Are Baytex Energy Corp.'s Growth Days Over?

Description

Baytex Energy Corp. (TSX:BTE)(NYSE:BTE) used to be a growth-focused oil company. However, as a result of a significant decline in oil prices, the company not only stopped growing last year, but its production dropped sharply. While the company expects to return to growth mode this year, it still has a long uphill battle just to get back up to its former peak. Unless something transformational occurs, Baytex's growth days could be in the rear-view mirror.

All good things must come to an end

As the following chart shows, Baytex's production was on a steady upward trajectory until last year:

Baytex Production

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Data source: Baytex. Chart by author.

However, that growth came to a halt as a result of the oil market downturn, which forced the company to take action to shore up its balance sheet. Among the measures it took was to shut in uneconomic production, significantly reduce capital spending, and sell some non-core assets.

The decline in capex had the most meaningful impact because the company could no longer drill enough new wells to maintain its output. For perspective, the company initially expected to invest $325-400 million last year, which would enable it to drill enough new wells in the U.S. and Canada to keep its production between 74,000 and 78,000 barrels of oil equivalent (BOE/d) after proactively shutting in 7,500 barrels of uneconomic production.

However, as a result of a sharp sell-off in oil prices to start the year, the company cut spending by another 33% to $225 million, including axing its entire Canadian drilling program, resulting in the projection that production would fall to a range of 68,000-72,000 BOE/d. In the end, the company was able to produce about 69,500 BOE/d last year after the dust settled on some M&A transactions that including jettisoning some non-core assets in the U.S. and Canada as well as recently completing an acquisition in Canada.

The road ahead

With higher oil prices on the docket for 2017, Baytex was able to increase its spending level for the first time in two years, setting an initial budget of $300-350 million. However, that's still not enough capital to maintain last year's production rate. Though, the company's output will steadily increase throughout the year, so production in the fourth quarter should be 3-4% higher than it was at the start of this year.

Still, that leaves Baytex quite short of its 2015 peak. At best, all the company will be able to do is deliver low single-digit output increases on an annual basis at current oil prices, which means it could be years before it reclaims the previous peak. The company would need oil prices to rise sharply, which would provide it with more cash flow to drill additional wells.

For perspective, Baytex needs $55 oil to fund its current $300 million capex budget, while $65 oil would give it upwards of $150 million in free cash flow, which it could use to fuel meaningful production growth. For example, the company can drill an Eagle Ford well for around US$5.6 million and deliver an initial production rate of about 1,300 BOE/d given its recent well results. Meanwhile, a Peace River well costs it about $2.5 million, and those wells have recently delivered initial production rates of around 600 BOE/d.

Baytex's other option is to look for acquisitions that move the needle. The company was able to find one deal last year, paying $65 million for assets in the Peace River, which added 3,000 BOE/d to its production base as well as another 3,000 BOE/d of shut-in production that it can restart for around $30 million. It would just take a few more deals like that to get the company back over the top.

Investor takeaway

The way things are going right now, Baytex is a long way from getting back to its prior peak, let alone start growing again. However, it wouldn't take that much to get the company back on track as a meaningful oil price improvement or a needle-moving acquisition would do the trick. The problem is that both of those things are largely outside the company's control, which means investors are betting more on hope, because Baytex can't deliver much growth given the way things are at the moment.

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