What’s the Worst-Case Scenario for Baytex Energy Corp.?

Description

Baytex Energy Corp. (TSX:BTE)(NYSE:BTE) is certainly in hot water right now, and with the WTI crude oil price hovering between $40 and $47 per barrel these past two weeks, investors are becoming increasingly worried about sub-$40 oil and the long-term impacts this will have on highly levered oil producers such as Baytex.

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The oil producer’s share price has proven to become more sensitive to oil prices of late, as it appears the market has priced in a significant risk of default into the company’s shares. At about $3.15 per share, the company’s equity is currently trading around 60% of book value, a level typically reserved for distressed firms. Investors buying in at these levels are hoping for crude prices to increase and maintain higher levels for a sustained amount of time. They’re also hoping for earnings results that come in better than expected later this month, highlighting how the company has done with respect to making operational changes to deal with lower crude oil prices.

Here are a few different scenarios of how things can roll out moving forward, assuming that oil prices stay stagnant or decrease and that Baytex management is not able to get out from under the debt load.

The absolute worst-case scenario for Baytex shareholders would be bankruptcy; in bankruptcy situations, shareholders are junior to debt obligations. Thus, shareholders typically receive nothing. In fact, over the past 12 months, debt holders of bankrupt mining and energy firms have typically only received 15 cents on the dollar on average, meaning bankruptcy is the absolute worst situation for everyone and therefore is likely to be avoided.

The more likely scenario, rather, is that Baytex is offered some sort of takeover offer for the entire company, or a deal for the company’s shale assets. The highly levered heavy oil assets have potentially been overlooked due to the fact that the company’s oil sands assets are significantly less desirable in this current market. Baytex management would be very unlikely to part with its shale assets, which are much more valuable in this current environment due to their low breakeven price. A takeover offer might be likely should Baytex’s share price approach the $2-per-share level again (or a 0.4 price-to-book ratio).

Some form of restructuring is looking more likely with asset sales topping the list of possible structural moves that management can make in a relatively short amount of time. Taking a loss on recently acquired assets may be out of the question, so this remains a sticky topic and an uncertain one moving forward.

Bottom line

Baytex remains an extremely speculative play. Heightened uncertainty relating to the company's ability to maintain profitability has cast a large shadow over its operations. I would recommend extreme caution with this name and let the gamblers and falling-knife-grabbers load up.

Stay Foolish, my friends.

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