Warning: Sell Your Canadian Oil Stocks Now!

Description

While the economic consequences of the ongoing Coronavirus pandemic are still unclear, we do know that social anxiety about the disease has already discouraged travel. People are staying at home, working remotely, cancelling large gatherings and avoiding international travel.

This lack of travel by road and air has severely decreased demand for our nation's most vital commodity: crude oil. Experts predict the price of a barrel of oil will decline sharply in 2020 if the slowdown in global travel persists.

In fact, **Goldman Sachs** just issued a forecast for Brent Crude and West Texas Intermediate (WTI) to hit US$45 and US$30, respectively, by April.

A decline of that magnitude could be detrimental for Canada's oil and gas sector.

Here's a closer look at why you should consider reducing your exposure to energy stocks if this crisis persists.

Gradual recovery

According to the International Energy Agency, the demand for crude oil could decline sharply in the first three months of this year — the first time in a decade. While three months of lower demand doesn't sound bad, here are two factors that make this piece of news deeply concerning for investors.

First, there's no clear indication that demand will recover anytime soon. The demand lost in this quarter is gone forever. It's not likely that people will travel twice as much next quarter to make up for the lost demand.

In fact, travel could be restricted even further if the virus spreads and more nations declare health emergencies. In other words, things could get much worse.

This means the recovery in oil demand (and price) is likely to be prolonged. The problem is that most companies don’t have the resources to survive a prolonged downturn.

Second, the reduced price of oil squeezes margins for high-cost operators such as the ones operating in Alberta’s oil patch, and extracting crude oil from tar sands is particularly expensive. Experts estimate that the oil sands operators need West Texas Intermediate (WTI) at US$40 in order to break even.

In other words, if the Goldman Sachs’ forecast is on target, Canada’s oil sector will have to suspend operations or operate at a loss.

Debt issues

A prolonged decline in the price of oil is a problem for the sector, but not all companies are equally exposed. Oil producers with diversified operations, lower costs and stronger balance sheets are likely to survive this crisis.

However, companies with too much debt and high operating costs could be in for a rough ride ahead. Warren Buffett’s favourite Canadian oil stock, **Suncor Energy**, appears well prepared for the crisis and has enough resources to survive.

Vermilion Energy, on the other hand, has $2 billion in debt and only $10 million in cash on its books. The company can barely afford its 20% dividend yield and could be forced to cut soon.

Bottom line

The sharp decline in oil prices has been unexpected, which means that Canadian oil and gas producers with slim margins and high debt could be caught off-guard.

Investors need to take a closer look at their portfolio and cull these vulnerable energy stocks *before* the damage spreads.

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