Could China Bring Down Baytex Energy Corp. and Birchcliff Energy Ltd.?

Description

With markets showing more volatility, you may have read about many of the factors contributing to a slowing Canadian economy. From the collapse in oil prices to an impending housing bubble, there are plenty of headwinds. Perhaps the biggest of all, however, is something Canada can't fix on its own.

As the world's largest importer of raw materials, China drives the prices of many global commodities. Specifically, it is one of the largest buyers of oil and gold in the world. China accounts for a third of all the growth in oil demand and 80% of all the growth in metal demand over the past five years. This could be bad news for the many Canadian companies that are exposed to swings in commodity prices.

Recently, **TD Bank** released a note saying "if Chinese growth surprises to the downside, commodity prices would surely fall further. If China's weakness spreads to Canada's trading partners, that could slow down Canada's export-driven recovery."

What companies are most at risk?

One commodity is hurting the most

Oil prices are over 50% lower than they were just a year ago. This is a bigger problem for Canada than almost any other country as it's the world's fifth-largest oil producer. Crude oil is also its biggest export, making up 27% of Canada's total exports.

With the TSX hitting new lows, it has become increasingly clear that the collapse in oil prices is doing much more damage to the Canadian economy than initially predicted.

Producers are taking the biggest hit

Energy producers as a whole shrank 44% in the past year due to the slump in oil prices. Not only are global oil markets grossly oversupplied, but the biggest source of demand (China) appears to be stumbling.

Chinese industrial companies reported that profits fell 9% in August, the most since the government began releasing monthly data in 2011. The biggest drops were concentrated in the oil and coal sectors. Regardless of whether a specific company exports to China, all producers are hurt by slowing demand given that most major commodities are priced more or less on a global level.

Avoid these two companies

As two major producers of oil, shares of **Baytex Energy Corp.** (TSX:BTE)(NYSE:BTE) and **Birchcliff Energy Ltd.** (TSX:BIR) have predictably performed very poorly over the past 12 months. Baytex is down nearly 90%, while Birchcliff has managed to only to lose around 40%.

Why are these companies especially at risk? While their share prices have come down quite a bit, it's clear that both firms need higher oil prices to survive simply because of their debt loads.

Baytex has a debt-to-equity ratio of 56 times, while Birchcliff stands at an incredible 60 times. In spite of being worth only $680 million, Baytex has spent $109 million in interest expense alone in the past 12 months. Birchcliff is in a better but still dire situation, spending over $20 million in interest last year, pushing profits into negative territory over the past two quarters.

Unless you're a major bull on oil prices, it's best to avoid most oil producers in Canada. Slowing Chinese growth could put a damper on profits across the industry for longer than many anticipate.

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Date
2025/07/05
Date Created
2015/10/05
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