



3 Reasons to Buy Baytex Energy

Description

Intermediate heavy oil producer **Baytex Energy** ([TSX: BTE](#))(NYSE: BTE) is fast shaping up as one of the most compelling plays in the patch, with crude prices well over \$100 per barrel. When considered in conjunction with the narrowing price differential between Canadian heavy crude and the West Texas Intermediate benchmark, it is easy to see why there is renewed investor interest in the company. Let's take a closer look at three key reasons why investors should consider Baytex.

1. It holds a range of high-quality oil assets

One aspect that makes mid-cap oil explorer and producer Baytex stand out is its high quality oil assets. The company has net oil reserves of 255 million barrels and despite reporting record 2013 oil production of 57,196, it was able to grow its reserves by the end of 2013 by 7% in comparison to 2012.

More importantly, Baytex continues to maintain a monster reserves replacement ratio, which for the last three years has averaged 251% annually. This highlights that Baytex's oil reserves are growing at a faster rate than they are being depleted by oil production, underscoring the sustainability of its oil production.

This reserves replacement ratio is also superior to many of its peers operating in the patch, being significantly higher than **Penn West Petroleum's** (TSX: PWT)(NYSE: PWE) 97% and marginally higher than **Pengrowth Energy's** (TSX: PGF)(NYSE: PGH) 217% for the same period.

The quality of these oil reserves is highlighted by Baytex's relatively high netback per barrel, which is a key measure of the profitability of its production. For 2013, Baytex reported a netback of \$32.91 per barrel, which is higher than many of its peers in the patch and superior to either Penn West's \$29.69 or Pengrowth's \$24.35.

2. The acquisition of Aurora Oil and Gas is a game changer

Baytex's proposed acquisition of Canadian-listed Australian oil junior **Aurora Oil and Gas** (TSX: AEF) continues to move closer to completion. Baytex has offered A\$4.10 per share and this falls within the mid-range of an independent valuation of Aurora. When coupled with Aurora's management recommending the transaction proceeds, it bodes well for its successful completion.

The acquisition is an important milestone in Baytex's development. Not only will it boost Baytex's core oil assets and production but it will give it access to higher margin light oil production in the prolific Eagle Ford Shale in East Texas. The deal will add almost 166 million barrels of light oil reserves with 2014 net oil production expected to average 21,500 barrels daily.

This acquisition would see Baytex's production grow by around 55% and increase the proportion made up of light oil by around 10% to 21% of total production once the deal is complete. Light crude produced in the Eagle Ford generates a higher margin than Baytex's Canadian light and heavy oil with a lower price differential to the benchmark price of West Texas Intermediate.

This is evident when the two companies' netbacks per barrel are compared. For the full-year 2013 Aurora reported a netback of \$45.34 per barrel which was 38% higher than Baytex's \$32.91 per barrel. More surprisingly, Aurora's light oil generates a significantly higher netback than Baytex's despite the company paying a higher royalty rate of around 27% compared to Baytex's average royalties of 20%.

All of this makes the acquisition of Aurora a game changer for Baytex giving a significant presence in light oil production.

3. Pays a tasty dividend yield

Baytex pays a steadily appreciating monthly dividend with a tasty yield of over 5%, making it one of the highest yielding players in the patch. On first impressions this dividend appears unsustainable with a payout ratio of 200%, but when operating cash flow is substituted for net income, the payout ratio falls to a sustainable 37%.

More promising is that the acquisition of Aurora will significantly boost Baytex's operating cash flow, with management estimating it will grow by over 17%, enhancing the sustainability of the dividend. In addition, because of this significant growth in cash flow, Baytex's management committed to increasing the dividend by 9% to \$0.24 per share when the acquisition of Aurora is complete. This will boost Baytex's dividend yield to a very attractive 6%.

Foolish bottom line

Baytex is fast shaping up as a compelling investment opportunity in the patch. Not only does it have a solid reserve base but its monster reserve replacement ratio highlights the success of its development program and the sustainability of its oil production.

Furthermore, the successful acquisition of Aurora will be a game changer for Baytex, boosting reserves and its operating netback by significantly boosting light oil production. Coupled with a delectable and increasingly sustainable dividend yield, that makes Baytex a compelling addition to any investment portfolio.

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Author

mattdsmith

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