Rushing Into Energy Stocks After the Market Crash? Not So Fast

Description

The past month has been devastating for Canadian energy stocks. Since February 20, the **S&P/TSX Capped Energy Index** has fallen 65%, following milder losses earlier in the year.

The collapse in oil has come from two main sources. First, the COVID-19 pandemic and the associated economic shutdown have reduced demand. Second, a price war between Russia and Saudi Arabia has increased supply. That "one-two punch" has been devastating for Canadian energy producers. Tar sands crude has always been cheaper than Texas, Brent, and Saudi crude, because it requires extra refining. As of this writing, Canadian crude was down to $8.50 a barrel from $33 just a month ago.

While it's tempting to buy stocks "on the dip" at times like these, it's best to exercise caution. The problem with energy stocks is that many could face bankruptcy before oil recovers. If it does happen, then many investors could lose their entire position.

Oil below break even for many producers

The big problem for Canadian energy companies is that many of them can't break even at current oil prices. While the price to break even varies from company to company, **IHS Markit** reported in 2019 that tar sands companies need about $40 a barrel. Current prices are nowhere near that. As a result, tar sands producers will struggle to make money in this environment. We're already hearing cries for government bailouts from companies that have no reason to continue operating as usual. Further, many of these companies may need to borrow or sell off assets just to service their debt, which is usually a precarious situation to be in.

Some companies could go bankrupt

Depending on how long oil prices stay depressed, some Canadian energy companies could be at risk of bankruptcy.

Case in point: **Baytex Energy** (TSX:BTE)(NYSE:BTE). Baytex is an Alberta energy producer that has been struggling for a long time. Its stock price peaked in 2012 and is down a stunning 99.48% since then. Things really started going south for Baytex during the 2014/2015 oil price crash. The company was borrowing extensively at the time, resulting in about $2.2 billion in debt and other liabilities. Then oil prices fell, and the company could no longer regularly turn profits.

It’s all been downhill from there. Year in and year out, BTE has been spiralling into the abyss, with no end in sight. It’s not from a lack of sales either. BTE’s five-year summary shows that it has grown its sales from $1.1 billion to $1.8 billion over the last five years. The company is bringing in plenty of money. The problem is that, as an exploration company, it has huge expenses, making it difficult to turn a profit on its sales. Add $2 billion or so worth of debt on top of that, and you’ve got a recipe for disaster.

Just recently, Baytex executives were informed that their stock may be de-listed from the NYSE. If the company’s woes continue, I wouldn’t be surprised if a TSX de-listing is next.

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