Canadian Oil Stocks Are in Trouble Again

Description

Many energy investors have been excited in recent months, as prices have rebounded. Even Warren Buffett is jumping in, purchasing 10.8 million shares of **Suncor Energy** (TSX:SU)(NYSE:SU).

Many analysts highlighted that Buffett's involvement could stoke renewed industry in the beaten-down sector.

Unfortunately, the same problem that brought Canadian oil companies to their knees last year may show its face again soon. Oversupply, it seems, is here to stay.

Understand what happened and why

While it's been covered in the past, it's incredibly important to know why so many Canadian oil stocks have been struggling over the previous six months.

In October, particularly in Alberta, oil prices plummeted. The root cause should have been predictable: oversupply.

As local operators ramped production, pipelines were hit with impossible demands, creating devastating transportation bottlenecks. With few other options to store or ship their oil, companies bid to the death to move output, causing prices to drop by 50% or more.

The Alberta government quickly instituted a province-wide supply cut of 8.7%, roughly 325,000 barrels per day.

The production curtailment had immediate effects.

"Four Fridays ago, at the bottom … we had WCS in the low teens," said the CEO of **PrairieSky Royalty** late last year. "And WCS two Fridays later, after the announcement of the curtailments, was at US$40."

Investors hoped the curtailment would be eased over the coming months, and the market would be rebalanced for good.

Recent revelations could kill those hopes for good, even if few people are talking about it.

History is repeating itself

On May 7, energy information provider Genscape revealed that Western Canadian crude oil storage inventories hit a record high of 37.1 million barrels the month prior.

“Record-high stocks in late April were a clear signal that the province’s efforts to control supply had so far been unsuccessful in alleviating the glut,” Genscape reported.

If you’re invested in Canadian energy stocks, this is devastating news, as supply could overwhelm transportation networks yet again, leading to a similar pricing collapse.

Pipelines can take years to plan and build. Meanwhile, crude by rail is an expensive and limited way to ship the extra capacity.

Even if pricing doesn’t collapse, further curtailments could put a bit dent in industry revenues.

Reuters reported that Genscapes data “raises questions over whether Alberta’s new United Conservative Party government, which was elected on April 16, will increase curtailments.”

Where can you hide?

Many investors have been willing to bottom-pick the Canadian oil market.

This remains a risky proposition, but if you’re intent on doing so, stick with integrated oil companies like **Imperial Oil** (TSX:IMO)(NYSE:IMO), **Husky Energy** (TSX:HSE), and Suncor Energy, which control all aspects of the value chain.

The benefits of being an integrated oil company have never been greater.

For example, the companies listed above all control their own refineries, and often their own transportation networks. This allows them to side-step the deep discounts other companies are forced to accept during periods of oversupply.

You won’t get massive returns by investing in Imperial, Husky, or Suncor, but your downside is significantly protected. With another supply glut looming, this downside protection is critical.

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