



## Is Baytex Energy Corp. a Takeover Target?

### Description

With oil prices hovering around \$50, energy companies have been forced to slash dividends, cut capital programs, and raise equity in an effort to shore up their balance sheets.

At some point, oil and gas producers will have to start dumping assets in order to survive. Opportunistic investors are already setting up new funds to take advantage of the expected fire sale, but large energy companies with strong capital positions are also eyeing strategic targets.

Here's why I think **Baytex Energy Corp.** ([TSX:BTE](#))(NYSE:BTE) might find itself on the radar of the big boys.

### Setting the scene

Baytex had an interesting 2014. Last February, the company announced its \$2.8 billion purchase of Aurora Oil and Gas Ltd., a company with significant production and development potential in the Eagle Ford shale play. The market loved the acquisition and Baytex rewarded investors with a 9% dividend hike after the deal closed in June.

Oil prices began to slide through the summer, but Baytex received investor support until the end of August. At that point, the stock traded above \$48, but by mid-December, the world had completely changed. Baytex reduced the monthly dividend from 24 cents to 10 cents per share and slashed 2015 capital expenditures by 40%. Shareholders watched in horror as the stock hit \$15.

The cuts appeared to be sufficient enough to ride out the oil slump for the first half of 2015, given the company's conservative hedging program and strong production from the new Eagle Ford assets. The stock began to rebound on the back of improving oil prices, but new information has pundits wondering about the company's future.

Baytex just released its Q4 2014 earnings report and the following statement really stood out:

“A sustained low price environment could lead to a default of certain financial covenants, which in turn could impact our ability to borrow under existing facilities or obtain new financing. It could also restrict our ability to pay dividends or sell assets and may result in the debt of the company becoming immediately due and payable.

Should the funds generated from operations be insufficient to fund the minimum capital expenditures required to maintain operations, the company may draw the maximum funds available under our current credit facilities. As a result, we may consider seeking additional capital in the form of debt or equity, however, there is no certainty that any of these sources of capital would be available when required.”

### **Debt woes?**

Baytex finished 2014 with \$2.7 billion in total monetary debt and contractual obligations. This includes \$1.42 billion in long-term debt that is due beyond 2020, and about \$670,000 in bank loans that are due in three to five years. At first glance, the situation doesn't look critical because most of the debt isn't due immediately, but a problem with the covenants changes the perspective.

The company said it reached an agreement with its lending syndicate to ease the financial covenants on the outstanding debt on February 20.

As you can see in the following chart, the company almost breached its maximum allowed senior debt to capitalization ratio at the end of Q4 2014.

Source: Baytex Energy Corp.

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### Is Baytex ripe for a takeover?

Baytex currently has a market cap of about \$3 billion. If you add in the \$2.7 billion in total obligations, you get a minimum value of \$5.7 billion for a company that has a very attractive asset portfolio. At this point, a suitor would probably have to pony up a large premium to get a deal done, so Baytex is unlikely to be acquired right away.

Investors should prepare for an equity issue in the coming months, as the company could move to shore up the balance sheet. If oil prices move higher through the back half of 2015, the dividend will probably be safe and the company should survive as an independent firm.

If oil prices head lower and stay there for an extended period of time, the dividend could disappear and I think the odds of a buy out go way up, especially if Baytex breaches its new covenants.

### CATEGORY

1. Energy Stocks
2. Investing

### TICKERS GLOBAL

1. TSX:BTE (Baytex Energy Corp.)

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