



Will Oil Recover Quickly Enough for Baytex Energy Corp. to Survive?

Description

If **Baytex Energy Corp.'s** ([TSX:BTE](#))(NYSE:BTE) management team could have seen the future, I doubt the company would have agreed to spend \$2.8 billion on Aurora Oil and Gas back in 2014.

At the time, it seemed like a pretty good idea. Aurora's reserves were located in the Eagle Ford area in Texas, a shale formation that had very attractive economics with the price of crude floating around \$100 per barrel. And perhaps most importantly, Eagle Ford offered Baytex light oil production, diversifying it from heavy oil—its previous focus at two other projects.

Oh, what a difference a couple of years makes. Crude has collapsed from more than \$100 per barrel all the way down to below \$30, yet Baytex is still on the hook for billions in debt it took on when times were good. Although the company has tried its best to cut costs, it's still been a rough time. The share price fell all the way from \$48 to \$2 on the TSX, and many investors think Baytex is on the cusp of bankruptcy if crude doesn't recover in a hurry.

Is it really that dire? Let's take a closer look.

Biding some time

There's no doubt Baytex needs oil to recover in a major way. With breakeven costs of approximately \$45 per barrel as an average for its three major projects, \$28 per barrel crude is not going to be enough for the company, no matter how aggressively it cuts costs.

But at the same time, Baytex has made some astute moves to bide some time. It issued some 35 million shares back in the second quarter of 2015 and used the proceeds to pay down the debt. It also eliminated the dividend of \$0.10 per share each month, which translated into annual savings of approximately \$250 million. And the company has cut its planned capital expenditures for 2016 to between \$325 and \$400 million, while only forecasting a small drop in production.

The debt isn't really a pressing concern either. There's no debt due until 2021, giving Baytex plenty of time to wait for oil to recover. Yes, the company could breach its debt covenants if crude stays this low for a long time, but it currently has plenty of wiggle room until it breaches these covenants. It also has

\$850 million in available credit if needed.

Huge upside if oil recovers

When oil recovers in a meaningful way, there's potentially massive upside for Baytex.

Back in June 2014, when oil peaked at approximately \$105 per barrel, Baytex shares traded hands for \$48 each. The current price is \$2.44, which represents a decline of 95%.

Ouch.

That's ugly, but it's all in the past. We have plenty of evidence that Baytex currently is an investment in oil on steroids. On January 20, oil fell to just over \$28 per barrel. A little more than a week later, it had rebounded nicely, flirting with \$34.

In that same period, Baytex shares surged. They hit a low of \$1.58 on the TSX. Just over a week later they opened at \$3.14 each, good enough for a double in just over a week. And that's just on a 20% move in the underlying commodity. If crude recovers to \$50, I can see a scenario where Baytex trades between \$8 and \$10 per share.

Baytex is a massive bet on crude recovering, plain and simple. If it happens, shareholders are likely going to be very happy. But if it doesn't, there's a very real possibility of bankruptcy. The nice thing about Baytex is the company looks poised to handle the downturn pretty well, even if it stretches out into 2017.

CATEGORY

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1. TSX:BTE (Baytex Energy Corp.)

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