Can Penn West Turn Itself Around?

Description

Floundering companies that turn themselves around can provide handsome gains for those who see the potential in the business. On the other hand, some companies flounder for a reason. That's why when it comes to **Penn West Petroleum** (TSX:PWT), which produces oil and natural gas in Western Canada, investors want to know where it falls.

While some companies flourished in this business, Penn West floundered. With a new management team, Penn West embarked on a journey to improve its competitiveness in the oil and gas business. Will they succeed? Time will tell. Fellow Fool Matt DiLallo and I examine the strengths, weaknesses, opportunities, and threats to Penn West's turnaround. Below, I review the weaknesses the company needs to overcome.

Financial weakness
Perhaps the biggest weakness in Penn West's business centres on its finances. The new President and CEO, David Roberts, discussed this during the latest earning's call and focused on debt and streamlining operations. But, he has his work cut out for him on several fronts.

First, the company has no cash on hand. Second, earnings have been in decline for two years. Third, the company reported declining cash flow for the past four years. Lastly, the company will take a $25 million charge in the third quarter related to recently announced layoffs, further impacting earnings. Not a good situation, but at least the company recognizes it and is taking action.

Inefficient operations
During the latest call, Mr. Roberts freely admitted Penn West spends $3 to $5 a barrel more in operating expenses than its competitors. Mr. Roberts further pointed out that the assets owned by Penn West were relatively low decline reserves and thus should be easy money. Some early changes in drilling techniques have reportedly reduced expenses by 30% in one of their exploration sites. The company hopes these improvements will scale to other drilling operations.

Penn West recently changed its Board of Directors as well as its CEO, and soon after three executives were laid off along with other employees. Further layoffs were recently announced in an effort to streamline operations. The company has downsized by 30% since the fall of 2012. While CEO Roberts publicly stated the company is appropriately staffed, there are also asset sales in the offing and with those, further layoffs may be needed.

An intangible weakness stemming from these layoffs is company morale. Those still working at Penn West might feel relief, but how much? How many employees have initiated job searches to protect themselves? Will key employees leave out of concern for being laid off in the future?

Reliance on limited oil plays
CEO Roberts declared the Cardium and Viking oil plays are at the heart of Penn West's future. Cardium and Viking contain light crude oil with Cardium alone containing an estimated 12 billion barrels of oil. These are old, established oil plays but offer large potential returns with the introduction of horizontal drilling and hydraulic fracturing.

While Cardium produced encouraging results, the Viking has been less encouraging. The risk here centres on these admittedly low risk plays generating enough revenue to keep the company afloat. Penn West operates elsewhere, but they seem to be “all in” the Cardium and Viking projects. If these don't produce, it's going to hurt.

Take-away capacity adds to the woes. Pipelines currently operate at capacity. **Kinder Morgan**, for example, recently signed multiple deals as part of its plans to expand its Trans Mountain pipeline in Western Canada. The proposed expansion increases capacity from 300 Mb/d to 890 Mb/d, all for C$5.4 billion. Unfortunately, for Penn West, the expansion will come online in 2017. In the interim, limited pipeline capacity will likely pressure the price of Western Canada Select crude oil and Penn West's revenue.

Final Foolish thoughts
Other companies see profit potential in this corner of the world. Penn West joins the likes of **Encana** in exploring for oil in Western Canada. In contrast to Penn West, Encana joined with **PetroChina**, to invest over C$4 billion in Western Canadian oil exploration. Encana certainly has its share of debt problems, and has also recently named a new CEO, but does have significant oil plays to fall back on, not to mention some cash in the bank. While both companies see promise in Western Canada, the stakes are clearly higher for Penn West.

Penn West has underperformed for some time. The company made management changes that resulted in streamlining operations and costs. Further efforts in the field improved efficiencies. But with no cash in the bank and no partners sharing the exploration risk, Penn West must score big. Past poor performance, the lack of cash reserves, and reliance on success in basically one play gives me a “thin ice” feeling about this company.

What are you doing October 1?
Our senior investment analyst will unveil his top two stock ideas for new money now on Oct. 1. And **YOU** can be one of the select few investors to find out first — just click here to reserve your invitation.

This post originally appeared on Fool.com and was created by Fool contributor Robert Zimmerman.

Fool contributor Robert Zimmerman doesn't own shares in any companies mentioned. The Motley Fool owns shares of Kinder Morgan.

CATEGORY

1. Investing

Category

1. Investing

Date
2025/06/30
Date Created
2013/09/26
Author
motley-fool-staff