How to Invest in Oil During the Coronavirus

Description

In March, the benchmark for West Texas Intermediate (WTI) oil dipped below US$30/barrel. Saudi Arabia and Russia feuded over proposed production levels. These events caused Canadian oil and gas companies to become collateral damage, causing a very sharp decline in the oil share prices. This negative supply shock for Canadian producers has been exacerbated by a very negative demand shock from the coronavirus outbreak. These factors have resulted in a very sharp decline in the spot price of oil.

With this backdrop, investors are now wondering about the solvency and ability of oil producers to weather low oil prices should they persist for a relatively prolonged time. The stock prices of certain producers have therefore begun to essentially simulate call options on a range of companies. Stock price trajectories in many cases appear to be binary — "all or nothing." Here are two examples.

Crescent Point

In Canada's oil patch, perhaps no company has been hit as hard as **Crescent Point Energy** (TSX:CPG)(NYSE:CPG). Like many other Canadian oil and gas companies, Crescent Point is highly levered, both to the commodity price of oil and from a balance sheet perspective. As a result, Crescent Point's management team has made the decision of cutting the company's dividend distribution to almost nothing: $0.01 per share annually. The company's share price has continued its downward descent, plummeting approximately 75% month over month, at the time of writing.

Crescent Point's market capitalization is now a small fraction of its previous highs. Investors seem to be pricing in significant insolvency risk at these levels. Thus, Crescent Point is too risky of a bet for conservative, long-term investors, in my view.

Baytex Energy

I've highlighted in the past the specific insolvency risk posed by **Baytex Energy's** (TSX:BTE)(NYSE:BTE) balance sheet. However, it appears the market has begun to catch on to this theme, pricing in some significant downside potential at current stock price levels. Baytex is one of those Canadian oil patch players that grew production levels aggressively in the pre-2014 commodity bull market. In essence, Baytex acquired assets and companies along the way, utilizing large amounts of debt to accomplish high production levels.

As it turned out, much of the production capacity acquired was only profitable at much higher oil prices. Therefore, the company's high debt levels became extremely precarious. Baytex has done well to deleverage in recent year. However, the company has retained a significant amount of leverage to the price of oil due to its asset risk. This makes Baytex a company to avoid by all but the most risk-loving investors out there.

Stay Foolish, my friends.

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