Surging Canadian Oil Prices Are Great News for This Oil Stock

Description

In late 2018, Canadian oil producers (specifically those producing in Alberta) were hit with a surprise headwind: its oil production was now worth 50% less than anticipated. While other North American oil producers were fetching prices of $50 per barrel or more, West Canadian Sweet prices tumbled to as low as $20 per barrel.

The reasons for this collapse should have been predictable. Surging regional production hit transportation bottlenecks, forcing producers to bid aggressively against each other to move its output. Alberta, specifically, lacked both local refineries and pipeline infrastructure to move crude to other provinces where it could be processed.

In an emergency move, the Alberta government mandated 8.7% production cuts across the board. In total, output in the province dropped by 325,000 barrels per day. The goal was to wind down rising stockpiles, alleviate pipeline bottlenecks, and increase the local price of crude. It worked almost immediately, removing a major headwind for many affected companies, especially **Baytex Energy Corp** (TSX:BTE)(NYSE:BTE).

Baytex Energy is winning big right now

Within days of the production cut, Canadian crude prices rallied to multi-month highs. This month, the differential between WCS and WTI prices narrowed to under $10 per barrel at times, down from nearly $30 per barrel less than two months prior.

“Four Fridays ago, at the bottom…we had WCS in the low teens,” said the CEO of **PrairieSky Royalty Ltd**. “And WCS two Fridays later, after the announcement of the curtailments, was at US$40.”

The 325,000 barrel per day cuts should end in a month or two, with cuts falling to just 95,000 per day for the rest of the year. While a government spokesperson said it’s “too early to say how long the program will remain in place,” it’s possible that the cuts could be suspended before the year is up.

In the last quarter of 2018, Baytex stock fell by 40% due to the oil glut, from nearly $4 per share to just

$2.50 per share. With the stock still near the same lows, it appears as if the market hasn't assigned any value to the pricing rebound. Not only has pricing recovered dramatically, but production cuts could end more quickly than most people realize. This mismatching is making Baytex stock look like a value at current levels.

Long term, watch for this trend to create value

Last summer, Baytex acquired Raging River Exploration in an all-stock deal worth $2.8 billion. In total, Baytex will now produce roughly 100,000 barrels of oil per day.

The big rationale for the acquisition was to create a company with enough scale to develop Raging River's Duvernay assets in Alberta. Those assets are wholly undeveloped, and could be one of the biggest Canadian shale opportunities in decades. Immediately following the transaction, Baytex closed a new $300 million credit facility, backed by Raging River's assets.

While analysts balked at the dilutive nature of the deal given it used 100% stock, the new Baytex is positioned well for the future. With pricing pressures alleviated, it can now focus on developing its undervalued assets and reducing debt. According to management, the company will be cash flow positive with the ability to de-lever the balance sheet as long as oil prices are above US$50 per barrel, around today's trading levels.

As long as current oil prices are sustained, expect the market to assign significantly more value to Baytex stock as Raging River's assets are integrated and developed.

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