What Does OPEC's Decision Mean for Canada's Highly Indebted Oil Producers?

Description

In a widely expected move, the Organization of the Petroleum Exporting Countries (OPEC) decided on Friday not to curtail oil production, despite the slump in prices. In fact, OPEC even raised its quota by 5%, an acknowledgement that member countries are producing above their assigned maximums.

Oil prices have fallen in response–as of this writing, the WTI price is hovering just above US$40 per barrel. And the Brent price is not much higher.

Of course, this has impacted the share prices of Canada's energy producers, especially those with high debt loads. **Baytex Energy Corp.** (TSX:BTE)(NYSE:BTE) is down by more than 4%. **MEG Energy Corp.** (TSX:MEG) is down by 6%, as is **Penn West Petroleum Ltd.** (TSX:PWT)(NYSE:PWE).

So what exactly is the future of these companies?

Lower for longer

Over the past year the message from most of these companies was very similar. They made the case that they had enough staying power to weather the downturn and were well positioned for when oil prices recover.

But over the past few months the lower-for-longer oil-price scenario has looked more and more likely. After all, OPEC is not budging, and neither are non-OPEC countries such as Russia and Mexico. The outlook is more uncertain for American shale oil producers, but these companies have been cutting costs at a furious pace.

Meanwhile, the demand picture doesn't look any better. China's economy is growing at a much slower rate. Europe is limping along. And the stronger U.S. dollar hurts the buying power of most oil-importing nations.

Is bankruptcy possible?

Of the companies mentioned earlier, MEG is most likely to survive intact. But bankruptcy is a real possibility for companies such as Penn West and Baytex, along with a host of other highly indebted producers. After all, lower oil prices not only reduce cash flow, but they also make asset sales exceedingly difficult.

Buyouts make the most sense

Interestingly, **Canadian Oil Sands** could have been included on this list, were it not for the takeover offer from **Suncor Energy**.

And buyouts are a likely outcome for many other highly indebted producers, especially with strong companies like Suncor and **Imperial Oil** on the lookout for bargains. Other buyers may include pension funds or private equity.

But don't be fooled: this doesn't mean you should start buying companies like Penn West and Baytex. They may end up being taken out, but their share prices could plummet before that happens, meaning you would still be losing money.

Just look at what has happened to Canadian Oil Sands. If you had bought the shares right on October 2, you would have made a 40% gain by now. But if you bought the shares in early May, you would be looking at a steep loss, and your losses would be even wider if you've held the shares for more than a year.

Put simply, these stocks are not for the faint of heart. You should tread carefully.

CATEGORY

1. Energy Stocks
2. Investing

TICKERS GLOBAL

1. TSX:BTE (Baytex Energy Corp.)

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