What to Expect When Penn West Petroleum Reports This Week

Description

Penn West Petroleum (TSX: PWT)(NYSE: PWE) is set to report earnings on Thursday. After years of poor returns for shareholders, the company is trying the unthinkable — deliberately shrinking the size of the business. Growth for the sake of growth is out of favour. Rather, management is forsaking size in favour of returns and profitability.

Can the company pull off this turnaround attempt? Let's review what has been happening at Penn West of the past couple of months and what we can expect in the upcoming quarter.

Stats on Penn West Petroleum

Analyst EPS Estimate	$0.08
Year-Ago EPS	$0.20
Revenue Estimate	$630.86M
Change From Year Ago Revenue	-9.40%
Earnings Beats in Past 4 Quarters	1

Source: Yahoo! Finance

Can Penn West manage to turn itself around?

Picture this…

It's the year 2000. You're a Penn West shareholder and oil is trading near $20 per barrel. I approach you with a stunning prediction: By 2014, oil prices will increase fourfold. However, the value of your shares will not increase one penny.

As shocking as that idea might sound, that's exactly the situation Penn West shareholders find themselves in today. Sure, the company has grown. Since 2004, revenues have increased by a factor of three. But the previous decade of effort has amounted to exactly zilch from the perspective of investors.

Needless to say, shareholders aren't impressed. But new Chief Executive Dave Roberts is planning to change that. Growth is out. Rather, Penn West is shrinking its operations to pare down debt and become a more efficient operator.

Roberts' plan consists of two parts. First, he has decided to trim Penn West's unwieldy asset portfolio. The company has committed capital spending to just three plays — namely the Cadmium, the Viking, and Slave Point. Any asset outside of these core positions is a candidate for divestment. Proceeds will be used to pare down the debt on its balance sheet.

Second, Roberts is committed to making Penn West a more efficient producer. In recent years, Penn West has spent more money bringing on production than just about any other operator. And once production was online, the company had the highest operating costs in the Alberta oil patch. But by becoming a specialists in only a few plays, Robert believes he can cut operating costs by $5 per barrel.

Analysts are starting to warm up to the plan. Over the past three months the street has increased its consensus earnings estimate by $0.12 per share. For the the full year, the average forecast has more than doubled to $0.16 per share. And over the past three months, the stock is up almost 20%.

Can this strategy actually work? Surprisingly, the shrink-to-grow approach is taking over the oil patch with positive results at other companies.

Encana (TSX: ECA)(NYSE: ECA) has struggled in recent years from chronically depressed natural gas prices. New Chief Executive Doug Suttles has pledged to focus his investment efforts on five core properties, shift production towards higher margin oil and liquids, and spin-off non-core properties.

Over the next five years the company is aiming to grow its free cash flow by 10% annually. Given that the stock is up 35% over the past six months, it's clear the plan is a hit amongst investors.

It's a similar story south of the border at **Chesapeake Energy** (NYSE: CHK). In mid-2013, the company's portfolio read like a wishlist of unconventional shale plays spanning 15 million acres across the United States. Now Chesapeake is in the process of rationalizing its development of those holdings and prioritizing the drilling of only the most profitable wells.

The company's fourth quarter results confirmed the turnaround is taking shape. Chesapeake boosted its adjusted EBITDA by 34% year-over-year, and earnings more than doubled to $1.50 per share. Although overall output only grew 3%, oil production increased by 32%, reflecting the shift Chesapeake has made away from dry gas toward liquids.

Foolish bottom line

In Penn West's report, watch the company's production guidance closely. Investors are worried that if the company pulls spending too quickly, production volumes could shrink much faster than management is letting on. Investors want to make sure that the company is still on track to produce 100,000 barrels of oil equivalent per day.

CATEGORY

1. Investing

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