Why Didn't Baytex Energy Corp. Participate in the Oil Rally?

Description

Last Friday the price of oil had one of its biggest jumps in months, up over 10% in a single day. With its crumbling financials desperately needing higher oil prices, many would guess that shares of **Baytex Energy Corp.** (TSX:BTE)(NYSE:BTE) performed strongly that day. Instead, the stock ended about flat to finish the trading session.

Why aren't shares popping with oil prices?

The company might not survive to enjoy higher prices

Right now, Baytex Energy isn't focused on the long-term potential of oil; it's focused on surviving. The company has lost over $1 billion over the last four quarters and has $1.9 billion in debt, despite having a current market cap of just $550 million. It's suspended all dividend payments and has cut capital expenditures by 50% to preserve cash.

Throughout all of this, it looks like its underlying business is deteriorating. 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.

Looking at all of this, it's no wonder that shares aren't participating in a rally. Whether oil prices are $25 a barrel or $35 a barrel, Baytex is still set to lose money. Across its three biggest projects, its breakeven oil price averages around $40 barrel. Once all extraction and business costs are factored in, it looks like $50 a barrel oil might be necessary to earn a respectable profit.

How has Baytex held on so far? Last year the company had an attractive hedging position that allowed it to sell oil for a significant premium over prevailing market rates. This year around 40% of its oil production is still hedged, allowing the company to realize selling prices around $10 higher than spot prices. By 2017, however, almost no production is currently hedged.

By not participating in oil rallies, it looks like the market is signaling its belief that Baytex may not make it another 12 months.

Should you take a chance?

If a company is primed for bankruptcy but can figure out a way to survive, shareholders who bought at the bottom sometimes stand to make 10-100 times their original investment. For Baytex, however, it’s a risk worth avoiding.

Due to its massive debt load (which costs over $100 million in interest payments alone) and mounting cash losses, potential investors need to predict both the direction *and* timing of oil prices. If your anticipated rebound happens six months too late, an investment in Baytex may still go to zero.

Falling production and a horrific capital structure will also make any likely suitor wait until the assets enter liquidation. At best, competitors will buy the company after Baytex restructures its debt, most likely handing over nearly all the equity to debtholders.

Unless you were already planning on buying lottery tickets this week, an investment in Baytex simply isn’t worth the risk.

CATEGORY

1. Energy Stocks
2. Investing

TICKERS GLOBAL

1. TSX:BTE (Baytex Energy Corp.)

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Date
2025/08/26
Date Created
2016/02/16
Author
rvanzo