Is Baytex Energy Corp. the Best Way to Play the Rebound in Crude?

Description

Sharply weak oil prices caught the energy patch off guard, and their sustained weakness continues to apply considerable pressure to oil companies, particularly those that remain heavily leveraged. One company that was caught flat footed by the calamitous plunge in crude was **Baytex Energy Corp.** (TSX:BTE)(NYSE:BTE).

However, over the last year management has worked hard to right the ship. Many investors are now wondering if it offers one of the best ways to play the long-awaited rebound in crude.

Now what?

In early 2014, Baytex pushed ahead to acquire Aurora Oil & Gas Ltd., which had the core of its operations located in the sweet spot of the Eagle Ford shale. At the time, with oil trading well above US$100 per barrel, it was hailed as a transformative acquisition for Baytex. This was because it would substantially boost Baytex's light oil production by about 28%, reduce its reliance on Canadian heavy crude as a key driver of revenue, and give it direct access to West Texas Intermediate (WTI) prices.

The last point is particularly important because the light tight crude produced from the Eagle Ford acreage sells close to the market price for WTI rather than at a significant discount like Canadian light or heavy crude blends.

Nonetheless, in order to complete this $1.8 billion transaction, Baytex had to make an equity offering and load up on debt. Baytex assumed Aurora's debt of $744 million.

Then the unthinkable occurred. The price of crude collapsed and, in the space of a year, had plummeted to the point where it was almost a third of its price at the time of the acquisition. This created a dangerous predicament for Baytex. Because of its heavily leveraged balance sheet and deteriorating cash flows, there was the danger that it would breach its financial covenants.

Accordingly, management moved quickly to shore up Baytex's balance sheet and improve operational cash flow by taking a knife to capital expenditures, slashing the dividend and reducing costs. These measures, which eventually saw it suspend its dividend and start to shut down uneconomical production, are paying dividends for Baytex.

Not only has it been able to shore up its balance sheet, but it now has some of the lowest cash costs per barrel among its Canadian peers. For 2015, cash costs were a very impressive US$16 per barrel, which was well below the price of crude, meaning that it could keep the spigots open to generate cash flow. A key reason for this is the company's Eagle Ford acreage has cash costs of less than US$16 per barrel, which are far lower than those for its Canadian oil acreage.

Furthermore, Baytex is not resting on its laurels. It remains focused on improving the sustainability of its operations over the course of 2016. Baytex recently announced that it has amended its credit facilities, reducing debt by US$575 million and restructuring its financial covenants. These amendments are expected to generate annual cost savings of $8 million during 2016 and give Baytex sufficient liquidity and flexibility to sustain its business for as long as oil prices remain weak.

So what?

Baytex is certainly making all the right moves to ensure that it emerges from the oil rout relatively unscathed, and the recent amendments to its credit facilities have given it extra room to breathe should crude fall any further.

Meanwhile, its ongoing focus on its Eagle Ford assets not only makes sense in the current harsh operating environment because of their superior margins, but will leave it well positioned to take advantage of any rally in crude.

For these reasons, Baytex shapes up as an interesting leveraged play on crude, but one that is certainly facing its fair share of risks at this time.

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