Baytex Energy (TSX:BTE): Buy the Dip?

Description

Baytex Energy (TSX:BTE) is one of the most volatile Canadian oil stocks. It has a 3.11 beta coefficient, which means that its price fluctuates a lot more than the benchmark. If you'd bought this stock a year ago and sold last week, you'd have made an impressive return. But in recent weeks, BTE stock has been falling.

WTI crude oil prices recently fell from a peak of $122 all the way down to $95. As a result, energy companies' profits are vulnerable. When a company makes money by buying and selling crude oil, lower oil prices result in lower revenue. Today's oil price of $95 is far higher than any observed last year, but it is low enough to reduce investors' expectations.

All E&P companies are vulnerable to the phenomenon described above. However, Baytex Energy is smaller than other oil companies with a $3.4 billion market cap, and it has $1 billion in debt. In this article, I'll explore why Baytex Energy is so sensitive to oil prices and whether it is worth buying on the dip.

Why Baytex is so sensitive to oil prices

BTE is sensitive to oil prices because of its small size and high debt load. When a company has a $3.4 billion valuation and 7.78 million shares traded daily, an order of 10 million shares coming in at once could significantly change the price. Baytex shares currently cost $6.38, so a 10 million share order could easily be put in. Many institutions have enough money to make a $63 million investment. It's partially for this reason that BTE stock swings so violently.

The company's debt load is a factor as well. Baytex Energy has $1.28 billion in debt compared to $121 million in free cash flow. $1.28 billion in debt at 4% interest produces $51.2 million in annual interest expense. That's a lot of interest for a company whose free cash flow is $121 million. It implies that Baytex requires high oil prices in order to break even. Interest is one of the costs that oil companies have to clear before they can turn a profit. The higher the interest burden, the higher the revenue level needed to produce profits. Without high oil prices, profits are unlikely for BTE.

The positive here is that when debt is high, earnings grow faster in percentage terms. If you grow revenue from $11 to $12 and you have $10 in expenses, you double your profit. If you grow sales from $11 to $12 with no expenses, you only increase it by 9.1%. So, BTE's profit can grow dramatically when oil prices go up — hence the large upswings as well as downswings.

Could things change?

As we've seen, BTE is very volatile due to its high debt and small market cap. The question is whether the stock will always be this way. The answer ultimately depends on whether Baytex can retire some of its debt. Highly leveraged (i.e., indebted) stocks are generally volatile, because their earnings are volatile. If Baytex pays off its debt, then its earnings will be less volatile. That's a positive for defensive investors considering BTE as an investment. However, the company's financials as they stand today tend to suggest that its stock will be volatile for the foreseeable future.

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