Bullish on Oil? Then Buy Baytex Energy Corp.

Description

Although crude oil is trading lower during Monday morning trading, the commodity has been on quite a ride of late.

In the first part of June, crude closed at about $53 per barrel. It slipped down to $48 by the first part of July, and then touched $40 per barrel in the first part of August. It then rallied back up to $46.85, where it trades today.

That’s a lot of movement to end up virtually unchanged over the last four months.

Many savvy investors are ignoring the short-term moves and positioning themselves to capture the next big leg up on crude. They point to things like the slowing of the oversupply problem that’s plaguing the market and predictions for long-term growth in the usage of crude, even accounting for electric cars and other new technologies.

There are many ways to play this long-term trend. Here’s the case for making **Baytex Energy Corp.** (TSX:BTE)(NYSE:BTE) the way to invest in it for your portfolio.

A levered play on crude

Back when oil traded above $100 per barrel, people didn’t care about the day-to-day fluctuations in price. The difference between $105 and $100 per barrel wasn’t really that big of a deal.

The difference between $40 and $45 per barrel is much bigger. That’s because the breakeven price for many producers is right around that mark. It’s the difference between having cash to reinvest in new production growth and not having enough to pay everybody.

Thus, many of the mid-tier producers are largely tied to oil prices. They have huge operating leverage, in other words.

That’s a good thing if you want to bet on higher crude prices. And because a higher crude price really matters to these companies, they often don’t just follow the price of crude. They become a levered play on the commodity.

Baytex is a terrific example. Back in January, when crude was languishing below $30 per barrel, shares traded under $2 each for a short time. These days they trade at $6.25–more than 200% higher. Yet oil is only approximately 75% higher.

Back in early 2015, when oil stabilized at about $60 per barrel, shares of Baytex traded at $20 each. I'm not sure if it can repeat that performance the next time crude hits that level, but one thing is certain: if oil prices go up substantially from here, Baytex shareholders will be very happy.

A strong position

Baytex, like many of its peers, took on too much debt during the good times. Fortunately, it has done a nice job weathering the storm.

One thing management did that's looking particularly astute is pushing all of its debt maturity well into the future. The company currently owes $1.87 billion in long-term debt. Of that, $350 million is in the form of bank loans that are due in June 2019 and can be renewed with the consent of the lenders. The remaining bonds don't begin coming due until 2021.

Baytex is focusing on production in the Eagle Ford area of Texas, one of the lowest-cost regions in North America. After numerous cost cuts, management has gotten breakeven prices in the area down to $30 per barrel. Even at $47 per barrel, the company can make enough to internally fund any expansion. In fact, thus far in 2016, it has even posted positive free cash flow.

And finally, management has begun a hedging program, locking in prices for 15,000 barrels of oil per day and 47,500 GJ of natural gas for the rest of 2016. These hedges represent 33% and 65% of production for each commodity, respectively.

The bottom line

Baytex has a lot going for it. It has its debt situation under control, low-cost production in a good area, and, perhaps most importantly, huge leverage if the price of oil heads higher. This combination of upside potential and downside protection is hard to beat.

CATEGORY

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1. TSX:BTE (Baytex Energy Corp.)

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