Could Baytex Energy Corp. Rebound to $12?

Description

Baytex Energy Corp. (TSX:BTE)(NYSE:BTE) is a popular stock around the energy water cooler.

Let's take a look at the current situation to see if investors who buy today have a reasonable shot at doubling their money.

Downside risk

Baytex traded for $48 per share a little over two years ago when oil was still trading close to US$100 per barrel.

Unfortunately, things haven't gone very well in the interim, and by January this year investors were staring at their computer screens in shock as the stock dipped below $2 per share.

That's the kind of volatility we are looking at in this name, so investors have to be willing to take a hit when betting on this stock.

How do things look now?

Baytex finished Q2 2016 with net debt of $1.94 billion, which is a heavy load for a company with a market capitalization of about $1.2 billion.

More concerning is the fact that liquidity is pretty tight. The company had already tapped about 45% of its available US$575,000 in credit facilities by the end of June, so there isn't a lot of wiggle room if oil falls back below US$40 per barrel and stays there for an extended period of time.

To make matters worse, production is falling because the company isn't spending enough money to replace output.

Baytex had average daily production of almost 85,000 barrels of oil equivalent per day (boe/d) in 2015. The Q2 2016 average was about 70,000 boe/d, and the latest guidance for full-year 2016 shows an average of 67,000-69,000 boe/d.

The company doesn't have the liquidity available to ramp up drilling and boost output, and prices aren't high enough yet to fund development through ongoing operations.

If oil stays in the US$40-50 range Baytex can keep its head above water, but that's not a reason to buy the stock.

If oil tanks again, investors could see a quick return to the January low.

Upside opportunity

At the time of writing, Baytex is trading at $5.60 per share.

A move back to $10 or $12 is certainly possible if oil can muster a sustainable move above US$50, and Baytex even pegged its value at about $11 per share earlier this year when oil was much lower than the current WTI price of US$50 per barrel.

Most of the 2016 move above US$40 has been driven by speculation that OPEC will cut production.

Is an OPEC cut likely to happen?

The group recently announced it had come to a verbal agreement to discuss a commitment to reduce output by 200,000-750,000 barrels of oil per day at a November 30 meeting.

The marketing spin seems to be working, but few analysts believe the agreement will be finalized, let alone honoured.

Why?

First of all, Iran is apparently exempt from the deal, which means the country will have the freedom to ramp up output as much as possible.

That won't go over well with other OPEC members who are facing severe budget issues. Why would you cut your own throat to help a bitter enemy fill his coffers? It doesn't make sense.

Another reason to be skeptical is the fact that Iraq, which is OPEC's second-largest producer behind Saudi Arabia, has already threatened to walk away from any deal if it doesn't like the numbers that are used to determine how much production each country has to cut.

Furthermore, if an agreement is announced and oil does move higher, U.S. producers will ramp up output and flood the market again.

So, betting on a sustained rally above the current price seems a bit risky. As such, I would avoid Baytex today.

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1. Energy Stocks
2. Investing

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1. Editor's Choice

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