



OPEC May Soon Declare War on Baytex Energy Corp.

Description

Goldman Sachs just came out with a report on the medium-term future for the oil market, and it wasn't particularly promising.

It essentially boiled down to this: Goldman Sachs thinks the price of oil will continue to languish until at least 2019 because of a number of factors. The biggest is shale oil production in the United States, which is poised to be strong both this year and next.

Investors assumed production would go down as the price went lower, and it happened. But oil producers adapted, in part, by cutting their costs. **Baytex Energy Corp.** ([TSX:BTE](#))(NYSE:BTE) reports that its shale drilling production in Texas's Eagle Ford formation has a current breakeven level of \$30 per barrel.

It isn't just Baytex that has reported lower breakeven costs. Most of its competitors have also been cutting costs by laying off employees or slashing head office expenses. This ensures they're able to continue production even if crude falls further.

There's just one problem. What happens when OPEC has enough?

The 600-pound gorilla

We've all seen what OPEC can do to the price of oil.

The world was first introduced to OPEC's power in the 1970s. It made the decision to cut oil exports to the United States (and some of its allies) for supporting Israel in the Yom Kippur war in 1973. Long lines appeared at gas stations as Americans struggled to get enough gasoline to fill their cars.

During this recent downturn, OPEC did the opposite. The cartel kept production high despite a weak crude oil price. The reason? Nothing was ever said officially, but it was still obvious. OPEC wanted to crush U.S. shale oil producers.

It didn't quite work, however. Yes, dozens of oil producers were bankrupted, in both the United States

and Canada. Production dropped, and thousands of employees lost their jobs. Many previously strong producers were on the brink of bankruptcy.

But then the price of oil recovered, increasing from a low of under \$27 per barrel to just over \$55 per barrel. This strengthened many producers just enough to convince bankers and other debtholders to keep the company going. They secured the financing needed to live another day.

Meanwhile, costs went down, and these companies discovered they could compete in a world where oil only traded at \$45 or \$50 per barrel. This would have been unheard of a few years ago.

There's nothing stopping OPEC from forcing down the price of crude oil again. The cartel's agreement to cut production could be suspended at any point, which would send prices tumbling.

The problem with Baytex

Baytex is poised to weather a short-term decline in commodity prices. But things get trickier over the medium to long term.

The company currently owes creditors \$1.75 billion. That is a huge amount for an organization that has a market cap of \$902 million and which produced funds flow of just over \$250 million in 2016.

Baytex doesn't have any debt due until 2019 at the earliest, when its bank-issued credit line comes up for maturity. The company currently owes \$256 million on its credit line. After that, it has just \$9 million of debt coming due in 2020 and then a whopping \$739 million coming due in 2021.

One of the things investors liked about Baytex was that its debt situation wasn't dire. The company had time to wait out the storm. But if oil continues to be weak until 2019 or beyond, things will get a lot dicier.

The bottom line

Baytex will likely end up being a very lucrative investment if the price of crude oil rallies. That much is obvious. Investors need to be more concerned with the downside.

If OPEC starts another price war, producers like Baytex will really feel the pain. Thus, investors looking to get in today should be cautious if today's low prices persist.

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Date

2025/07/08

Date Created

2017/03/22

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