Is Baytex Energy Corp. Headed to Bankruptcy?

Description

In a sector filled with victims, perhaps no fall from grace has been as painful for investors as **Baytex Energy Corp.** (TSX:BTE)(NYSE:BTE).

Baytex started off 2015 at right around $20 per share, and ended up flirting with $25 when the price of crude recovered in April. But since then, it's been a long road down for the beleaguered producer. Even after surging 10.6% yesterday, Baytex is still down more than 75% thus far in 2015 and more than 88% over the last year.

What's gone wrong, besides the decline in crude? Like many other mid-sized producers, Baytex is dealing with too much debt. The company loaded up on debt while times were good, a move that's coming back to haunt it now that times are bad.

Can Baytex survive? Let's take a closer look.

The damage

Like many of its peers, Baytex picked the wrong time to bet on the future of crude.

Back in mid-2014, Baytex officially acquired Aurora Oil & Gas for a price tag of $1.8 billion and assumed some $1 billion in debt. Aurora was active in the Eagle Ford shale formation in Texas, which was a very attractive asset back when crude was $100 per barrel. Analysts also liked the deal because it helped Baytex diversify away from heavy oil.

Unfortunately, the deal doesn't look so good at $45 per barrel of oil.

Through the first six months of 2015, the numbers haven't been good. The company generated $376 million in cash from operations compared to $974 million for the whole year in 2014. At least capital expenditures have come down as well, coming in at $253 million so far this year.

The big issue is debt, and Baytex has a lot of it. At the end of June the company owed almost $1.7 billion, and that's after issuing nearly $700 million in new shares to pay back some of its loans. Management projects that it'll exit 2015 with senior debt of between $1.8 and $1.9 billion. That's a lot for a company with a market cap of just $1 billion.

The good news

Fortunately for Baytex shareholders, bankruptcy doesn't look to be imminent.

We'll start with a closer look at the debt. Yes, there's a lot of it, but none of it is due anytime soon. In fact, there's no major repayments due until 2021. And the company isn't in danger of breaching its debt covenants either, since it's allowed a senior debt-to-EBITDA ratio of 4.5 times until the end of 2016. Currently, that ratio is projected to be 3.5 times at the end of 2015.

Baytex also has the ability to borrow if needed. The company has more than $1 billion available on its credit facility, which was recently extended out until June 2019. This means Baytex should be able to tread water even if crude stays low for years.

Baytex is also cutting costs significantly. Management projects that it'll save $135 million in drilling and administrative costs by the end of 2015, and the recent decision to suspend the dividend will save an additional $165 million per year. These are prudent moves.

There's also the potential to expand production in Eagle Ford. After the recent cost cuts, breakeven in the area has fallen to $35 per barrel. Thus, if oil moves from just $45 to $55 per barrel, returns from Eagle Ford double.

Finally, there's the potential for the company to be acquired. It would take just $2.7 billion to scoop up the entire company at today's price, including assuming the debt. Remember, Baytex paid more than that to acquire Aurora just a year ago, a deal analysts liked at the time.

Over the next year or two, I see little risk that Baytex goes bankrupt. The company has good assets, no near-term debt maturities, and management has done a nice job cutting costs. It still needs crude to recover for it to be out of the woods, but overall, there are far worse companies in the sector. And if crude does head higher, Baytex shares could really surge.

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Date
2025/07/08
Date Created
2015/10/06
Author
nelsonpsmith