Why Donald Trump Just Created 2017's Best Opportunity to Buy Baytex Energy Corp.

Description

This year has not been good to Canadian oil stocks in general. **Baytex Energy Corp.** (TSX:BTE)(NYSE:BTE) has started off the year down 22%. The most striking thing about this performance is the fact that the price of oil has been essentially flat since the year started. West Texas Intermediate crude oil started the year off around $53 per barrel and has basically stayed between $51 and $53 per barrel.

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Donald Trump can be blamed for the big gap in performance between the price of oil and Baytex shares. The main concern (and reason for the sell-off in Canadian oil names) is over something called a border adjustment tax. This 10% tax was suggested in January by the head of Trump's inaugural committee and would apply to all imports at the border. This would include Canadian crude oil.

The goal of such a tax would be to encourage U.S. domestic production, and many investors think the results would be disastrous for Canadian oil stocks.

How will a border adjustment tax affect Baytex?

Currently, if an American business buys a Canadian product (like a refiner buying crude oil, for example), they would pay tax only on the net profit that they make from selling the finished good. However, under the new plan being proposed, the American business would not only pay tax on the profit, but they would pay a tax on the profit and the entire cost of the imported input used.

This means that a refiner in the United Stated purchasing Canadian heavy oil to make gasoline would not only need to pay tax on the profit, but also on the cost of the heavy oil purchased from Canada. This tax would only apply to imported goods, and the goal would be to encourage refiners to purchase domestic products instead of imported products.

For Baytex (and many other Canadian businesses), this is bad news. The fear is that the U.S. would purchase less Canadian crude in this situation. In addition, there is also concern that the price of Canadian heavy oil in particular would decline should refiners decide to prefer U.S. crude sources over Canadian sources. This would affect the prices Baytex could have on its production.

These fears are heavily overblown

Fortunately, none of these concerns warrant the sell-off Baytex and other heavy oil producers have seen. In fact, Baytex could benefit in some ways should such a tax go through.

If such a tax went through, **National Bank** estimates that while three-quarters of Canadian exports go to the U.S. (and this number would likely decline), Canadian petroleum exports would only fall by 0.3%.

This is because many U.S. refineries are built specifically for heavy oil. In fact, 28% of U.S. refinery feedstock is from heavy oil. While U.S. light oil production can certainly grow quite a bit, the U.S. does not have the capacity to grow heavy oil production to fill its refining needs. This means Canadian prices will likely not take a hit.

In addition, it is also unlikely that such a border adjustment tax will end up applying to crude oil. This is because it would result in a huge increase in gasoline prices for U.S. consumers, because refiners would need to pay more for their feedstock. This would be passed on to the consumer in the form of higher prices.

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Analysts at **Bank of Nova Scotia** see only a 10% chance of such a tax going through, and the end result is that the massive sell-off in Baytex is a buying opportunity. In fact, 50% of Baytex's production is from U.S. sources, which would mean Baytex would win if a border adjustment tax actually goes through.

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