Why You Should Buy Canadian Oil Stocks When Oil Is $30 Per Barrel

Description

Oil prices continue to surprise investors in the worst ways possible. On February 11, oil set yet another milestone—by dropping below US$27/bbl, levels not seen since 2003. While this may be bad news for owners of oil stocks, it's an opportunity to investors with cash on the sidelines.

One thing is certain: nobody knows where oil will end up in 2016. **Morgan Stanley**, for example, is now predicting average oil prices in the high $20/bbl range for 2016. This contrasts with **RBC** and **TD Bank**, which are forecasting $40/bbl and $47/bbl average prices for 2016, respectively.

Regardless of who is correct, the simple fact is that oil prices below $30 are simply not sustainable over the long term. While oil may in fact plunge significantly in the near term, the $30 level is a good point to start buying high-quality energy names as market fundamentals will lead to prices rising from this level over the mid to long term.

North American oil production can't sustain itself at these price levels

Non-OPEC oil production has already been responding strongly to low oil prices, and this reaction is set to increase. In 2015 non-OPEC production grew by 1.4 million barrels per day, down from 2.1 million barrels per day in 2014.

In 2016 the IEA estimates that non-OPEC production will decline by 600,000 barrels per day, and RBC estimates that these declines could be as high as 800,000 barrels per day. These declines are supported by low prices and should help to offset new supply coming from OPEC producers, which will in turn allow overall supply to remain stable or shrink, while demand continues to grow and eat up the current surplus (which is estimated to be 1.6 million barrels per day in 2016).

Currently, U.S. producers have overall breakeven costs (including capital expenditures) of around $30/bbl. Some are much higher, and most firms are bleeding cash quickly. One consultancy group estimates that the funding gap for U.S. producers in 2016 will grow to a massive US$102 billion.

This means that these businesses are spending US$102 billion more on capital expenses and interest payments than they are taking in. Canadian producers have capital budgets that require, on average,

$45/bb. This means that in both Canada and the U.S., capital expenses are set to come off even more if prices remain low.

Since U.S. producers have production that declines quickly, constant reinvestment is needed to maintain production, and the current environment does not allow for that. If prices stay low, there is also the risk that banks could tighten up financing, which could lead to more bankruptcies.

With this in mind, while prices could fall over the near term, they likely can't stay at these levels for long.

Suncor and Crescent Point are good ways to play a recovery

For investors who are risk-conscious, **Suncor Energy Inc.** (TSX:SU)(NYSE:SU) and **Crescent Point Energy Corp.** (TSX:CPG)(NYSE:CPG) are good ways to play a rebound.

Suncor benefits from downside protection through its large refining and marketing segment, which accounted for 46% of cash flow in Q4 2015. Suncor's refining segment has grown cash flow significantly as its oil sands segment's cash flow declined significantly, acting as a hedge. This is because crude oil is the feed stock for refining operations, and as oil plunges, so do a refineries costs.

At the same time, Suncor is heavily weighted to oil sands production (even more so after the recent **Canadian Oil Sands** purchase). This means Suncor is poised to rebound as oil prices do.

Crescent Point offers similar downside protection. Currently, Crescent Point has 34% of its 2016 oil production hedged at prices of around US$59 per barrel. In addition to this, Crescent Point has the option to monetize its 2017 and 2018 hedge book this year, which could raise another $130 million to support cash flows.

Crescent Point is positioned in some of the most economic oil plays in North America and should rebound substantially once prices recover.

CATEGORY

1. Energy Stocks
2. Investing

TICKERS GLOBAL

1. NYSE:SU (Suncor Energy Inc.)
2. NYSE:VRN (Veren)
3. TSX:SU (Suncor Energy Inc.)
4. TSX:VRN (Veren Inc.)

Category

1. Energy Stocks
2. Investing

Date
2025/08/16
Date Created
2016/02/13

Author
amancini