



Can Baytex Energy Corp. Survive?

Description

Last year, when shares were at \$7, **Baytex Energy Corp.** ([TSX:BTE](#))(NYSE:BTE) completely discontinued its monthly dividend, saving the company roughly \$240 million a year. With the company losing over \$1 billion over the last four quarters, the dividend cut was seen as a last-ditch effort to stem the tide of deteriorating energy prices.

With its stock now down to just \$2.50 and the operating environment arguably much worse, can Baytex Energy continue to survive?

Debt may be its downfall

In the last 12 months Baytex has seen its operating cash flow fall from \$347 million a quarter to just \$168 million today. The company has been able to avoid generating negative free cash flow by slashing capital expenditures by nearly 50%. Still, free cash flow last quarter was just \$41 million, which pales in the face of the company's \$1.9 billion debt load. Last year it spent over \$100 million in interest expenses alone.

While cutting capital expenditures has allowed the company to conserve cash, it's having some real effects on the underlying business. In 2015 the company averaged around 86,000 barrels a day of production. In 2016 management is guiding for only 74,000-76,000 barrels a day.

In the race to stay financially solvent, it looks like Baytex is gutting its future. Unfortunately, that may be its only option. Debt levels are now over three times EBITDA, and lenders are becoming increasingly impatient with loss-making producers. The company does have a \$1.06 billion credit line, but 25% of it has already been used up.

Baytex management wants investors to look into the future and imagine higher oil prices, but growing losses and mounting debt levels are forcing the company to focus on preserving today.

Today's oil prices are simply not survivable

Baytex believes that across its three biggest projects, its breakeven oil price is between \$35 and \$47 a

barrel. In fact, the company's return forecast for each well is based on \$50 crude. With oil sticking around \$30 a barrel, things need to improve fast. The company does have one trick up its sleeve, however.

For 2016, Baytex looks to have a relatively attractive hedging program, one that might allow it to survive until oil prices improve. Around 40% of its oil production is now hedged through various arrangements. In total, the company should realize selling prices around \$10 higher than spot prices. At \$50 a barrel, however, the hedges start to wear off. Still, Baytex may have bought itself a lifeline if prices remain under \$50.

Unfortunately, by 2017, almost no production is currently hedged. If low prices persist until then, it's hard to see Baytex surviving in its current state.

A tricky thesis

If oil prices rebound in a meaningful way, Baytex will no doubt have significant upside. The issue with taking a bet is that you need to predict both the direction and timing of oil prices. If you're right about oil staging a rebound, you may still lose with Baytex if things take an extra year or so to develop. As a debt-ridden company that's completely unhedged next year, Baytex needs \$50+ oil by 2017 to survive.

CATEGORY

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1. TSX:BTE (Baytex Energy Corp.)

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