1 Chart No Oil Investor Wants to See

Description

It’s been a tough year for investors in the energy patch. Oil prices have slumped close to their lowest level since the global financial crisis six years ago. This has had a sharp impact on Canada’s economy and the investment portfolios of many investors. A number of energy companies have slashed their dividends, and many, including big industry names such as **Crescent Point Energy Corp**., are down by 50% or more.

The bad news doesn’t stop there.

Now what?

Recent data suggests that oil is set to fall even lower, and this is despite the U.S. rig count being at its lowest level since May 2002.

You see, U.S. oil inventories have hit their highest level since late May, and there are signs that they could move even higher despite the sharp drop in the U.S. rig count.

As the chart highlights, not only have U.S. oil inventories continued to grow over the last year to now be 25% higher, but refinery utilization rates have fallen sharply over the last month to now be well under 90%.

Image not found or type unknown US Oil Inventory Chart 281015 *Source: U.S. EIA.*

This is particularly bad news for the price of oil as growing U.S. oil inventories are set to apply further pressure to already weak crude prices.

I don’t expect this situation to improve for the foreseeable future.

U.S. oil output still remains well above what it was a year ago when OPEC commenced its strategy of boosting production to push the price of crude lower in an effort to regain market share. I also expect refinery utilization rates to continue falling for the remainder of this year, causing many refineries toshift to their maintenance cycle.

On top of this, the global supply glut is expected to grow because of a slowing Chinese economy and because the Saudi's continue to boost oil exports.

All of these factors will continue to apply pressure to oil prices, and it is possible that the price of West Texas Intermediate, the North American benchmark price, could slide to under US$40 per barrel. This is not good news for the energy patch. If prices remain below US$40 per barrel for a sustained period, this will result in a devastating impact on the patch with many companies potentially forced into bankruptcy.

So what?

This makes it important for energy investors to understand the financial health of the companies in which they have invested because the most vulnerable will be those with highly levered balance sheets.

Some of the most vulnerable companies include **Penn West Petroleum Ltd.** (TSX:PWT)(NYSE:PWE), **Lightstream Resources Ltd.** (TSX:LTS), and **Pengrowth Energy Corp.** (TSX:PGF)(NYSE:PGH). All three have burdensome levels of debt, and Penn West and Lightstream are also dealing with declining production as they sell off assets in order to reduce debt. This means that they can't ramp up production in order to boost operational cash flows.

However, integrated energy majors such as **Suncor Energy Inc.** (TSX:SU)(NYSE:SU) and **Imperial Oil Limited** (TSX:IMO)(NYSE:IMO) will weather any further sustained weakness in oil prices quite well.

This is because cheaper oil means their refining operations will generate higher margins, and these will offset the reduced profitability from their upstream or oil producing operations. It will also have very little impact on Suncor because the company has some of the lowest breakeven costs per barrel in the patch at US$30 per barrel.

CATEGORY

1. Energy Stocks
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TICKERS GLOBAL

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