2 Oil Stocks to Avoid During COVID-19

Description

Oil prices have become abysmal, and it is no wonder why investment has been steadily leaving Canada. Over the past five years, we have seen global oil companies abandon their Canadian assets.

Energy companies of the past are not what they are today; with strong oil prices, we could overlook badly run companies because they could still return a profit. But the wake-up call is here, and with low oil prices, highly indebted companies are struggling to survive.

Supply glut

On April 20, 2020, for the first time, we saw negative future oil price for May contracts. This technically means that energy companies are paying for someone to take their oil, free of charge!

The COVID-19 pandemic has decimated oil demand, as economic activity has slowed to a halt. As you can imagine, if there is no demand, supply will increase. This reduces the price drastically to the point where oil companies are storing oil rather than selling it.

And because there is so much supply, oil companies have run out of capacity to store it. This has forced oil companies to actually pay to get rid of their oil, as it may cost more to store than to simply give it away.

Oil companies to avoid

Baytex Energy (TSX:BTE)(NYSE:BTE) is considered to be a high-leverage play in the oil investment field and is on my watch list to go bankrupt. Falling from a high of $45 a share in 2014, the company now sits at $0.30 per share. It is no surprise this has occurred. The company has taken on a large amount of debt to generate higher returns.

This strategy is successful when oil prices are strong and damaging when oil prices are weak. Therefore, with oil prices decimated, Baytex is struggling. With short-term assets not covering short-term liabilities, Baytex is in a distressing situation. If you are bullish on oil prices and want extreme risk, this is your pick, but be forewarned of the risk of bankruptcy.

Crescent Point Energy (TSX:CPG)(NYSE:CPG) is the second company to avoid. I will point out that Crescent Point has ample cash and unutilized capacity to cover short-term debts, but the company also lacks the ability to be profitable at these low oil prices. The company has cut the dividend multiple times over the past five years and has done so during COVID-19.

If the dividend is being cut when oil prices are high, it paints a picture of how the company is being run. These are strong indications to avoid investment in the company, as it indicates that the company cannot generate strong free cash flow to support a dividend, let alone dividend growth.

Foolish takeaway

I have made my case, but it is ultimately up to you as an investor to form your own opinions. I believe the outlook for oil is bleak and that renewable energy will become the future of energy. If you are a contrarian investor, oil is ripe for the extreme risk. But you must only invest money you are willing to lose, as there is a high possibility of such an event occurring. That being said, I would avoid any investment in oil companies, specifically these two.

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