Baytex Energy (TSX:BTE): Should Contrarian Investors Buy the Stock Today?

Description

The Canadian energy sector is full of beaten-up stocks trading at prices that would have been unimaginable just five years ago.

The biggest losers are those who took on too much debt at the peak of the market in 2014 and have not been able to clean up their balance sheets through asset sales or new share issues.

Long-term investors who held on through the downturn are desperately waiting for a recovery back to the heights of the glory days. That, unfortunately, is wishful thinking.

However, new investors with a contrarian investing style are starting to kick the tires on some of the walking wounded in the energy sector. Fund managers have essentially given up on the group, and while challenges remain in place, the upside potential on a rebound in oil price could be substantial.

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

Painful slide

Baytex traded for $48 per share in the summer of 2014 and was a darling among dividend investors.

In June of that year, Baytex closed a game-changing acquisition when it purchased Aurora Oil and Gas for $2.8 billion. The deal gave Baytex a substantial position in the growing Eagle Ford shale play in Texas. The mood at the time was very positive, and investors cheered the board's decision to raise the dividend by 9% to an annualized payout of $2.88 per share.

Fast forward five years, and the world has changed completely for Baytex and its shareholders. The price of oil began to slide shortly after the closing of the Eagle Ford purchase, and by the end of 2014, Baytex had dramatically slashed the dividend in an effort to protect cash flow.

The stock price tanked, and despite a couple of brief bounces on short-term pops in oil prices, has continued to hit new lower lows in the past four years.

How bad has it been?

At the time of writing, Batex trades for $1.70 per share, which isn't too far off the recent low of $1.53.

The dividend is long gone, and despite the merger with Raging River Exploration last year, the balance sheet remains under pressure. Baytex finished Q2 2019 with net debt of about $2 billion. That's hefty for a company that sports a current market capitalization of less than $1 billion.

Opportunity

The market didn't like the Raging River marriage, and despite improved cash flow and some debt repayment, investors continue to punish the stock.

In the full year 2018 financial results reported in March 2019, Baytex calculated its net asset value at the end of 2018 to be $7.27 per share, so there is a disconnect between the market's view and the view of management.

The company took advantage of improved oil prices in the first half of 2019 to reduce net debt by $147 million. Baytex said it generated $200 million in free cash flow in the first six months of the year and recently redeemed US$150 million in unsecured notes.

WTI oil is back down to about US$53.50 per barrel, after briefly topping US$60 in the days that followed the attack on Saudi Arabia's oil facilities. The 20% surge that initially occurred in the oil market is a reminder of how quickly the situation can change.

In the event of an extended supply disruption in the Middle East, or a firm trade agreement between the United States and China, oil could rally back toward US$65 per barrel, or even move higher. A prolonged recovery would give Baytex more room to reduce debt and boost capital spending to drive higher production.

Given the depressed state of the stock, the upside could be significant on an improvement in the market.

Should you buy?

The stock remains volatile and further declines in oil prices, or a broad-based drop in equity markets, could send it toward $1 per share. As such, I wouldn't back up the truck right now.

However, oil bulls might want to consider taking a small contrarian position if they are of the opinion the oil market is nearing a near-term bottom. The stock isn't going to go back to $48, but a run at $3 wouldn't be a surprise.

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aswalker