Will Baytex Energy Corp. Cut its Dividend?

Description

Oil production companies are getting hammered right now as increased supply coming out of the U.S. and worries about global growth are driving world oil prices much lower. West Texas Intermediate (WTI) is now trading close to a two-year low.

Many investors use the generous dividends paid by energy companies to supplement their income. With the oil market in a free fall, some of the big payouts could be at risk.

Baytex Energy Corp. (TSX: BTE)(NYSE: BTE) pays one of the largest dividends in the Canadian energy sector and investors are wondering if the distribution will get cut.

Let’s take a look at Baytex’s situation to see if the dividend is safe.

Overview

Baytex Energy produces crude oil, natural gas, and natural gas liquids. In Canada, the company’s focus is in the Peace River and Lloydminster regions of the Western Canadian Sedimentary Basin. The U.S. operations are located in the Eagle Ford play and Williston Basin in the United States.

Approximately 86% of Baytex’s production now consists of high-margin crude oil and natural gas liquids.

Financials

In its Q2 2014 earnings statement, Baytex reported a realized oil and NGL price of $81.74 per barrel, a 24% year-over-year increase.

In order to get the highest price possible for its production, Baytex is sending more of its heavy oil by rail. In Q2 2014 the company shipped about 55% of its production by rail and expected that number to be 60% for the third quarter.

Baytex had an operating netback of $40.74 per barrel of equivalent oil for the second quarter, a 28%

increase compared to the same period in 2013.

Baytex has an aggressive hedging program to protect earnings. For the third quarter, the company hedged 51% of WTI exposure at $96.45 per barrel. The company has also hedged 54% of its natural gas production and 45% of its exposure to Western Canadian Select pricing.

The company recently closed its $2.8 billion acquisition of Aurora Oil and Gas Limited adding 22,350 net contiguous acres of property in the liquids-rich Eagle Ford shale region. The added production and cash flow will help support the current payout.

Dividend risk

In the most recent earnings report, Baytex announced a 9% increase to its dividend. The current monthly payout of $0.24 yields about 8.7%. The dividend has doubled in the past five years.

Baytex maintains a conservative payout ratio. During the second quarter, the payout ratio before taking the dividend reinvestment plan (DRIP) into consideration was 47%. The payout drops to 37% when the DRIP is included.

If oil prices stabilize at current levels, Baytex should be able to maintain the dividend and still have ample cash flow for capital projects. The company’s hedging program combined with a weakening Canadian dollar will mitigate a large part of the recent fall in oil prices. A sustained drop in WTI to lower levels would probably put the distribution at risk.

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1. TSX:BTE (Baytex Energy Corp.)

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