



Why \$50 Oil Is Great News for Baytex Energy Corp.

Description

When crude prices crashed into the low \$30s earlier this year, **Baytex Energy Corp.** ([TSX:BTE](#))(NYSE:BTE) was forced to make significant changes. The company shut in 7,500 barrels per day of low and negative margin heavy oil production, while also canceling plans to drill nearly three dozen wells in two of its core plays. However, with crude touching \$50 a barrel in recent days—the first time it has hit that mark since last July—the company is in a much better position than it had been.

\$50 oil improves its netbacks

When the oil-price decline accelerated earlier this year, Baytex proactively shut in 7,500 barrels per day of heavy oil production that just wasn't profitable at weak prices. It was a very meaningful amount of production, equal to 9% of its fourth-quarter output. However, oil around \$50 a barrel significantly improves the netbacks the company could be earning from this production.

Because of that, Baytex is in a much stronger position to increase its cash flow. Not only can it quickly bring this shut-in production back online, but it can also capture higher netbacks on the rest of its production.

For perspective on what \$50 oil means for the company, we just need to look to its recent past. When oil averaged \$30 a barrel last quarter, the company was only able to capture operating netbacks of \$11.41 per barrel when adding in the impact of its oil and gas hedges. Contrast this with 2014, when the company was able to capture \$34.04 per barrel in netbacks as oil averaged \$53.72 per barrel.

In other words, not only can the company quickly put its shut-in production back online, but it can capture substantially higher netbacks overall, which will drive much stronger funds flow going forward as long as oil stays above \$50 a barrel.

\$50 oil puts more drilling back on the table

In addition to turning off the pumps of its lowest-margin production, Baytex also had to stop drilling in two of its core plays earlier this year. The company had initially planned to drill a dozen wells in its Peace River heavy oil play and two dozen more at Lloydminster. However, with oil in the \$30s, it had to

cancel those plans.

Not only did it need to cut capex spending because of its weak cash flow, but those plays just weren't profitable to drill. In fact, its Lloydminster play required \$43 oil to break even, while Peace River needed oil above \$46. Those were much higher levels than its Eagle Ford play, which had a breakeven cost in the low \$30s.

However, with oil over \$50 a barrel, these two plays are now appealing drilling options. In fact, at \$50 oil Lloydminster's rate of return is north of 50%, which is above the rate it could earn in the Eagle Ford. Meanwhile, Peace River is once again profitable, though it needs oil to rise above \$57.50 a barrel before it would beat the Eagle Ford. Still, with oil around \$50 a barrel, Baytex's drilling options and return potential have increased substantially.

Investor takeaway

While many in the market see oil above \$50 a barrel as a key psychological mark, it's more than that for Baytex. It's the price where the company's netbacks and drilling options improve dramatically. Needless to say, the company hopes this oil price holds, so it can really start cashing in.

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Date

2025/08/15

Date Created

2016/05/30

Author

mdilallo

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