Why Penn West Petroleum Ltd. and Talisman Energy Inc. May Suffer More Than Other Energy Producers

Description

On Monday, the news was once again very sombre for Canada's energy producers, with oil prices continuing to slide. And it leaves us with a very important question: Which companies will be the biggest losers from this low price environment?

Those words were chosen carefully, because no Canadian energy company wins from the current situation. That being said, certain companies suffer more than others. Below we show two prime examples.

1. Penn West Petroleum Ltd.

The oil price slide has just been the latest in a series of misfortunes for **Penn West Petroleum Ltd.** (TSX: PWT)(NYSE: PWE) and its shareholders. Years ago, the company expanded too quickly, highlighted by its purchase of Canetic Resources Trust for $3.6 billion in 2008. Operational problems ensued, and the company has been in retreat mode ever since. Assets are being sold (sometimes at bargain prices), and $400 million worth of accounting restatements this year haven't helped.

So as it stands, Penn West's strategy remains clear: sell assets, pay down debt. To put this in perspective, the company hopes to get its debt-to-cash flow ratio down to 1.5 by sometime in 2016.

This will require the company to sell more assets, a very tricky proposition with oil prices falling so sharply. Making things worse, many of these assets aren't even producing.

So Penn West is being hit in a number of ways. The low oil prices are not only hitting cash flow, they're making these asset sales that much harder. Therefore, unless the pricing environment turns around, expect things to get much worse. This could start with a dividend cut (the shares currently yield nearly 14%).

2. Talisman Energy Inc.

The story has been fairly similar for **Talisman Energy Inc.** (TSX: TLM)(NYSE: TLM). The company has been trying to sell assets (or even the whole company) after expanding too aggressively. And this has been a struggle.

The real problem has been in the North Sea, where assets face declining production, big abandonment liabilities, and crippling capital commitments. This was likely the major concern for Repsol, the Spanish giant that appeared interested in acquiring Talisman, but eventually backed off.

So like Penn West, Talisman is trying to sell down assets to reduce its debt burden, which currently stands at roughly $5 billion (a big number for a company valued at $5.6 billion). And the low oil price environment only makes that more difficult.

Making matters worse, Talisman has been burning cash, so when insufficient assets are sold, the debt burden actually increases (as has happened the last couple of quarters). With collapsing oil prices, expect this to continue.

These two stocks have both collapsed, which may make them look cheap. But they're likely not worth holding at any price.

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