At Under $2 Per Share, Is Penn West Petroleum Ltd. Worth a Look?

Description

It hasn't been a good year for shareholders of **Penn West Petroleum Ltd.** (TSX:PWT)(NYSE:PWE).

It all started with terrible operating metrics leading to an accounting scandal approximately a year ago. When the new CFO took over, he discovered the previous management team had been counting operating expenses as capital expenses, which artificially boosted cash flow.

Once that was taken care of, the price of crude really started to decline. The price of the commodity has melted down more than 50%, which was somewhat offset by the decline in the Canadian dollar.

All this wouldn't have been so bad if the company's balance sheet was in better shape. Although it spent most of 2014 selling off assets to help pay down the debt, as I type this the company still owes more than $2.4 billion to creditors. Plus, it has the misfortune of having most of its outstanding debt denominated in U.S. dollars, which doesn't look pretty once it gets converted back to loonies.

These issues have pushed down shares more than 80% over the past year, and has made Penn West the subject of bankruptcy rumours. But surprisingly, there's actually a bullish scenario here, at least for investors who like to speculate a little. Let's take a closer look.

Bankruptcy isn't imminent

CEO Dale Roberts has made it his mission to reduce the company's debt. The plan was going quite well until the price of crude collapsed.

Roberts made sure Penn West was one of the first energy producers to get concessions from lenders. The company's debt covenants have been stretched out to five times its total debt to EBITDA ratio until June 30th, 2016, gradually being reduced to four times total debt to EBITDA by the end of 2016. That buys it more time to wait for crude to recover.

As part of the agreement with lenders, the company also agreed to sell off a minimum of $650 million worth of assets by 2017. This process has already started, with management selling $415 million worth of royalty lands and other assets in just the second quarter alone. Reaching $650 million in asset sales shouldn't be an issue, assuming the market is healthy enough for Penn West to get decent prices.

Plus, the company has $1.2 billion credit line it can use as a last resort, and has cut its formerly generous dividend to just a penny per share per quarter. These are both good things for a company that still needs to shed debt.

Other improvements

One of the other things Roberts has focused on is making cost cutting a priority. Thus far, he's done a good job. Throughout 2014 Roberts cut staff, reduced overhead, and improved efficiencies, all in an effort to bring costs down and improve netbacks. Results were there, at least when the price of crude cooperated.

Like every other energy producer, Penn West also cut back capital expenditures for 2015 from $732 million in 2014 to an estimated $650 million this year. Based on assumptions of $65 crude (in Canadian dollars), that will net the company a cash flow of approximately $550 million. Considering the overall weakness in the sector, the $100 million shortfall isn't bad.

There's also the value of the company's reserves. According to the company's latest investor presentation, it has more than 15 years' worth of reserves just waiting to be extracted. Accordingly, based on internal estimates, these reserves are worth approximately $14 per share. That doesn't mean shares are worth $14, since there are liabilities to subtract from the value of those assets. But it goes to show how there's some significant value here if the company can get through its current difficulties.

Penn West is a risky stock; that much is obvious. But there's also potential for it to double or triple if the price of crude recovers and if management can continue getting good prices for the assets it has on the block. For investors looking for a little speculation, it might be a good play. I know I'm still happy to own it.

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