What if Oil Doesn't Rebound This Year?

Description

Global oil giant **BP plc (ADR)** (NYSE:BP) isn't planning for higher oil prices until at least the second half of 2016, when surplus production starts to get rebalanced. "We are very bearish for the first half of the year," CEO Robert Dudley said this week.

BP isn't the only major organization anticipating further pain. The U.S. Energy Information Administration doesn't forecast the oil glut to be absorbed until next year. For now, global oil production still outpaces consumption by roughly 1.7 million barrels a day.

While many companies can withstand six to 12 more months of low prices, some are already in a tight position. Debt loads for energy companies are the highest in over a decade, adding a high degree of uncertainty to the future of many firms, even if oil prices do rise eventually.

According to *Bloomberg*, falling oil has pushed the "average debt burden among Canadian energy firms to the highest since at least 2002, and another measure of their ability to make interest payments to the third-lowest level in a decade."

For example, **Trican Well Service Ltd.** (Canada's largest provider of fracking services) recently revealed that it may suspend its business operations to avoid breaching its debt covenants. Others have already hit a wall. **Southern Pacific Resource Corp.** filed for bankruptcy in January, **Connacher Oil and Gas Ltd.** was handed over to its lenders, and **Lightstream Resources Ltd**. is teetering on the edge of insolvency.

Which companies are in trouble?

Larger players, many of which still have plenty of access to financing, will likely continue to operate even if oil prices remain low for years. The best positioned of these companies may even dedicate some cash to buying up defunct competitors' assets.

"Some of the integrated E&P players are actually swimming in cash and need to figure out how to spend a liquidity war chest," said DBRS, a credit rating agency. "If there are M&A activities, those witha significant liquidity war chest will be in a better position to pursue."

The next companies to fall will likely be smaller, highly indebted operators with little recourse other than bankruptcy. For example, **MEG Energy Corp.** (TSX:MEG), once a $10 billion company, has seen its market cap drop to just $700 million. Its long-term debt is now over 16 times bigger than its operating cash flow in the past 12 months.

Worse yet, its biggest properties are located in Canada's oil sands. According to **Toronto-Dominion Bank**, "virtually no oil sands projects can cover overall costs, including production, transportation, royalties, and sustaining capital, with U.S. benchmark crude below $30 a barrel."

Other companies that are facing crushing debt loads and deteriorating cash flows include **Paramount Resources, Ltd.** (TSX:POU), **Penn West Petroleum Ltd.** (TSX:PWT)(NYSE:PWE), and **Enerplus Corp.** (TSX:ERF)(NYSE:ERF).

If you're bottom picking the industry because you expect oil prices to rise long term, be careful with smaller companies with limited financing options, because even if your thesis is right, they may not stay solvent long enough for you to benefit.

CATEGORY

1. Energy Stocks
2. Investing

POST TAG

1. Editor's Choice

TICKERS GLOBAL

1. NYSE:BP (BP)
2. NYSE:ERF (Enerplus Corporation)
3. TSX:ERF (Enerplus)
4. TSX:POU (Paramount Resources Ltd.)
5. TSX:TCW (Trican Well Service Ltd.)

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