Goldman Sachs Group Inc. Says Buy These Oil Companies

Description

According to **Goldman Sachs Group Inc.** (NYSE:GS), oil prices could be entering a “Goldilocks scenario.” At $35 a barrel, many shale producers can keep pumping given that selling prices are slightly above production costs. Still, Goldman thinks that the current price is low enough to discourage companies from initiating expansion projects.

Limited supply growth could lift oil to $55-60 a barrel by 2017. “We view our second-quarter 2016 oil outlook as an idealistic Goldilocks scenario,” Goldman’s report said. “$35 a barrel WTI is not too high and not too low but just right–above cash costs but keeping a too-early shale restart at bay.” It expects oil to average $38 in 2016 and $57.50 next year.

On its list of recommended stocks are Canadian producers **Cenovus Energy Inc.** (TSX:CVE)(NYSE:CVE) and **Encana Corporation** (TSX:ECA)(NYSE:ECA). Should you take a look?

There’s reason to believe in higher oil prices

Kuwait, a major oil exporter, recently called for $50 per barrel by the end of 2016, citing “increased demand and shrinking supply.” Right now, global oil production is about two million barrels per day above consumption. By 2017, the EIA expects this gap to close and be completely eliminated by the end of the year. The last time the market was completely balanced, oil was at $100 a barrel.

While it may take time for oil to regain its previous highs, most analysts are expecting prices to rebound over the long term. Even the historically conservative World Bank believes oil will steadily rise over the next decade.

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World Bank Oil Forecast. Image Source: OilPro.com

Are Cenovus and Encana safe ways to play the rebound?

Even if oil moves higher, that doesn't necessarily mean Goldman Sachs's picks are your best options. Let's take a look at its two top Canadian picks.

First, Encana Corporation. In the past few months, the company has cut its 2016 capital budget by 55%, reduced its workforce last year by over a third, and reduced its production focus to just four core properties. Drastic moves like these helped Encana reduce its debt by roughly $2 billion last year; over 75% of its remaining long-term debt is not due until at least 2030. It also has access to $3.5 billion in fully committed, unsecured, revolving credit facilities.

Not only has it improved its financial position, but management has taken measures to permanently improve its business mix. By focusing on just four core areas (Eagle Ford, Permian Basin, Montney, and Duvernay), the company's production profile should slowly shift towards oil rather than natural gas. Natural gas (which is much less profitable) will likely comprise less than 50% of production by 2018, down from 82% in 2014. Encana looks poised to not only survive the current downturn but compound profits as prices slowly rebound.

Second, Cenovus Energy. Despite low oil prices and a lack of hedging programs this year, Cenovus is well positioned to survive the current bear market. According to CEO Brian Ferguson, "even if Brent crude prices remain in the $40-per-barrel range through 2016, we believe we can continue to fund our sustaining capital program, growth projects that are nearing completion, and our current dividend level."

This year, only 15% of production is hedged, allowing for significant swings in earnings based on changes in oil prices. For every $10 increase in oil prices, cash flow increases by a whopping $620 million. Wherever oil prices go, expect Cenovus shares to follow.

If Goldman Sachs's prediction for oil prices comes to fruition, both Encana and Cenovus look like reliable ways to profit.

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