Is it Time to Buy Baytex Energy Corp. (TSX:BTE)?

Description

It has been a challenging year for energy investors and oil stocks. After oil rallied sharply to see the international benchmark Brent reach a multiyear high of over US$86 per barrel and West Texas Intermediate (WTI) soar to over US$76 a barrel, it has come crashing to earth with a resounding thud. The latest price collapse, which sees WTI trading at less than US$46 a barrel, has occurred despite OPEC and its allies agreeing to implement further production cuts in January 2019 that will shave 1.2 million barrels daily off their collective oil output.

The latest price collapse has hit energy stocks hard, causing some, such as **Baytex Energy Corp.** (TSX:BTE)(NYSE:BTE) to shed more than 50% for the year to date. The driller has been heavily marked down since it acquired Canadian light oil producer **Raging River Exploration Inc.** While there is considerable gloom surrounding the energy patch, Baytex appears attractively valued as a contrarian play on oil.

The latest deal has significantly reduced risk

The acquisition of Raging River significantly reduced the risks associated with investing in Baytex, as it gave the company's light and medium oil reserves a solid lift, further reducing its dependence on lower margin heavy oil production from its Peace River and Lloydminster assets.

For 2019, Baytex anticipates that 46% of its total production will be composed of higher margin light oil compared to 30% before the merger with Raging River – an important development because of the significant discount applied to Canadian heavy crude. Alberta's mandated production cuts aimed at draining the record oil inventories that have accrued in Western Canada and freeing up pipeline capacity to boost heavy oil prices will be of considerable benefit to Baytex.

This is not only because they have caused the price of Western Canadian Select (WCS) to soar to more than double its record low hit in November 2018, but they have also boosted the price Canadian light crude. Edmonton par also more than doubled in value after the cuts were announced. While it has pulled back in recent weeks because of weaker oil, it is still trading at US$37 per barrel.

When the OPEC production cuts take effect in January 2019, oil will rally, which, along with narrower price differentials for Canadian heavy and light crude, will give Baytex's earnings a healthy lift.

A key aspect of Baytex's operations that bolster its attractiveness as an investment is its Eagle Ford Shale holdings. These span 20,200 contiguous net acres and hold oil reserves of 233 million barrels, making up 43% of Baytex's total reserves. The importance of that asset is underscored by the light oil produced by Baytex's Eagle Ford wells**,** which, unlike Canadian heavy and light crude**,** typically sells at around the same price as the North American benchmark.

For the third quarter 2018, the oil produced at Baytex's Eagle Ford acreage was sold for an average realized price of $93.37 per barrel, almost 3% greater than the average price for WTI over the quarter of $90.84.This can be attributed to that oil desirable characteristics including its light gravity and low sulfur content.

Unlike Canadian heavy crude, it flows freely**,** meaning that Baytex doesn't have to mix it with costly diluent to make it flow. This reduces the costs associated with production and transportation, which, along with the high realized sale price, makes Baytex's assets the most profitable. This is evident from the third quarter operating netback for the Eagle Ford operations of $38.03 per barrel sold, which was 47% greater than the $25.94 per barrel netback generated by Baytex's Canadian assets.

The negative effect of oil's latest price collapse on Baytex's performance won't be as severe as the market believes, however. The driller has a hedging strategy in place that will mitigate the financial impact of sharply weaker oil prices. The completion of the Ragin River deal also strengthened Baytex's balance sheet, seeing net debt fall to a manageable 2.1 times adjusted funds flow. In conjunction with no debt maturities occurring until 2020, Baytex can weather any further prolonged weakness in oil, which appears unlikely in light of OPEC's production cuts.

Why buy Baytex?

It is proving to be almost impossible to predict the outlook for crude with any degree of certainty. While the latest price collapse makes energy stocks unappealing, after its latest sell-off, Baytex appears very attractively valued, particularly when its high asset quality and growing production is considered. For these reasons, it is a compelling contrarian play on higher oil.

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