Why the OPEC Agreement Is Such a Big Deal for These Oil Stocks

Description

OPEC's recent decision to end its market share war should drive oil prices much higher over the next year than they would have without OPEC's support. For some oil stocks, that is icing on the cake after they spent the past couple of years getting their costs down to thrive at lower prices. However, for **Baytex Energy Corp.** (TSX:BTE)(NYSE:BTE) and **Pengrowth Energy Corp.** (TSX:PGF)(NYSE:PGH), this agreement could tip the scales to enable both companies to start growing again.

Closing in on the pivot point

Before the OPEC announcement, Baytex's CEO Jim Bowzer expected that 2017 capex spending would "be at the levels that we are at today." That's about $225 million, which is less than the roughly $300 million spending level required to hold production flat. To reach that spending level while remaining within cash flow, the company needs oil to average about $55 a barrel next year.

That pricing level is much more likely now that OPEC is supporting oil prices. The company could restart its dormant Canadian drilling program, which it shut down this year amid weak pricing. Further, the deal could provide Baytex with the cash flow and economic incentive it needs to restart the shut-in production from its recently acquired heavy oil wells in Peace River. Suffice it to say, the OPEC deal could be just what Baytex needs to at least keep production flat next year, if not grow it should oil prices move well beyond $55 per barrel.

Just what the balance sheet needed

Fellow heavy oil producer Pengrowth had also cut capex spending well below the maintenance level. In fact, the company only intends to spend about $65 million in 2016 on capex, which was well below the $184 million it spent in 2015. However, unlike Baytex, that level was well below its projected cash flow because the company's aim was to generate excess cash flow, so it could get out ahead of looming debt maturities.

Unfortunately, despite reducing debt by more than $400 million over the past year, Pengrowth still has a long way to go. In fact, the company recently warned investors that "absent an improvement in oil and natural gas prices, Pengrowth may not remain in compliance with certain financial covenants in its senior unsecured notes and credit facilities during the second half of 2017." Such an event could result in the company's senior unsecured notes and credit facilities becoming due on demand, which would likely force the company to declare bankruptcy.

However, with OPEC stepping in, it might push prices high enough so Pengrowth can remain in compliance. Further, it could open new doors to help the company address its balance sheet issues, including enabling it to sell some non-core assets, which has been a challenge due to market conditions.

Meanwhile, the company might be able to refinance some of its 2017 debt maturities instead of having to find a way to pay them off. If any of these solutions turns into a reality, Pengrowth could start investing capital back into its business next year to halt the output slide.

Investor takeaway

Baytex and Pengrowth desperately need higher oil prices to get back on solid ground, which is much more likely after OPEC cuts production. That said, both companies still have plenty of work ahead of them because they need to pay down debt and reduce costs, so they will not need to rely on outside help going forward. So, while things are certainly looking up for these two, there's still significant risks in owning these stocks; for example, OPEC could take away its support before they fix their financial issues.

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1. Editor's Choice

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1. TSX:BTE (Baytex Energy Corp.)

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