



3 Reasons to Buy Baytex Energy Corp.

Description

North America's energy patch is attracting considerable interest from investors amid claims that the slump in crude is over and markets are on their way to rebalancing. One company that stands to significantly benefit from a surge in oil prices is **Baytex Energy Corp.** ([TSX:BTE](#))(NYSE:BTE). The one-time dividend darling may have come crashing to earth in the wake of the oil slump destroying the dreams of many investors, but there are signs that Baytex could be among the best contrarian-levered plays on crude.

Now what?

Firstly, Baytex's tremendous pile of debt is not only its greatest problem, but one of the reasons it is a highly levered play on oil.

This is because it allowed Baytex to establish its position in the sweet spot of the Eagle Ford shale through its acquisition of Aurora Oil and Gas Ltd. way back in 2014. The oil produced at this acreage has allowed Baytex to survive the deepest, darkest days of the oil crash.

That acreage has been the most productive and produced the highest margins for Baytex in the current harsh operating environment. The light, tight oil produced has consistently garnered a premium to the North American benchmark West Texas Intermediate.

It is also extracted with far lower costs than Baytex's Canadian operations. For the second quarter 2016, operational expenses for its Eagle Ford operations were \$6.88 per barrel, or almost half of the \$12.62 incurred at its Canadian acreage.

Secondly, the risks attached to that tremendous debt load are overblown.

Baytex's net debt totals a massive \$1.9 billion, or greater than six times its projected 2016 cash flow. It is this which has attracted the wrath of the market; there are fears that if lower oil prices continue, they could cause the company to fail.

Nonetheless, Baytex has renegotiated its financial covenants, which has given it some breathing space.

More importantly, the majority of that debt does not fall due until 2019 or later, giving plenty of time for oil prices to recover.

In recent weeks, crude has rallied strongly, now trading around its highest price in a year because of the OPEC agreement to cut production and Moscow's support for those cuts. This has many pundits predicting that \$60 oil is on its way; if true, this will be a boon for Baytex.

You see, with WTI at US\$55 per barrel, Baytex becomes free cash flow positive, and at US\$60 per barrel, its free cash flow more than doubles to roughly \$150 million. This would significantly boost the funds available to invest in exploration and development activities as well as reduce debt.

Finally, Baytex remains focused on reducing costs.

Key among the initiatives being implemented by Baytex is the focus on improving the drilling and performance of its Eagle Ford operations. It has boosted the average initial production rates of its Eagle Ford wells by almost 20% and reduced operating expenses by just over 7%.

This can only improve as further efficiencies and cost-reduction strategies are implemented.

Not only does this mean that the breakeven costs associated with its Eagle Ford wells are falling, but, in an environment where oil is rising, it will help its margins to grow exponentially, thus generating additional cash flow.

So what?

Without a doubt, Baytex is a risky contrarian bet on oil, but the risk/reward equation is firmly in favour of investors, particularly with indications that oil markets are now rebalancing. It isn't hard to see Baytex doubling in value in coming months if crude continues on its upward trajectory.

CATEGORY

1. Energy Stocks
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1. TSX:BTE (Baytex Energy Corp.)

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Author

mattdsmith

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