Why Oil Won't Rebound Until These Producers Go Bankrupt. Part 1

Description

In Canada's energy patch, there's a common belief that low oil prices are temporary and that the market will come roaring back. For example, the CFO of **Suncor Energy Inc.** recently said oil will rise "probably over time to US$90 in three to four years' time." Unfortunately, there's a big problem with this hypothesis: If oil companies can drill, they will. The past six months have demonstrated that.

So, for Mr. Cowan to be right, some producers will have to turn off the taps, something they will not do by choice. In other words, we'll have to see some bankruptcies.

This leaves the all-important question: Who will be the first to go? We take a look at some possibilities below.

1. Penn West

Penn West Petroleum Ltd. (TSX:PWT)(NYSE:PWE) has been a basket case for years, plagued by poor acquisitions, operational problems, an accounting scandal, and a heavy debt load. An oil price plunge was the last thing this company needed.

Now, it's in desperate straits. Total debt stands at over $2.1 billion, and the company has already started negotiating with creditors. It's trying to sell assets, but many are non-producing, and will have a tough time fetching fair value. Its reserves carry a big valuation, but only with an optimistic pricing forecast, and require more investment than Penn West can afford.

At this point, Penn West's only hope is a strong oil price rebound. Unfortunately, that won't come as long as drillers like Penn West are still around.

2. Lightstream

Lightstream Resources Ltd. (TSX:LTS) has a lot in common with Penn West. Once a favourite among dividend investors, it has nearly collapsed under a mountain of debt, and is desperately hoping for a price rebound.

In the meantime, Lightstream is trying to sell its assets in the Bakken formation. Unfortunately, it is having trouble getting reasonable offers. This is to be expected; It is clearly a buyer's market right now, and no one wants to overpay (or even pay a fair price) for oil assets in this environment.

Also like Penn West, there's tremendous upside in Lightstream's reserves, should there be a rebound in the oil price. That said, if oil does rebound, Lightstream probably won't be around to see it.

3. Whiting

It's time to give some credit to Canada's oil producers. After all, with just a few exceptions (see above), Canadian oil producers have been much more responsible than their American counterparts. South of the border, some of these balance sheets are very scary.

For example, consider **Whiting Petroleum Corp.** (NYSE:WLL), whose US$5.6 billion in debt is more than three times last year's operating cash flow. After capital investment is included, cash flow for Whiting was negative last year. Making matters worse, this was when the oil price averaged more than US$90 per barrel. Whiting has put itself up for sale, which should tell you what you need to know about the company.

Penn West and Lightstream are hoping that American producers like Whiting will go under first, prompting an oil price rebound. While that may very well happen, I wouldn't count on a strong bounce back. So, at the end of the day, I would avoid all companies on this list.

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1. Energy Stocks
2. Investing

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