Negative Oil Prices: Are Oil Stocks Too Cheap to Ignore?

Description

Negative oil prices. What many thought was impossible became a crude reality on Monday, with West Texas Intermediate (WTI) prices falling as low as -US$40 (emphasis on the negative sign). The coronavirus-induced demand shock and the souring of OPEC+ that sparked further turmoil in the oil patch will undoubtedly wipe out many Canadian energy producers across the Albertan oil patch. But not for the reasons you may think.

Negative oil prices: the crude reality

You see, negative oil prices don't mean that you'll be able to fill up your car and get US$40 worth of snacks at the attached convenience store for free. Negative or even zero oil prices ought to be viewed as unsustainable by investors. That's a huge reason why oil stocks didn't crash violently on Monday and why WTI prices were quick to move back into positive territory.

At the time of writing, WTI is sitting at US$9 and change. Given it's going to be hard to find storage for the growing glut amid this pandemic, investors should brace themselves for single-digit oil to be the new norm. While such a shock may be indicative of a global depression, the unprecedented amount of fiscal stimulus should limit the economic damage to a severe recession. As such, investors shouldn't expect the lights to but shut out on the oil patch entirely.

Suncor Energy may be the best bet amid negative oil prices

Big-league oil operators, including Warren Buffett-fave **Suncor Energy** (TSX:SU)(NYSE:SU), have operating cash flows and a balance sheet that's healthy enough to survive these painful times. While Suncor was designed to operate in a "lower-for-longer" type of oil price environment, single-digit, zero, or heck, even negative oil prices is pushing it. By lower for longer, we're talking about US$40 oil, where it's somewhat economical to continue to keep the taps on. But with negative or borderline "free" oil, it only makes sense to leave the crude in the ground.

While Suncor will survive this whole ordeal, there's no telling when the stock will bottom. Fortunately, shares can't go into negative territory in conjunction with negative oil prices! But that doesn't mean you should be backing up the truck on the stock here, even if the 9%-yielding dividend is well covered by cash flows.

In an era of free, near free, or negative oil prices, firms like Suncor could be at risk of hitting the pause button on growth projects for a lot longer than expected. Moreover, one can't expect the dividend to remain sustainable over the long term if oil prices can't at least make a sustained move past the US$20 mark.

That said, I see Suncor as a compelling play for younger, more risk-tolerant investors who are willing to trade 30% in downside for a potential double. I see the risk/reward trade-off as being tilted in favour of the investor with Suncor trading at just $20, but if you're not looking to take on even more excessive volatility, it may make more sense to take a rain check on the name.

Foolish takeaway

We're living in unprecedented times. And for the oil sands operators like Suncor, there is a long-term value proposition. Unfortunately, many investors may not be patient enough to reap the rewards that will come after what could be another rout amid worsening conditions.

Stay hungry. Stay Foolish.

CATEGORY

1. Coronavirus
2. Investing

TICKERS GLOBAL

1. NYSE:SU (Suncor Energy Inc.)
2. TSX:SU (Suncor Energy Inc.)

PARTNER-FEEDS

1. Business Insider
2. Msn
3. Newscred
4. Sharewise
5. Yahoo CA

Category

1. Coronavirus
2. Investing

Date
2025/08/19
Date Created
2020/04/22
Author

joefrenette