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Published By: NEWS COMMUNICATIONS since 1977

Saturday January 9th 2016

5 THINGS THE OIL PATCH IS WATCHING FOR IN 2016

There's no light on the horizon now, but energy sector hopes for signs of a recovery

There's no question that 2015 was a bad year in Canada's oilpatch, but optimism dies hard in the energy sector and as a new year dawns, executives and investors are scanning the horizon for signs of light. Here's what they're looking for.

For nearly a year now, analysts have been calling for U.S. oil supply to roll over, collapse, fall off a cliff. It hasn't exactly happened yet, no matter how quickly rig counts have fallen south of the border.

The U.S. produced 9.2 million barrels per day the week ending Dec. 25. That's more than the country was producing in late 2014 when OPEC decided that enough was enough and that it wasn't going to cut its production to offset more oil coming from the U.S.

Energy analyst Stephen Schork said he thinks OPEC would like to see U.S. oil supply drop below nine million barrels a day, something he's not expecting soon.

"Supply has been extremely sticky," said Schork. "We did not see the turndown in 2015 to the extent that we were expecting. We came off 9.5 million and are holding at 9.1 or 9.2 million."

Oil producers are caught in a cycle in which no matter how low oil prices go, they need to continue to produce to generate cash. As a result, there's a growing sense that U.S. production won't roll over until companies run out of cash.

"This could be the year," said Martin Pelletier, a portfolio manager with Trivest Wealth Counsel.

"What's delayed the production response has been access to debt markets. That has closed, the regular bank lines are being clawed back, they can't go to capital markets, you're relying on cash flow and that cash flow is being used to service debt.

"Many are underestimating the supply response," said Pelletier."

The recent conflict between Saudi Arabia and Iran had a short-lived effect on the price of oil.

"If that had happened a year or a year and a half ago, oil would have responded a lot more to what just happened in Saudi Arabia than what it did recently," said Pelletier.

Iran is increasing its oil production after the removal of sanctions related to its nuclear program. It has called for OPEC members to cut production to support prices. Saudi Arabia declined to do so at the most recent OPEC meeting in December, adding to the tension in the region.

"You're looking at a region of the world that is always on a short fuse," said Schork. "But that fuse is getting shorter and shorter."

The main reason oil prices haven't reacted to conflict in the Middle East is because the news from China continues to be bad.

On Monday, manufacturing numbers from China showed demand was still falling. China has cut its interest rates six times in the past year, and is cutting the value of its currency to spark exports, all signs of an economy under pressure.

"A lot of growth in oil demand came from emerging markets," said Pelletier. "And demand is still growing for oil, but at a much slower pace. Unfortunately, it looks like it's going to get worse before it gets better."

It is a bit of a puzzle why there hasn't been more merger and acquisition activity in the energy sector. A report from the Toronto firm Crosbie & Company showed that oilpatch merger activity over the spring and summer was down by more than 50 per cent, compared to the summer of 2014.

The slow pace of deals may simply be because it's hard to price a deal when you don't know where oil prices are going. But Pelletier thinks that something else is at play, specifically the self-interest of junior oil executives, who have risked everything and don't have other jobs to go to if they sell their companies.

"It's hard to do consolidation in this kind of market because people don't want to lose their jobs. You're living off that $200,000 you're making. Where are you going to find that anywhere else?"

The biggest deal to surface in the past year has been Suncor's offer for Canadian Oil Sands, which has a deadline of Friday and is too close to call at the moment. That shows that investors are not universally keen to do deals at any price.

Regardless, there's a broad expectation that more takeovers will happen as banks tighten up their lending.

This month, the Alberta government will release its review of the oil and gas royalty system in the province.

In a speech late last year, Peter Tertzakian, a respected economist and member of the royalty review panel, said that the current system is too complicated and doesn't reward the highest value products. When asked if Alberta producers would remain competitive, he said that segments of the industry would remain competitive.

That may not be cheering to marginal oil and gas producers, but is part and parcel of what often happens during a downturn in any industry.

Schork thinks that the price rout sparked by OPEC more than a year ago will end up as a sort of gift for the North American energy sector.

"It's forcing North American production to become more efficient than, as painful as it is," he said.

PRICE OF OIL LOSES ANOTHER 3%, DRAGGING CANADIAN DOLLAR BACK BELOW 72 CENTS US

Loonie sheds 1/3 of a cent as oil takes another drubbing

The benchmark price of North America's main oil blend lost more than three per cent to change hands below $37 US a barrel on Monday, dragging the Canadian dollar below the 72-cent US level in the process.

West Texas Intermediate was going for $36.85 a barrel on Monday, down 3.4 per cent on the first trading day after a mini-rally last week.

The catalyst for the sell-off was a report that Iran intends to increase exports by 500,000 barrels per day once economic sanctions are removed. That would only add to excess global supplies that have helped depress oil prices.

Currently, the world is pumping out more than a million barrels per day of oil more than it needs to meet global supply. That's keeping prices low as it's a buyer's market.

The bleakness in oil has been bad news for Canada's dollar, which is closely tied to the commodity's value. The loonie was down more than a third of a cent at 71.98 cents US on Monday.

The Toronto Stock Exchange was closed for its Boxing Day holiday. But U.S. markets were open. The Dow Jones industrial average was down 95 points, or about half a per cent, in late morning trading.

OIL INDUSTRY TO LOSE 100,000 JOBS BY THE END OF 2015 AS POLICY UNCERTAINTIES AND LOW PRICES DECIMATE SECTOR

That includes 40,000 direct jobs, the head of the country's oil and gas industry group says.

"Canadians should be concerned in times like these," Tim McMillan, president and chief executive of the Canadian Association of Petroleum Producers, said in an interview.

"We have a lot of big policy pieces moving around. We need … to ensure we can compete in a slower price environment and if prices do bounce back , that we are the preferred investment jurisdiction and that we are picking up more than our fair share."

Crude oil prices have halved in the space of a year to around US$35 per barrel and could slip further to the high US$20s as major producers continue to flood the market with record output, Citigroup estimates.

Alberta alone has seen job losses of 63,500 jobs in the first eight months of the year, mostly related to the oil sector, according to Statistics Canada.

Apart from the protracted price declines, Alberta's oil and gas sector has also had to contend with a 20 per cent hike in corporate taxes, a carbon tax and new regulatory policies to limit rein in carbon emissions.

Meanwhile, a new provincial royalty regime is to be announced in January, leaving Alberta oil and gas producers under a cloud of uncertainty. The new federal government also plans to unveil new policies, including a review of the regulatory process, which the sector sees as more burden in an already difficult environment for the industry.

McMillan said those burdens are chipping away at Alberta's competitiveness as an energy jurisdiction. In the 1990s, Canada attracted 37 per cent of all oil and gas investments in North America, a figure that now stands at 17 per cent, he said.

"I would like to see us getting more of the North American investment," said McMillan, who was previously Saskatchewan's energy and resources minister.

On Friday, American lawmakers lifted a 40-year export ban on U.S. crude oil, which would bring a new competitor into the already-crowded international suppliers market. McMillan said while scrapping the export ban will bring more efficiency to the North American oil landscape, Canada should try to forge its own path to international markets.

"I am may be more passionate about Canada controlling its own destiny as opposed to relying on our neighbours to the south to pass laws and have more freedom; that we are piggy-backing on their freedoms as opposed to developing our own infrastructure where we can control our own destiny," McMillan said.

Even if oil prices rise early and fast next year, it may take a while for Canadian oilsands to rebound as the industry has mothballed a number of long-term projects.

Canada has led the world in deferments since the oil crisis unfolded in November last year, with just under 40 projects scaled back due to low prices and lack of market access, according to Texas-based energy investment and merchant bank Tudor, Pickering, Holt & Co.

Next year is also rife with challenges, as the industry braces itself for a third royalty review in nine years in early January.

"My expectation (from the royalty review) is that we re-establish ourselves as a competitive jurisdiction," McMillan said. "And all those costs we have seen added in the last year or two be included in that positioning."

The industry is still assessing the implications of Alberta's climate change policy announced in November that sets a cap on carbon emissions in the oilsands to 100 megatonnes, aims to cut methane emissions by 45 per cent within 10 years and phases out coal-powered electricity by 2030. The cap on oilsands emissions has rattled many smaller producers who fear they may be sitting on stranded assets if the major players move quickly.

At the moment the oilsands sector emits 70 megatonnes annually to produce 2.3 million barrels per day. Analysts believe the remaining 30 million tonnes can accommodate up to a million barrels of new production with current technologies.

The challenge will be to manage that cap within the industry. McMillan said he is seeking more clarity from the government on how the cap will be implemented. "There are a great number of details that have not been made clear and those details will matter a great deal. We are working to find what we think will be a workable solution for Alberta."

McMillan, who attended the recently concluded climate summit in Paris, said Canada is ahead of other major exporters such as Saudi Arabia, Iraq and Venezuela — none of which have meaningful carbon policies.

"Canada has been a leader having a carbon price on our energy producers and that has left us standing out alone," McMillan said. "At two per cent of global emissions for Canada as a whole — our industry being just a portion of that — we can't solve this and we shouldn't think we can do it on our own."

ACTIVISTS SABOTAGE ENBRIDGE PIPELINE IN ONTARIO TO PROTEST OILSANDS CRUDE

Enbridge Inc. says flow on a pipeline through southwestern Ontario was shut down for several hours by protester activity near Cambridge, Ont.

Spokesman Graham White says the protesters partially restricted flow on Enbridge Line 7 on Sunday night by tampering with a manual valve.

White says the pipe was shut down for approximately three hours on Monday morning as a safety precaution and so that maintenance workers could inspect the valve station.

He says Enbridge has safely restarted the line -- which carries various products from Sarnia to Westover -- and there was no impact on client deliveries.

A Monday post by "no pipelines" on the Reddit Anarchist News site claimed responsibility for the sabotage, saying it was to protest the flow of oilsands products through pipelines in Ontario.

Enbridge's Line 9 pipeline was offline for about 90 minutes on Dec. 19 after three activists concerned about the line's environmental impacts locked themselves to a valve site on the outskirts of Sarnia.

AS SUNCOR OFFER NEARS DEADLINE, CANADIAN OIL SANDS REPEATS CALL TO REMAIN INDEPENDENT

Shareholders have until Friday to accept all-stock offer in hostile-takeover play by energy giant

Suncor issued a final plea to shareholders of Canadian Oil Sands (COS) on Monday to tender their shares to its hostile takeover offer, while Canadian Oil Sands issued its own "declaration of independence," urging their investors to hold on and stay the course.

"We are urging COS shareholders to act now to protect the value of their investment by tendering their shares to our offer," said Steve Williams, Suncor's president and chief executive officer, in a statement.

"We have made a full and fair offer that provides immediate value, a safer haven as compared to COS in an extremely difficult market environment and significant upside when commodity prices finally improve," he said.

"That said, we can only invest so much time and money in this effort and will feel compelled to move on to other opportunities if we don't see substantial support for our bid on Friday," Williams warned.

Suncor took its $4.3-billion all-stock offer for Canadian Oil Sands directly to the company's shareholders in October, after failing to negotiate a friendly deal with COS management.

Suncor wants Canadian Oil Sands' only asset — its 37 per cent stake in the Syncrude heavy oil development in northern Alberta. Suncor already owns 12 per cent of Syncrude.

Suncor's CEO said in his Monday note to COS investors that the prospects for Canadian Oil Sands to thrive as an independent company "have worsened considerably" since it first approached COS 10 months ago because of the current low oil price environment.

But COS management issued what it called its own "declaration of independence" on Monday as a further rebuttal to Suncor's hostile bid.

"You invested in Canadian Oil Sands for a pure-play exposure to oil prices, and you have held your investment through unprecedented hard times in the energy sector," said COS chair Don Lowry in a note to shareholders. The company also took out full-page newspaper ads to argue its case that the best option for COS shareholders is for them to refuse to tender to the Suncor offer.

"COS has the financial resources to weather the current downturn. Oil prices will recover," Lowry said. "Shareholders have more upside owning 100 per cent of COS' reserves than less than eight per cent of Suncor's."

The battle for the future of Canadian Oil Sands has at times been bitter and the oilpatch has been riveted by the clash between the two Syncrude partners.

In a Canadian Press interview, Suncor CEO Steve Williams insisted that Suncor has been playing nice.

"We've tried to keep this friendly," Williams said. "Unfortunately, Canadian Oil Sands didn't want a friendly arrangement."

Canadian Oil Sands, for its part, predicted that Suncor would engage in last-minute fear-mongering. "Make no mistake, Suncor will try to instill fear in the final hours before its bid expires," read Monday's public note from COS to its shareholders.

"But remember, Suncor will only resort to this tactic because it desperately wants what you have."

The deadline for COS shareholders to tender their stock to Suncor's offer is 6 p.m. MT on Friday. Suncor needs at least two-thirds support from COS shareholders for the bid to succeed.

LNG INVESTMENT MAY BE TOO LATE AFTER 2016, COMPANIES SAY

Energy workers are facing a 'triple whammy' due to poor economic conditions, says representative

The organization representing contractors and service providers to the B.C. oil and gas industry says time is running out to invest in LNG, after what it calls one of the worst years for LNG in the province.

The B.C. government has made no secret of its intentions to back major LNG projects, saying the investment will yield money to pay back the province's debt and tens of thousands of jobs.

But skeptics have continually criticized the government for falling behind on its plans to grow the province's LNG sector. Now, the executive director of Energy Services B.C,, says contractors and firms servicing the industry need to know now whether or not that investment is coming.

"We really need it in 2016. We need to know the answer and move ahead," said Art Jarvis.

Jarvis says LNG workers suffered in 2015 due to three main factors, including cuts — as much as 20 per cent — to companies' profit margins, fewer projects, and more competition for jobs due to waning LNG sectors in other provinces.

"We're kind of hit with a triple whammy in this region," he said.

"What that means of course is less income to the communities, less income to the province, and of course, [it's] pretty tough to be sustainable," said Jarvis.

Jarvis is optimistic that if more projects break ground this year there will still be opportunity for B.C. workers to benefit. He says workers in the energy service industry have no choice but to look forward.

But the window of opportunity for LNG is closing quickly because prices are dropping while costs are rising, according to Jarvis.

"When you look at the sale price for natural gas internationally and the cost to develop it regionally, those are fast coming to parallel to each other. And if they ever get that way, they're close enough that it makes it more difficult."

Small companies are already out of the game, said Jarvis.

"The only producers that can play this game are left with people with a large budget and a big pocketbook because it's already knocked the smaller producers off the pole."

"We're pretty concerned here about the future — the near future and the long future."