Buy Baytex Energy Corp. (TSX:BTE) Regardless of Oil's Latest Weakness

Description

After trading at multiyear highs almost two-months ago, oil has collapsed once again to see West Texas Intermediate (WTI) hovering at around US$50 a barrel, prompting considerable speculation that crude has entered a new bear market and could fall even further. That has triggered a sharp sell-off of energy stocks that sees **Baytex Energy Corp.** (TSX:BTE)(NYSE:BTE) to be down by almost 59% for the year to date. While the outlook for crude remains uncertain, it shouldn't deter contrarian investors from buying Baytex.

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Now what?

In late August 2018, Baytex completed its strategic combination with **Raging River Exploration Inc.** which significantly bolstered its light oil reserves and production. That is an extremely positive event when the difficult operating environment for Canadian oil sands producers is considered.

You see, it was only earlier this month when the price of Canadian heavy oil known as Western Canadian Select (WCS) fell to a record low of less than US$12 a barrel. While it has since recovered to be trading at around US$17 per barrel, and many oil producers are still operating at a loss.

Because of the Raging River deal, light oil is now the single largest component of Baytex's total oil output, which makes it responsible for generating most the driller's revenue, significantly reducing the impact of the deep-discount applied to WCS on its financial performance.

The completion of the deal also means that Baytex's profitability will improve. This becomes evident when it is considered that Baytex was able to reduce its projected 2018 operating expenses by around 4% compared to its earlier guidance to between $10.50 and $10.75 per barrel produced. That is a particularly positive outcome in an operating environment where WTI could fall below US$50 a barrel.

The combined business is also expected to produce 95,000 to 100,000 barrels daily over the course of 2019, which, along with reduced costs and increased exposure to higher margin light oil, will give earnings a healthy lift. If WTI averages US$62 a barrel over the course of 2019, Baytex expects to generate sufficient funds flow to bankroll its capital program, generate an annual average netback of $25 per barrel produced and be cash flow positive.

Notably, Baytex has commodity hedges in place for roughly a quarter of its projected average 2019 production, which will mitigate the financial impact of weaker WTI. While analysts do expect oil to recover to around US$60 per barrel, there are a range of risks that could see it average less over the course of 2019, including the rapid growth of U.S. shale oil production, OPEC not electing to implement further production cuts to bolster prices and weaker economic growth leading to lower consumption.

Also notable is that Baytex has no debt maturities falling due until 2020, giving it enough time to complete integrating Raging River's operations, thereby reducing costs through generating additional efficiencies and boosting its cash holdings.

So what?

The sell-off of Baytex's stock appears overdone with the market having overbaked the degree of risk associated with the company. The completion of the acquisition of Raging River has eliminated the risks associated with the deal.

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While Baytex's increased light oil production, quality Eagle Ford acreage and stronger balance sheet all pointing to the company being well-positioned to benefit from higher oil. These factors also mean that it is capable of weathering lower prices if WTI fails to recover as many analysts expect.

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