



Contrarian Investors: Should You Bet on Baytex Energy (TSX:BTE) Stock Today?

Description

The energy sector is full of fallen former dividend stars with some of the stocks down more than 90% from their previous highs. This has contrarian investors wondering if the pullback has gone too far.

Let's take a look at **Baytex Energy** ([TSX:BTE](#))(NYSE:BTE) to see if it deserves to be on your [buy list](#) right now.

Disaster chart

A quick peek at the Baytex chart gives you a good understanding of how tough things have been for the company. Baytex traded at \$48 per share five years ago, and the board had just increased the monthly [dividend](#) by 9% to \$0.24 per share.

What happened?

Baytex completed its \$2.8 billion purchase of Aurora Oil and Gas in June 2014. The deal gave Baytex a significant presence in the Eagle Ford play in Texas and was supposed to be a game changer for the company. As things turned out, that proved to be the case, but not in the way management expected.

Oil prices began to fall shortly after the deal closed and by the middle of December 2014, Baytex had slashed its payout, and investors sat in shock, as the stock price plunged to \$15. A brief oil rebound in early 2015 gave Baytex a chance to raise cash through a stock sale, and management negotiated new terms with lenders. These actions probably saved the company, but oil subsequently extended the rout, and by early 2016 Baytex was a \$2 stock.

Another short-lived rally pushed the share price above \$7 that year, so there is strong upside potential when market sentiment improves. However, the party didn't last long. Today, Baytex trades at \$1.90 per share.

Risks

The balance sheet remains the largest risk. Baytex finished Q1 2019 with net debt of just under \$2.2 billion. That's a lot for a company that currently has a market capitalization of \$1.05 billion. Raising capital through a stock sale isn't a viable option right now, so Baytex needs higher oil prices to boost margins, so it can chip away at the debt while spending enough on the capital program to increase production.

Opportunity

In the Q1 report, Baytex indicated it anticipated adjusted funds flow for 2019 to be about \$950 million, which would be about \$350 million more than the midpoint of its capital guidance. As a result, a good chunk of that could go to pay down debt. The company reduced net debt by \$90 million in the first quarter.

Production at the Eagle Ford assets hit a record 41,000 barrels of oil equivalent per day (boe/d) in the quarter and total company production came in at 101,000 boe/d. Baytex is targeting 96,000 boe/d for the year across all of its assets. The company gets WTI pricing for the oil produced at the Eagle Ford sites compared to the lower WCS price it receives for some of its Canadian production.

WTI oil currently trades near US\$60 per barrel, which is where it was at the end of Q1. If the market holds at this level or moves higher, Baytex should be able to reduce its debt at a decent pace.

Should you buy Baytex?

The stock has the potential to rocket higher on an improvement in oil prices. If you are bullish on oil through the end of 2019 and into 2020, a small contrarian position at the current price might be worth a shot.

That said, any reversal in oil prices would be negative, and stocks that trade below \$2 can see large percentage moves to the downside in a short period of time, so you have to be willing to ride out additional potential downside. Further weakness could start to attract suitors, but I wouldn't bet on a big takeover premium.

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