Are Oil Markets Rebalancing? What Does This Mean for Energy Investors?

Description

There are growing signs that global oil markets are rebalancing, and it is this which saw crude break the psychologically important US$50 per barrel mark recently. Even if markets rebalance, which is critical to the survival of the energy patch, there are signs it may be too little too late for many smaller, struggling oil companies.

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In fact, of even greater concern are signs that any recovery in oil prices may be short-lived and that further upside is limited.

Now what?

According to consulting firm McKinsey, the oil futures market indicates that a balance between supply and demand is emerging. This can be attributed to the oil outages that, to date, have helped to shrink the global supply glut to the tune of three million barrels daily, thereby supporting higher oil prices.

However, while this a positive development for the energy patch, what it doesn't reveal is that newly emerging balance between supply and demand does not bode well for higher prices.

You see, while prices may be almost double their February low, oil futures indicate that between now and 2020, they won't move much higher than US$55 per barrel. And this can be attributed to ongoing overcapacity on the supply side along with a lack of strong growth in demand.

Furthermore, the majority of supply outages that triggered the rally in crude were temporary, and there are signs that global oil supplies will continue to rise.

Already, Canadian oil production that was affected by the fires is starting to come back online, and Nigeria is focused on boosting output after the outages caused by the attacks of the Niger Delta Avengers. Then you have Iran, Iraq, and Libya all seeking to grow oil production in order to boost desperately needed government revenues and drive economic growth.

Another important consideration is that as the price of oil rises, North American shale oil companies will recommence drilling and development activities, boosting their output and placing further pressure on oil prices.

So what?

These factors certainly don't bode well for a significant bounce in crude and will leave many heavily indebted oil companies struggling to survive. For many, US$50 per barrel is just not high enough to generate sufficient cash flow in order to meet their financial obligations and pay down debt.

Nonetheless, one of the most vulnerable, **Penn West Petroleum Ltd.** (TSX:PWT)(NYSE:PWE) has been able to extract itself from its financial difficulties by recently completing a remarkable $1.1 billion in asset sales.

Surprisingly, despite this gloomy outlook, Canada's largest integrated oil company **Suncor Energy Inc.** (TSX:SU)(NYSE:SU) appears to be positioning itself to make further acquisitions. Since the slump in crude began, Suncor has made $9 billion in acquisitions that included purchasing an additional 10% interest in the controversial Fort Hills oil project and boosting its stake in Syncrude from 12% to 53%.

Now Suncor has recently completed an equity raising to the tune of $2.5 billion, which it has stated will allow it to reduce debt and increase balance sheet flexibility for opportunistic growth-oriented transactions in the future. I would not be surprised to see Suncor take advantage of weak asset prices and make further accretive purchases to grow its oil reserves and production, leaving it in a stronger position than when the slump in crude began.

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