Is Baytex Energy Corp. (TSX:BTE) Ready to Rally?

Description

Despite crude rallying significantly this week to see West Texas Intermediate (WTI) up by 32% for the year to date, intermediate oil producer **Baytex Energy Corp.** (TSX:BTE)(NYSE:BTE) continues to languish.

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The driller's market value remains flat even after Baytex successfully completed the transformational merger with **Raging River Exploration Inc.** which significantly bolstered its light oil assets.

Now what?

The new Baytex has oil reserves of 539 million barrels, which is more than 80% weighted to oil and other petroleum liquids. This is reflected in the combined entity's forecast 2019 production, which is estimated to be somewhere between 100,000 to 105,000 barrels daily weighted 85% to oil and natural gas liquids.

That is important to note because it means that Baytex is well-positioned to benefit from higher WTI and thus avoid the impact of weak natural gas prices or the stagnant outlook for fossil fuels.

Forecast 2019 production represents an approximately 8% increase over 2018. When coupled with higher crude, this will give its earnings a solid lift.

Key to Baytex' appeal lies in its extensive acreage in the Eagle-Ford shale. The light oil produced by that asset trades at a slight discount to WTI, making it more profitable than Baytex' Canadian heavy oil operations.

For the second quarter 2018, Baytex realized an average price for its Eagle Ford light oil $86.75 per barrel compared to $49.70 for heavy crude and $31.37 for natural gas liquids (NGLs). That saw Baytex report an operating netback for the Eagle Ford of $35.42 per barrel produced compared to $18.12 for its Canadian operations, underscoring the profitability of that acreage.

It is for this reason that Baytex has focused its capital spending on the Eagle-Ford, which is now the company's single largest producing asset. The addition of Raging River's light oil acreage has boosted the proportion of Baytex's production of lighter crude blends, further reducing the impact of the significant discount being applied to Western Canadian Select (WCS), which deepened since the end of May 2018.

Light oil production will likely grow at a solid clip, as Baytex has chosen to allocate a considerable chunk of its planned 2019 capital expenditure to developing Viking light oil assets acquired as part of the Raging River deal.

Baytex anticipates drilling 275 wells in the Viking during 2019 and another 30 in the Eagle Ford. This will go a long way in the expansion of its highly profitable light oil production, thereby boosting earnings and Baytex's bottom line.

A notable achievement from the acquisition of Raging River is that Baytex was able to strengthen its balance sheet reducing debt to a manageable 2.2 times adjusted funds flow from operations. This has enhanced its financial flexibility as well as the ability to weather any further downturns in the price of crude.

Baytex expects free cash flow to grow significantly as oil rises. For 2019, free cash flow of $400 million has been forecast if WTI averages US$65 a barrel over the course of the year. Given that WTI is hovering at around US$75 per barrel Baytex's 2019 free cash flow could be as high as $500 million.

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Such solid free cash flow growth will provide Baytex with the opportunity to retire further debt and increase spending on exploration and development drilling.

So what?

It is difficult to comprehend why the market is failing to recognize Baytex' strengths as well as its high-quality assets, but this has created an opportunity for investors seeking to cash in on higher oil.

There is every indication that the company's earnings and cash flow will grow substantially amid an operating environment where WTI is trading at US$65 a barrel or greater — and this ultimately will cause its stock to soar.

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Date
2025/08/25
Date Created
2018/10/04
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