Soaring commodity prices offering little fuel to energy stocks

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Crude oil prices may be flirting with record highs, but one would never know it from the performance of some energy stocks. Some of the biggest names are still trading where they were last summer or lower.

Crude closed at $111.76 (U.S.) yesterday, which means it is up nearly 76 per cent over the last year and has doubled since December, 2006. Natural gas has also been on the move, rising from $5.29 last September and $7.16 at the end of last year, to $10.03 now.

But those impressive commodity price gains haven't been reflected in the prices of some energy issues.

Why the disconnect? Many investors don't believe the price of crude will stay at current levels. The popularity of the UltraShort Oil & Gas ProShares (DUG) exchange-traded fund has soared. If the oil and gas index falls 1 per cent, the DUG ETF gains about 2 per cent, and vice versa. The number of DUG shares outstanding has risen 340 per cent since Feb. 1, noted Cleve Rueckert, an analyst at Birinyi Associates.

Matthew Pugsley, managing editor of U.S. equity strategy at BCA Research, pointed out that not all energy stocks are languishing. "If you look beneath the surface in the U.S., you would see that some of the energy service stocks are very strong; the exploration and production stocks are very strong," he said. Those groups are actually reflecting the strength in the price of oil. But he noted the high crude prices are hurting refining margins. "So I think the reason for ... maybe a little bit of a lagging performance from some of the bigger names is from the refining side of the business."

PetroChina Co. Ltd. is an extreme example. Back in November, its shares were changing hands at $20.25 (Hong Kong dollars) ($2.65 Canadian), but since then, they have slumped as low as $8.82 (HK) and currently trade at $9.80. The collapse of China's indexes has hurt the shares, but so has the company's falling profit margins.

Citigroup Global Markets Inc. recently downgraded PetroChina to a "sell" from "hold" and cut its price target to $9 a share from $15.40, saying that while higher oil prices will boost profits from the exploration and production division, it expects that will be more than offset by higher losses in PetroChina's refining operations. PetroChina's refining division is suffering losses because of the rising oil price and government price caps on refinery products.

The other big oil companies of the world aren't down as much, but are still underperforming crude prices. **Exxon Mobil Corp.'s** stock price has fallen 4 per cent so far this year. At $89.70 (U.S.) on the New York Stock Exchange, Exxon shares still have a way to go to match last October's high of $95.27. **Chevron Corp.** shares are currently changing hands at $89.30, but that is still significantly below its high of $95.50 set last September. **ConocoPhillips Co.** shares, at $79.81, are even further off their peak of $90.84 established last July.

Petro-Canada shares' performance over the last several years has been up and down. The current price is on a par with that of April, 2007, and December, 2006. Moreover, at $49.05 (Canadian) the shares are substantially below the high of $61.25 established last July when crude was trading in the mid-$70s (U.S.) range. **Talisman Energy Inc.** shares still have a little way to go to climb back to the levels of last summer, while **Husky Energy Corp.** shares hit a high in early January at $46.75 (Canadian) but have eased since and currently trade around $42.50.

However, there are exceptions to the rule: **Canadian Natural Resources Ltd.,** whose shares hit a high of $82.32 yesterday, for instance.

Sam La Bell, an analyst with ***Veritas Investment Research Corp***., studied seven major Canadian energy issues, and concluded in a report issued last week that their valuations are geared to account for a possible decline in oil prices to $50 (U.S.) by 2012.

The commodity prices have gone up but "really, valuations are still stuck at last year's prices," he said. He suggests a few explanations for that. One is a feeling that the high commodity prices are unsustainable. Another is that investors now see the group as higher risk, requiring a higher rate of return and leading to a lower multiple. Thirdly, investors are skeptical about the cost and timing of some projects.

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Flat trading over the last year and one half

Petro-Canada

SHARE PRICE, DAILY CLOSE, (PCA-TSX)

Yesterday's close:

$49.05, up $1.55

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Talisman Energy

SHARE PRICE, DAILY CLOSE, (TLM-TSX)

Yesterday's close:

$20.06, up 62¢

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PetroChina

SHARE PRICE, DAILY CLOSE, (PTR-NYSE)

Yesterday's close:

$125.92 U.S.,

Down $3.45