As Oil Prices Get Hit, Should We Buy the Dip or Head for the Hills?

Description

Crude oil prices are being hit hard today, declining more than 2.5% and fast approaching $60 again.

With last week's reported rise in inventories and a general unease in the marketplace, what should investors do with their energy holdings?

Let's start with the inventory number. Inventories rose by 6.7 million barrels, and while this was widely expected and it is less than the five-year average withdrawal, this may indeed have spooked investors.

But when we look at inventories, we also need to look at global inventories. With global inventories falling and demand in developing nations rising, the oil market will probably see some upward pressure on prices going forward.

Further, with continued geopolitical tensions, there is still the real possibility of supply disruptions coming from several sources.

Crude prices are 60% higher than they were in early 2016, so things are looking good for energy companies.

Companies like **Baytex Energy Corp.** (TSX:BTE)(NYSE:BTE) will report their fourth quarter earnings on March 6.

The stock is trading below 2016 levels despite the 60% run up in the price of oil.

This signals a big opportunity because the market is not believing oil prices. However, if they at least hold above $55 or $60, which they have for some time now, energy companies will be beating market expectations, which will send their stocks climbing higher.

Baytex Energy, as we know, has been hit by the fact that the company was and is still carrying too much debt. But, while at sub $30 oil, this poses a huge problem. Baytex has big leverage to the oil price; accordingly, the stock has a big upside.

It has been slowly reducing its debt, and has taken it down from $2.1 billion to the current $1.7 billion.

The company's asset disposition plan, which is expected to bring in much-needed proceeds from the sale of non-core assets, will go a long way toward deleveraging the balance sheet and reducing the risk of investing in these shares.

And the company has been performing better operationally, with management producing in the upper end of its guidance and reducing its 2017 operating cost guidance by 10%.

As a reminder, at $50 per barrel, Baytex is free cash flow neutral; at $55 per barrel, Baytex generates incremental free cash flow of $75 million. Oil at $65 per barrel means incremental free cash flow of $175 million.

Another option would be to invest in energy services companies like **Precision Drilling Corp.** (TSX:PD)(NYSE:PDS), which is seeing rising activity levels, soaring revenue, and a recovery in earnings.

As of the latest quarter, the company was still reporting net losses and the improvement — to the tune of 44% — was significant. More important, cash flow from operations was $37 million.

Precision had more than double the amount of rigs working than it had last year, and pricing remained firm as the sector continued to ramp up.

In summary, with oil holding above $60, and supply/demand environment having improved dramatically over the last while, energy stocks are still a good bet.

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