Canada’s Energy Sector Is Off to a Brutal Start in 2016

Description

Just two weeks into 2016 and the U.S. stock market is off to its worst start ever. A big factor that’s been pushing stocks down has been the price of crude. The global crude benchmark is below $30 a barrel for the first time since 2004. That plunge also weighed on Canadian oil producers, but it was far from being the only issue to surface since the start of 2016.

Cheapest crude in the world

While all eyes are on the top-traded oil benchmarks of Brent and WTI, which are the global and U.S. benchmark prices, Canadian crude has quietly slipped in to the abyss. Western Canadian Select, Canada’s main oil benchmark price, fell below $20 a barrel in early 2016. That is the lowest price since the benchmark began tracking Canadian crude in 2008 and that makes it the cheapest crude in the world.

This price is forcing Canadian oil producers such as **Baytex Energy Corp.** (TSX:BTE)(NYSE:BTE) and **Canadian Natural Resources Limited** (TSX:CNQ)(NYSE:CNQ) to shut off some of their oil pumps because the production is no longer economic. So far, the two companies have shut in 35,000 barrels a day of production, which is about 4% of their combined production as of the third quarter. More shut-ins could be on the way because a growing number of producers are losing money on each barrel they produce.

Explosive news rattles the sector

If low oil prices weren’t bad enough, the sector was rocked with news last week of earthquakes and an explosion. A magnitude 4.8 quake rattled Alberta and was believed to have been caused by the hydraulic fracturing activities of Spain’s Repsol, which had to suspend operations in the area for a couple of days.

This was the second major quake in less than a year and is one the more than 300 seismic events to be recorded in Alberta over the past year. What's most concerning about this quake is that it has been linked to the actual hydraulic fracturing of a well–not to disposal wells, where most U.S. fracking earthquakes have been linked.

Worse yet was news of an explosion at **Nexen Energy's** Long Lake oil sands facility in Alberta, which killed one worker and injured another. This is the second major incident at the Nexen site in the past year, with the other being an oil spill from a pipeline leak, causing one of North America's largest oil-related spills on land.

Problems in the pipeline

That spill and others like it are one of the big factors leading to increased pushback for proposed oil sands pipelines by **Kinder Morgan Inc.** (NYSE:KMI) and **Enbridge Inc.** (TSX:ENB)(NYSE:ENB), both of which suffered another setback last week.

Kinder Morgan was told that it hasn't met any of the five conditions that British Columbia established before it would approve the pipeline. Meanwhile, Enbridge's pipeline lost a key court battle after the B.C. Supreme Court ruled that the province didn't properly consult First Nations. These setbacks will make it even harder for either pipeline to get built.

Investor takeaway

Investing in the energy sector isn't for the faint of heart because the risks are multiplied. Right now, however, those risks are not only multiplied, but amplified by low oil prices. This will lead to a lot more volatility until oil is priced above levels where producers can make economic returns.

If there's one key takeaway for investors, it is this: if you choose to invest in Canadian oil stocks, find ones that are less risky. That means companies that have strong balance sheets, geographic and asset diversification, and come with a relatively clean safety and environmental records. Those are the companies best suited to make it through the dark days and fuel strong returns when the new normal emerges.

CATEGORY

1. Energy Stocks
2. Investing

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1. NYSE:CNQ (Canadian Natural Resources)
2. NYSE:ENB (Enbridge Inc.)
3. NYSE:KMI (Kinder Morgan Inc.)
4. TSX:BTE (Baytex Energy Corp.)
5. TSX:CNQ (Canadian Natural Resources Limited)
6. TSX:ENB (Enbridge Inc.)

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Author
mdilallo