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Alberta energy firms face harsh new reality as oil's slide steepens

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Organization of the Petroleum Exporting Countries decides not to cut production, squeezing out high-cost competitors

Canada's energy sector faces the prospect of a lengthy downturn in oil prices and broad spending cuts after OPEC said it does not intend to cut production – a move that sent crude prices and energy shares plunging.

Investors immediately punished Canadian energy companies in reaction to the Organization of the Petroleum Exporting Countries' decision Thursday to stand firm on its production plans, defying industry hopes for a cut. The S&P/TSX Capped Energy Index sank 7 per cent, hitting its lowest point since April, 2013. The price for Brent oil, the global benchmark, dropped $5.17 (U.S.) a barrel to close at $72.58, a four-year low. West Texas Intermediate oil, the North American standard, dropped $4.64 a barrel to $69.05.

Oil prices have been skidding since June, reflecting a global oversupply of crude resulting from surging U.S. production and slack demand growth.

Now, Canada's energy producers, along with the Alberta government, must reconsider their financial future. Oil firms must prepare for pinched profits, and may have to shelve expansion aspirations.

So far, the energy industry has taken few major steps in reaction to plunging oil prices, showing a reluctance to pull back production and give up revenue. But analysts say any sustained downturn will force action to face the new reality.

"I think we're probably still in a state of denial. The producing industry, not just here in Calgary but in North America, is still thinking that these prices aren't going to be here for long, so no one's wanting to react yet," said Randy Ollenberger, a Bank of Montreal analyst.

"But I think if we see these prices for a couple of months more – and I think that's a distinct possibility – then you might start to see people looking at this more seriously and become a little more concerned about what it means."

U.S. crude could hover around $70 for up to two years as top OPEC producer Saudi Arabia attempts to squeeze high-cost competitors out of the market, according to John Stephenson, a portfolio manager at Stephenson & Co. Capital Management in Toronto.

From Saudi Arabia's point of view, "You do not want any more U.S. production coming on. That means a minimum of six months to two years of low, low prices," he said.

That will spill over into Canada's oil patch. "So you are eventually talking capex cuts for sure," said Mr. Stephenson.

Energy shares were hammered across the board. Suncor Energy Inc. shed 6 per cent on the Toronto Stock Exchange Thursday; Canadian Natural Resources Ltd. (CNRL) gave up 7 per cent; Cenovus Energy Inc. dropped 5 per cent; and Penn West Petroleum Ltd. plummeted 14 per cent. Seven Generations Energy Ltd. lost 14 per cent to close at $18.75, its lowest point since its initial public offering late last month.

A number of Canadian energy firms have released oil price projections for 2015 that are significantly higher than current levels. Penn West intends to spend $840-million in 2015, and its budget assumed WTI will trade at an average of $87.50 (U.S.) a barrel next year. Penn West said it may trim spending in the second half of 2015 if oil traded below $75 (Canadian) a barrel through the second quarter of next year.

Suncor's $7.2-billion to $7.8-billion 2015 budget forecasts WTI crude selling for an average of $78 (U.S.) a barrel next year, and Brent crude at $85 a barrel. Suncor's chief executive Steve Williams said the company could generate free cash flow if the world benchmark traded between $80 a barrel to $85 a barrel next year.

"If [oil] went to levels in the $40s and $50s, of course we'd have to reflect, but right now nothing we see will cause us to change course on that capital budget," Mr. Williams said during his company's third-quarter conference call at the end of October.

CNRL in early November based its $8.6-billion budget on WTI trading at $81 (U.S.) a barrel, and said it could quickly cut $2-billion of spending if necessary. CNRL president Steve Laut said its new oil sands project, dubbed Horizon, could bring in between $3.5-billion to $4-billion in free cash flow per year for "decades to come" with a barrel of oil worth $70 (U.S).