



## Institutional Investors Are Buying Beaten-Down Penn West Petroleum Ltd. — Should You?

### Description

Beaten-down intermediate oil producer **Penn West Petroleum Ltd.** (TSX: PWT)(NYSE: PWE) has certainly seen better times, with its share price plunging a massive 77% over the past five years.

But even with oil prices tanking and the company struggling to successfully implement its transformation program, it has caught the eye of Wall Street hedge fund manager Joel Greenblatt and Prem Watsa, sometimes called the “Canadian Warren Buffett.” These men have invested US\$1.3 million and US\$273,000, respectively, in the troubled oil company.

Does this mean Penn West now represents value? Should everyday investors take the plunge? At current prices, there is certainly some value there for investors, but in my mind, it is a speculative play.

Let me explain why.

First, Penn West is struggling to successfully implement its transformation program and make over its operations.

While it has successfully completed more than \$1 billion in asset sales since committing to improving its balance sheet, the company still holds a huge pile of debt, totaling \$2.2 billion. This is impacting its ability to adapt to an operating environment where softer crude prices dominate, and operational flexibility — particularly in regards to capital spending on developing oil assets — is the key to remaining profitable.

Second, Penn West’s production remains heavily weighted toward lower-margin natural gas.

For the third quarter of 2014, natural gas accounted for 36% of its total production, virtually unchanged from the equivalent quarter in 2013 — even though a key goal of its transformation strategy is to boost oil and natural gas liquids production.

Combined with weaker crude prices, this continues to impact Penn West’s margins per barrel of crude produced, or netback. For the third quarter, Penn West reported a netback of \$32.51, a 4% decline

year-over-year. It is also among the lowest netbacks in the energy patch.

For comparison, equally troubled peer **Lightstream Resources Ltd.** (TSX: LTS), reported a third-quarter netback of \$48.67 per barrel, while **Crescent Point Energy Corp.** (TSX: CPG)(NYSE: CPG) reported a netback of \$51.25 per barrel for the same period.

Penn West's low netback per barrel leaves little fat to absorb any sustained softness in crude prices before cash flow and profitability are impacted.

But on a positive note, Penn West has been able to successfully rein in operating expenses. These expenses for the same period were down 20% year over year and rose only 6.5% on a per-barrel basis due to asset disposition activity. This reduction in expenses will help to boost Penn West's profitability, particularly when crude prices recover over the longer term.

Finally, at its current share price, Penn West looks attractively priced to me.

It is trading at an enterprise value, or EV, of a mere 4 times its EBITDA and 10 times its oil reserves. This makes it appear cheaper than Crescent Point, which has an EV of 9 times EBITDA and 28 times its oil reserves, as well as Lightstream Resources, with an EV of 5 times EBITDA and 14 times oil reserves.

Such attractive valuation multiples highlight that Penn West certainly offers investors considerable value at this time, particularly with the transformation program having gained some traction. But I am skeptical that the company continues to pay a dividend that is yielding almost 12%, when it has such a heavy debt burden and has yet to significantly boost its margins. In my view, this makes it essentially a speculative play on a rebound in crude prices.

## CATEGORY

1. Energy Stocks
2. Investing

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1. NYSE:VRN (Veren)
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