Baytex Energy Corp. Avoids Bankruptcy: What Now?

Description

Earlier this year **Baytex Energy Corp.** (TSX:BTE)(NYSE:BTE) was on life support. With shares languishing around $2, many investors were expecting the company to declare bankruptcy.

Today shares have tripled off their lows and now trade above $6. A big help has been the resurgence of oil prices which are now around US$50 a barrel. Still, Baytex stock remains well below its previous trading level of $35-45 a share. Will Baytex shares continue to climb?

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Hedges guaranteed its survival

Why was Baytex able to survive the latest oil rout? Thankfully, the company's management team implemented a large hedging program that took a lot of pressure off its cash flow situation.

About 80% of 2016 oil production was hedged through a variety of contracts. In all, the hedges gave Baytex a boost in profitability with prices under $50 a barrel. While its attractive hedging program is allowing it to eke out the rest of 2016, only 50% of next year's production is hedged.

Can Baytex maintain its momentum into next year despite losing some of its selling price protection?

Production is shifting towards the United States

Last quarter roughly 55% of output stemmed from the United States with the remaining 45% coming from Canada. Such a large contribution from Canadian oil sands has killed profitability. For example, during the first quarter of this year, Canadian heavy oil sold for $10 a barrel despite the list price of crude averaging above $30.

The good news is that Baytex is shifting its production towards more attractive projects, complete with lower costs and higher-quality output. By redirecting its capital expenditure budget to the Eagle Ford region, Baytex is naturally boosting its U.S. output nearly every quarter. For example, in the firstquarter of 2015, 53% of production came from Canada.

Only one problem

Investors will likely appreciate the improving fundamentals that come from higher-quality production. Still, this is unlikely to continue over the long term.

In 2016, 33% of production was considered "light oil." Another 32% came from the lower-quality "heavy oil." As Baytex focuses spending on the Eagle Ford region, more light oil should be produced, improving revenues and profits. But this can only happen for so long considering just 14% of reserves are light oil. Meanwhile, heavy oil constitutes 42% of reserves.

Unless Baytex sells properties or makes a transformational acquisition (which is unlikely considering its financial condition), output should trend towards heavy oil over the long term. This will be inevitable. For example, when oil prices fell the company was forced to suspend 7,500 barrels a day of heavy crude production in Alberta. In recent months, Baytex restarted 95% of these heavy oil rigs.

While many investors are getting excited about the "new" Baytex, shares will likely underperform its competition in the coming years considering its production will inevitably trend towards lower-quality, lower-profitability sources.

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1. TSX:BTE (Baytex Energy Corp.)

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