Why Are Shares of Penn West Petroleum Ltd. Surging?

Description

On Wednesday morning, **Penn West Petroleum Ltd.** (TSX: PWT)(NYSE: PWE) became the latest Canadian energy company to slash its dividend. Starting in the first quarter of 2015, the payout will be $0.03, a big decrease from the current figure of $0.14.

Yet the company's stock price reacted in a way that I did not expect — it went up, by a lot. So what exactly is going on?

Two wise steps

In an article posted just before Penn West's announcement, I argued that its dividend should go to zero. The company has a big debt load, declining production, and declining cash flow. The $0.14 dividend would have put the company under even more financial pressure.

And to the company's credit, it came very close to doing so. As a result, investors don't need to worry about a further dividend cut. This is in contrast to companies like **Canadian Oil Sands Ltd.**, which cut its dividend by 42%, but still yields close to 9%.

Secondly, Penn West suspended its dividend reinvestment program (DRIP). Under the DRIP, shareholders were incentivized to receive their dividend in stock, rather than cash. But with the company's share price beaten up so much, the company doesn't want to give away shares at a bargain price. So this move sends a strong signal about management's optimism.

Finally on the right track

So the dividend cut could have been seen from a mile away. But that still doesn't explain why the stock is surging.

Well, Penn West also announced a $215 million cut to its capital program for 2015. This amounts to about a 25% reduction. But at the same time, the company's production guidance has only been reduced by 5%, to roughly 95,000 barrels per day. Better yet, Penn West hopes to grow production in the years afterwards. This is likely what the market is reacting to.

Contrast this with a company like **Lightstream Resources Ltd.** (TSX: LTS), which not only slashed its dividend this week, but also hopes to sell all of its Bakken assets. Lightstream will have a tough time getting fair value for those assets in this environment. But now that Penn West has more financial flexibility, it is able to take the opposite approach.

A way to bet on oil's recovery?

Throughout the year, I have been one of Penn West's harshest critics. But this time, the company seems to be taking some very positive steps.

I am still not ready to jump on the bandwagon. But there are some things to like about the company.

For instance, Penn West does have very high-quality light oil assets, something that people (including me) tended to forget this year amid the company's other issues. And with growing production over the long term, the balance sheet should eventually fall more into line. Best of all, the share price is still down by about 50% over the past month. So any recovery could lead to big share price gains.

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