Baytex Energy Corp. Just Hit its Breaking Point

Description

Everyone has a breaking point. For many oil companies, including **Baytex Energy Corp.** (TSX:BTE)(NYSE:BTE), that's oil at $30 a barrel. It's at that point that the company and many of its peers can no longer make money on production out of some of their wells, which forces the company to shut down until conditions improve.

Laying down the rigs

In response to low oil prices last year, the entire industry cut back spending; Baytex Energy cut its capex budget down to $521 million, which is a hefty drop from the $766 million it spent in 2014.

That said, despite the steep cut in spending, the company's production actually increased from 78,395 barrels of oil equivalent per day (BOE/d) to 84,648 BOE/d. This is primarily because it was able to focus on its best opportunities while becoming much more efficient; the company realized $150 million in efficiencies alone last year.

Unfortunately, with oil prices even lower in 2016, the company has no choice but to make another deep cut to its capex budget.

As things stand right now, it plans to spend just $225-265 million this year, which is 33% lower than its initial budget and roughly half of what it spent last year. It's a spending level that is not high enough to drill the wells needed to maintain its current rate of production. In fact, with this latest cut the company has decided not to drill 12 wells at Peace River and two dozen more at Lloydminster, which were needed to help offset the decline from legacy wells in both plays.

Turning off the pumps

Worse yet, the company has decided to shut in production from wells that are no longer economic. Overall, Baytex plans to shut in 7,500 BOE/d of production from wells that just can't make much money, if any, at $30 oil. That's a significant amount of production at roughly 9% of its average production rate last year.

It’s not alone either. **Penn West Petroleum Ltd.** (TSX:PWT)(NYSE:PWE), for example, is also being forced to shut in a significant amount of its production in 2016 because it’s no longer economic. Currently, the company has 4,000 BOE/d shut in with another 2,500 BOE/d likely to follow because it can’t justify the spending it would take to repair the equipment needed to keep that production flowing. Combined, that represents about 8% of Penn West Petroleum’s production.

When the production shut-ins are combined with declining production from legacy wells, Baytex Energy’s production is expected to drop to a range of just 68,000-72,000 BOE/d in 2016, which is 17.3% less at the mid-point than what it produced last year. That’s a bit better than Penn West Petroleum, which will see its production drop by 19.5% over last year.

These decline rates really make it abundantly clear that $30 oil is the breaking point for many of Canada’s smaller oil producers.

Investor takeaway

In 2015 Baytex Energy showed strength amid the storm by growing its production while spending much less than in previous years. However, with even lower oil prices in 2016, the company has hit a wall and it can no longer invest what it will take to maintain its current production rate. It’s a sign of just how tough conditions are right now, which leaves investors holding out hope that higher oil prices are just around the corner.

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