3 Canadian Energy Stocks That Could Fail During 2019

Description

Since the oil slump began in late 2014, it has been tough to be a Canadian energy investor. While there are signs that the climate for upstream oil and gas stocks is improving, many Canadian drillers remain under significant pressure. A combination of heavy debt loads, high breakeven costs, thin profit margins, and growing uncertainty over the future of oil sands are all weighing on Canada's smaller intermediate oil producers.

Let's take a closer look at three drillers that may not survive in their current form to the end of the year.

MEG Energy (TSX:MEG)

Intermediate oil sands producer MEG has focused on reducing debt and boosting efficiency at its operations, but it appears that this may not have been enough to ensure the company's survival. For the full year 2018, MEG reported meagre adjusted funds flow from operations of $180 million, which was less than half of the $374 million reported a year earlier. This was essentially insufficient for MEG to fund its operations, capital program, or make any meaningful inroad into reducing its substantial debt totaling $3.7 billion, which is 21 times adjusted funds flow from operations.

It appears that the only option to reduce that eye-watering level of debt is for MEG to monetize further assets through sales and direct the capital raised to repayments. The only positive factor regarding MEG's debt is that it has a well-laddered profile with no maturities until 2021, giving it some breathing space to benefit from higher oil.

While MEG does appear to be running on fumes, and management's decision to reject **Husky's** offer was poorly timed, growing production combined with higher Canadian heavy oil prices and greater operational efficiency do point to the company surviving.

Pengrowth Energy (TSX:PGF)

Time to own up to my mistakes. After taking a bearish view of Pengrowth, I altered course, believing that several positive catalysts, including higher oil, growing production, and significantly lower debt pointed to a brighter future. Even Alberta's mandatory production cuts that triggered considerable fallout for the energy patch benefited Pengrowth by substantially narrowing the gap between Canadian heavy crude and WTI.

None of that appears to have been enough to save the company. After reporting some disastrous fourth-quarter 2018 results, including a $503 million net loss compared to a $210 million loss a year earlier, Pengrowth announced it would commence a strategic review. Typically, such an announcement doesn't bode well for any business and points to a looming restructure that could wipe out existing shareholders.

Nonetheless, Pengrowth has secured from lenders an extension to its $330 million credit facility, which matured on March 31, 2019, to 30 September 2019. That provides it with some breathing space, but with $716 million in debt and negative funds flow of $2.3 million for the last quarter, the future doesn't appear bright, particularly with around $184 million in debt maturing by May 2020.

There is a risk that Pengrowth could seek bankruptcy protection and make a deal with creditors to restructure its debt, which could make existing equity worthless.

Baytex Energy (TSX:BTE)(NYSE:BTE)

One-time market darling Baytex has been roughly handled by the market since the price of crude plummeted to under US$40 a barrel in 2015. A combination of high cost heavy oil assets, deteriorating profitability, and weak balance sheet, including a mountain of long-term debt totalling $2.1 billion at the end of 2018, have all been weighing on Baytex's value. That massive debt pile, which is a worrying five times Baytex's adjusted annual funds flow from operations, underscores the risks faced by the driller. The 2018 acquisition of Raging River Exploration, while bolstering light oil reserves and production, placed further pressure on an already fragile balance sheet.

A large portion of Baytex's debt, including its US$575 million credit facility, of which 50% remains undrawn, and a $300 million bridging loan secured against the assets of Raging River is due to mature in June 2020. There are further material debt maturities in 2021 and 2022 totaling US$550 million and $300 million, respectively, which will place further pressure on the driller and could trigger a liquidity crisis if Baytex is unable to bolster its cash holdings.

This underscores just how important a sustained period of higher crude is for Baytex.

Unlike MEG or Pengrowth, Baytex is not as significantly exposed to the headwinds threatening the viability of Canada's oil sands, because light and medium crude makes up around 69% of its production. In fact, its Eagle Ford acreage, which is responsible for 39% of its petroleum output, is a cash-generating machine, which will benefit substantially from higher oil.

For these reasons, Baytex does stand a chance, especially if crude remains firm for a sustained period, allowing it to bolster its cash and make meaningful inroads into reducing debt.

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