Why Baytex (TSX:BTE) Has Lost 31% Since the Start of 2019

Description

Oil has rallied sharply in recent weeks to see the North American benchmark West Texas Intermediate (WTI) gain 21% since the start of 2019. This has done little to lift the value of many Canadian energy stocks, some of which have declined sharply in value regardless of higher oil. Among the worst affected is upstream oil producer and explorer **Baytex Energy** (TSX:BTE)(NYSE:BTE), which has lost a whopping 31% for the year to date. This has sparked speculation that Baytex is significantly undervalued, making now the time to buy. While there is some evidence that the market's perception of risk relating to the driller is overbaked, there are plenty of factors indicating that Baytex is cheap for a reason.

Mixed results

Key among Baytex's problems is at the height of the last oil boom, it loaded up on debt to acquire shale oil driller **Aurora**, giving it acreage in what is considered the sweet spot of the Eagle Ford shale. That transformative deal saw Baytex become a light oil producer, which helped to shield it from the prolonged weakness of crude and the deep discount applied to the Canadian heavy oil benchmark Western Canadian Select (WCS).

In 2018, Baytex completed the $1.4 billion all-stock acquisition of Raging River Exploration, boosting its light oil reserves and production as well as exploration upside while strengthening its balance sheet. That deal was expected to give its stock a solid lift, but Baytex is trading at close to its 52-week low late last month.

A key issue hanging over Baytex is that by the end of the third quarter 2019, it had a massive pile of debt totalling $1.9 billion, which is a considerable burden for an oil explorer and producer with a $943 million market cap. What makes it worse is that there are looming debt maturities, including Baytex's bank loan, which has $571 million drawn falling due in April 2021, $530 million of notes maturing in June 2021 and further $300 million of notes in July 2022.

This couldn't come at a worse time for Baytex, because oil has not rallied as strongly as many pundits were predicting in 2018. There are fears that despite the renewed optimism surrounding the global economy and demand for oil and natural gas, that another oil price collapse could occur in 2020. Softer manufacturing data across all the major industrialized economies combined with a general slowdown in China, the world's second-largest economy, doesn't bode well for stronger oil demand over the long term.

While Baytex's production continues to grow, expanding by 15% year over year to 94,927 barrels daily, its netback, a key measure of operational profitability, remains weak. For the third quarter, Baytex's operating netback before hedging was $26.27 per barrel, 16% lower than a year earlier, although that can be attributed to weaker oil rather than operational failings. On a positive note Baytex's operating and transportation expenses fell by 1% and 15%, respectively, year over year.

Nonetheless, Baytex's netback is lower than many of its peers, which can be attributed to 27% of its oil production being comprised of heavy oil. WCS trades at a discount to WTI, which, over the last two weeks, has widened considerably because of a leakage from the Keystone pipeline forcing it to be shutdown. The differential increased from US$17 per barrel to US$22 per barrel as concerns grew over the impact that the shutdown will have on local inventories.

There is a significant risk that WCS prices could fall sharply if there are any further pipeline outages or when Alberta further reduces or eliminates its mandatory production cuts. That would sharply impact Baytex's financial performance and its ability to meet its financial obligation.

Foolish takeaway

There is no denying that Baytex has worked hard to improve its financial positions, boost profitability, bolster cash flow, and shore-up its balance sheet. Considerable progress has been made to date, but the driller's debt overhang is weighing on its outlook, as are fears that another oil price collapse could occur making it extremely difficult for Baytex to meet its near-term financial obligations. For these reasons, despite its appealing valuation, there are superior opportunities to play higher oil among Canadian energy stocks.

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