Is PennWest Strong Enough to Turnaround?

Description

One of the best exercises an investor can undertake before buying a stock is to do a SWOT analysis of the company. In putting together a list of its strengths, weaknesses, opportunities and threats it forces investors to take a more critical look at the company. Investors are then less likely to be blindsided in the future by knowing ahead of time what might go wrong.

One stock that's worth a deeper, more critical look is **PennWest Exploration** (TSX: PWT) (NYSE: PWE). The company is trying to turn things around, having slashed its large dividend while letting many of its employees go in an effort to improve its overall returns. However, in order for a turnaround to be successful, the company needs to have an underlying strength worth building upon. With that as a back drop, let's take a closer look at the three areas where PennWest is strongest.

Light oil leader

PennWest boasts of having one of the best light oil resource bases in North America. Light crude oil is typically more highly valued because it produces a higher percentage of gasoline and diesel fuel when it's refined. PennWest's oil has an API of 32, and for some perspective, the Bakken rates above 40 while the bitumen of the oil sands is really heavy at less than 10. Basically, if refiners had a choice of which Canadian oil to refine it would be PennWest's.

Overall, PennWest has amassed 5.6 million acres which it is developing. The company has eight resources that it's targeting including the Cardium, Duvernay, Swan Hill and Viking. It's not alone in its pursuit of these light oil areas as **Devon Energy** (NYSE: DVN) for example has amassed an acreage position to target many of these same formations. In fact, according to Devon, the Swan Hills is particularly unique in that it contains the second largest original oil in place accumulation in Western Canada at over 1.4 billion barrels of light crude oil.

Enhancing recovery

PennWest is typically only able to extract a small amount of the resources that are in place. In order to produce more oil the company uses enhanced oil recovery, or EOR technology to more than doublethe amount of oil it's able to recover. Some of the methods it uses are waterfloods and carbon dioxide.

The company is focusing its EOR efforts on its Cardium position which is developing into a core holding as well as Viking. It has actually been shifting its capital from Waskada, which had been receiving a lot of its capital, to those other
plays. Waskada, which is a play that **EOG Resources** (NYSE: EOG) also operates in, is a shallow light oil play. Wells here are typically inexpensive to drill but don't produce a whole lot of oil, which is why both companies are focusing elsewhere. In fact, Penn West currently is only able to recover about 2% of the oil that's in Waskada.

Prudently managing future upside

In addition to its present strengths in light oil, PennWest is developing three other projects with an eye toward the future. In 2010 the company signed joint venture agreements with Asian companies to develop its Cordova natural gas assets as well as its Peace River oil sands assets. In addition to this the company has amassed a nice position in the liquids rich Duvernay, which it's looking to unload.

What's important to see here is how PennWest is developing these assets, which are outside its core light oil expertise. The company is mainly utilizing joint venture capital, or in the case of Duvernay, it's allowing its industry peers to de-risk the play. Of the three, the Cordova shale gas JV could turn out to be an important future driver because of its close proximity to the proposed LNG export terminals, such as the one at Kitimat, B.C., which EOG Resources had owned a 30% interest in before it sold its stake earlier this year. Because Canada doesn't use a lot of natural gas, and its top customer has plenty of shale gas reserves of its own, exports are the only hope for increasing the price of Canadian gas.

Final Foolish thoughts

PennWest does have solid resources with which to build upon. Its biggest strength is the light oil assets under its control. Meanwhile, it's building a stronger future by prudently developing natural gas, heavy oil and NGLs assets. The next question is if PennWest's weaknesses outweigh its strengths. For a deeper look at those weaknesses, stay tuned to the continuation of this series.

Looking to replace you large Penn West dividend?

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