



## What Does Sub-\$40 Oil Mean for Baytex Energy Corp.?

### Description

It appears the bull market in energy was short-lived.

Almost two months ago the price of crude oil was comfortably over \$50 per barrel, and traders were talking about how the glut of supply that plagued the market was perhaps finally behind us. For the first time in a long while, people were optimistic.

Oh, how things can change. Crude quickly plunged after hitting \$52 per barrel in early June. By the end of Tuesday's trading, a barrel of West Texas Intermediate was \$39.67.

What exactly does sub-\$40 oil mean for **Baytex Energy Corp.** ([TSX:BTE](#))(NYSE:BTE)? Let's take a closer look.

### Production

Baytex has three main areas of production: Eagle Ford in Texas, and Lloydminster and Peace River in Alberta. Eagle Ford is all light oil, while production from both sites in northern Alberta is primarily heavier oil.

Eagle Ford is the big draw; the company spends 100% of its capital budget in the region. Thanks to aggressive cost-cutting measures, breakeven prices per barrel dipped from \$35 to \$30, meaning even if oil spends time below \$40 per barrel Baytex can still eke some cash flow from Texas.

Things are a little more dire for its heavy oil production in Lloydminster and Peace River. Breakeven prices for both of those projects are approximately \$45 per barrel. Approximately 38% of production comes from northern Alberta and 62% comes from Eagle Ford.

### Hedging program

Baytex has traditionally been a company that was content to just get market price for crude—a strategy that worked out pretty well when the price of oil was in excess of \$100 per barrel. These days, however, the company has taken a much more conservative approach.

The hedges are a little complicated, but here's how they work.

The company has hedges in place that protect approximately 35% of projected 2016 output. These are in the form of either straight price hedges or as part of a floating contract that guarantees a certain price difference between heavy oil and lighter oil.

Baytex also has a natural gas hedging program with some 65% of production protected.

In short, Baytex has done a nice job protecting its downside in an era where such a move is especially prudent.

### **Balance sheet**

The good news for Baytex is the company's balance sheet should be solid enough to withstand even an extended period of sub-\$40 oil.

The company's debt load of \$1.9 billion does seem pretty daunting on the surface, but it isn't so bad. Management managed to pay down approximately 5% of the total owing in the first half of 2016 during challenging market conditions.

The company was smart when it took on much of this debt from an acquisition in 2014 by stretching most of the maturities well into the future. Now it doesn't have to worry about making any major debt repayments until at least 2021.

Additionally, the company is well under debt covenants and still has some \$400 million in unused credit facilities it can tap if needed.

### **Overall outlook**

Overall, Baytex is in pretty good shape to endure even a prolonged drought in the energy market.

For most of the past year Baytex shares have been acting as a levered play on oil. When crude goes up, Baytex shares bounce even higher. And when crude sinks, Baytex shares fall proportionally more.

Shares peaked at nearly \$9 each back in early June when crude was comfortably over \$50 per barrel. These days shares trade hands at \$5.72. That's a decline of approximately 33%, while crude is down just over 20%.

If investors can handle the volatility, Baytex seems to be a good choice to play crude's recovery. It has good assets in Texas, a solid balance sheet, enough internal cash flow to fund capital expenditures, and a hedging program to help protect on the downside.

### **CATEGORY**

1. Dividend Stocks

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2. Investing

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1. TSX:BTE (Baytex Energy Corp.)

Category

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Date

2025/09/11

Date Created

2016/08/03

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