costs of any big oil producer, you'd figure the company is very profitable. For example, Cenovus had cash operating expenses of just $12.48 per barrel last quarter. But these numbers exclude upfront costs, and when making this adjustment, oil production becomes much more uneconomic. This creates a problem, especially in the short term.

Many of these upfront costs have already been spent and cannot be recovered. So, oil producers have no choice but to plough ahead anyways. Even projects that haven't yet been completed—such as Suncor's Fort Hills and CNRL's Horizon—aren't being stopped, partly because they've come so far already. Thus, you shouldn't expect a big drop off in production, even in some of the highest-cost regions.

Optimism and a refusal to quit

This might be the main reason why output hasn't slowed down. Shutting off production, only to turn it back on again later, is extremely expensive. So, if a company believes an oil recovery is on the horizon, it's better to just keep production flowing in the meantime.

And oil executives are very optimistic about a recovery. Take Crescent Point as an example. In the second quarter, the company refused to cut its dividend, and even made a big acquisition at the same time, believing that oil prices were rebounding. Only when the oil price turned south again did the company slash its dividend. Suncor's CFO also made some very optimistic projections earlier this year.

There's a point to all this: production is unlikely to be cut any time soon. And that means oil prices will stay low for quite some time. That's bad news for any energy producer.

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Date
2025/07/21
Date Created

2015/09/01
Author
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