# Opportunities for a Penn West Turnaround

## Description

Giving up on a floundering company is easy, but it can be a mistake. A critical review of a company's strengths, weaknesses, opportunities and threats can help investors decide if a company's core business is a worthy investment.



**Penn West Petroleum** (TSX:PWT) has floundered despite producing oil and natural gas from some of the best oil plays in the country. Previously, Matt DiLallo and I examined some of Penn West's strengths and weaknesses. Here, I look at some opportunities for both the company and its investors.

**Oil acreage opportunities**
No question, the Cardium and Viking plays possess light crude oil and lots of it. It's good stuff, too. The Cardium and surrounding plays contain light sweet oil that, in some ways, rivals the oil from the Bakken. The play was discovered in the 1950's, but only with the advent of horizontal drilling and hydraulic fracturing has its full potential been appreciated. The Cardium alone may contain as many as 12 billion barrels of oil. However, a US Geological Survey report in 2012 estimated that in the entire region, only 1.3 billion barrels of undiscovered oil were recoverable.

Penn West owns over 5 million acres of Cardium and other oil rich plays. Even better, Penn West claims its completion costs are now 30% less than before with room for improvement. These assets, and improved well economics, should provide years of revenues.

Other companies see opportunity in the Cardium and Western Canada as well. **Encana Corporation** (TSX:ECA) and **Devon Energy**, both turn around stories themselves, own acreage along with Penn West. Encana produces oil from 455,000 acres of the nearby Duvernay field with encouraging results. During the most recent earnings conference call, management indicated Encana will not only continue exploration, but will change from its current practice of using single-well pads to multi-well pads. This should improve well economics and profitability. All of this is a deliberate shift away from Encana's past emphasis on natural gas production to more profitable oil production.

Devon owns over 4 million acres and claims its Swan Hills assets alone contain over 1.4 billion barrels of light sour crude. These assets are integral to Devon's overall efforts to produce more oil, more efficiently. At the end of the second quarter, the company projected oil production near the high end of its annual guidance due, in part, to its growing Canadian oil production.

All to say, Penn West's optimism regarding the Cardium and Viking plays seems rational as other companies like Encana and Devon believe this part of Canada deserves exploration attention.

**Improved recovery opportunities**

Newly named CEO David Roberts claimed Penn West was one of the biggest and best companies regarding waterflood techniques in the Western Canadian Sedimentary Basin. Waterflooding, as the name suggests, involves injecting water into a reservoir to physically displace residual oil. One interesting change the company plans going forward is deployment of waterflood recovery techniques earlier in the life of a well. Two pilot wells will have early waterflooding to optimize ultimate oil recovery. If this works as hoped, Mr. Roberts suggested that the company could double its ultimate oil recovery. This expertise offers intangible value to the company beyond the value of the additional oil recovered.

**Managerial opportunities**

The recent installation of CEO David Roberts, along with changes in the board, heralded a new direction for Penn West. All concerned know the company can't continue as it has. So they have taken decisive, if unpopular, action. First, they cut the dividend. While Penn West generates cash flow to cover it, the company's debt situation demanded a dividend cut. Second, management cut staff, 30% of it, including three executives. The company will take a $25 million charge in the third quarter for this, but long term these changes will improve the company's finances. Lastly, the company improved its drilling techniques at one of its drill sites, leading to improved well economics. The company hopes to export this success to its other operations.



The combination of decreased dividends, leaner staffing and lower drilling costs opens the door for greater profitability without increasing operating expenses. These actions indicate Penn West management is not "asleep at the switch." Rather, they indicate management possesses resolve to make Penn West profitable, even if it means making difficult decisions.

**Final Foolish thoughts**

Penn West stock generally declined over the past two years despite sitting on potentially lucrative oil plays. Additionally, Penn West possesses expertise in waterflooding techniques to improve oil production. These two assets spell opportunity for the company and its investors. Perhaps the biggest opportunity for the company is not the oil under its feet, but the management at its head. The new CEO and board members seem determined to exploit the company's oil holdings and expertise with a leaner, meaner business style. While headwinds persist, there are clearly opportunities for growth and profits with Penn West.



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

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