



Is Baytex Energy Corp. a Screaming Buy Under \$5?

Description

It seems as though the oil market can turn on a dime.

Just a couple of months ago, investors thought the market was finally going to power through this downturn and oil was going to start heading much higher. Sentiment was positive, crude was comfortably above \$50 per barrel, and investors were finally starting to make money again.

Baytex Energy Corp. ([TSX:BTE](#))(NYSE:BTE) shares were performing well, even temporarily surging past \$8 each on the Toronto Stock Exchange in June. That's a far cry from January, when Baytex shares traded hands at less than \$2 when oil had plummeted below \$30 per barrel.

Oh, what a difference a few months can make. The price of crude oil is down some 20% since peaking in June, currently flirting with \$44 per barrel. Baytex shares have also gotten hit, falling below \$5 each in inter-day trading on the TSX.

If you're a bull on oil, this might be the last time to buy Baytex shares at a bargain price. Here's why they could head much higher if crude recovers in a big way.

Recent history

Since the crash in energy prices, companies like Baytex have become levered plays on the price of oil.

Back in June, when the company's shares peaked at more than \$8 each, the price of crude momentarily surged past \$53 per barrel. Investors were confident crude was about to head much higher, so they bought Baytex as a way to play such a move.

Now that the opposite has happened, traders are flooding out of the name. Even though the price of the commodity has only fallen about 20%, Baytex shares are down some 40%.

What's interesting is Baytex shares are lower than they were during the first part of August, when crude dipped below \$42 per barrel. Back then, shares found support just under \$6 per share.

This tells me there's one important difference between six weeks ago and now: investors are much more bearish on crude now, even though the price is higher. That's good news for long-term bulls on Baytex.

Why Baytex?

There are a number of reasons why I like Baytex over other producers.

The biggest is the company's exposure to Eagle Ford, a low-cost area of operations in Texas. Aggressive cost cuts have pushed the company's break-even costs in the region to just over \$30 per barrel. Naturally, all capital expenditure dollars are being spent in this area, which has much more attractive returns than Baytex's heavy oil production in Alberta. This production has breakeven costs of about \$45 per barrel.

Although Baytex does have nearly \$1.9 billion in debt, this isn't as bad as it seems. Only \$347 million of this debt is due before 2021, and it's likely the company will be able to renew that debt with bankers when it comes due in 2019. Although it still has the ability to borrow from on its credit facility, management has made the smart move to fund capital expenditures from internal cash flow.

Finally, Baytex has made the smart decision to hedge a portion of its crude oil and natural gas production. Some 44% of 2016's remaining production is hedged, and 66% of natural gas production has some sort of price protection in place. So even though oil is plummeting, Baytex's near-term cash flows won't be affected that much.

Upside potential

If oil recovers to \$60 per barrel, what will happen to Baytex shares?

Some investors think \$20 per share is possible in such a scenario. They point to recent history in early 2015, when oil traded at \$60 per barrel and Baytex shares were more than \$20 each.

But that might not be realistic. One, investors were generally much more bullish about oil then than they are now. And two, shares still paid a dividend. That payout is long gone.

I say \$10 per share is a more realistic price target. While that might be disappointing to some investors, it still represents an upside of more than 100% versus today's share price. That's the kind of potential return no investor should scoff at.

CATEGORY

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1. TSX:BTE (Baytex Energy Corp.)

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