Baytex Energy (TSX:BTE) Could Rebound Sharply as Oil Prices Surge

Description

Oil prices at the end of 2022 were lower than expected. A confluence of factors pushed the price of crude down to US$70 a barrel. Unsurprisingly, oil and gas stocks followed along. Small-cap energy producers like **Baytex Energy** (TSX:BTE) lost about 37% of its value between June and December 2022.

Now, the stock looks undervalued, even if oil prices stay stable. Here's a closer look.

What's driving oil lower?

Two key factors pushed oil prices higher last year: Russia's invasion of Ukraine and a persistent undersupply of crude.

After a decade of underinvestment, energy producers didn't have the spare capacity needed to meet growing demand from a reopening economy. Meanwhile, Russia's invasion attracted sanctions and changed the global supply chain of crude. Experts believed that these factors could push a barrel of crude oil over US$200 by winter 2022. That didn't happen.

Instead, Europe cut back on energy consumption and imported more gas from other sources. The continent is also using coal to replace some crude oil consumption. Winter 2022 has so far been unexpectedly mild, which means there wasn't much need for heating in homes.

All these factors allowed crude oil to sink to pre-invasion levels by late 2022. Consequently, Baytex stock dropped from $9 a share in June to just $5.5 in December.

Could oil rebound?

West Texas Intermediate (WTI) crude has been range-bound for several months. The global shortage of energy supply has placed a floor on energy prices. China's retreat from the "Zero Covid" policy has also acted as a tailwind.

However, the global economy is on the verge of a recession. A sudden pullback in economic activity could reduce the need for oil and gas in 2023. The U.S. Energy Information Administration expects the average price of a barrel of Brent crude to be $83 in 2023 — 18% lower than last year.

WTI, meanwhile, is expected to remain stable or lower for the rest of the year too. However, energy stocks like Baytex are undervalued, even if oil prices don't rebound.

Baytex valuation

Baytex stock currently trades at just three times trailing earnings per share. The company also generated 15% free cash flow yield in 2022. Management expects to deliver $3 billion free cash flow through 2026. Meanwhile, analysts have an average price target of $8.6 per share — 53% higher than current levels.

Put simply, Baytex is undervalued even if oil prices remain stable or drift mildly lower. Investors can expect a steady stream of cash flows for the next few years. A sudden supply shock, geopolitical tensions or a severe winter in 2023 could push the stock much higher.

Bottom line

Oil stocks have been consistently undervalued during this cycle. The recent pullback in energy stocks could have created a rare opportunity for long-term investors. Keep an eye on this trend.

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