Is Penn West Petroleum Ltd. Worth More Than $1 Per Share?

Description

In a recent interview on *The Business News Network*, portfolio manager Eric Nuttall said that at current energy prices many producers' equity values are zero. In other words, the value of their future production isn't even enough to cover their debt. Consequently, we'll likely see some bankruptcies in the coming months.

Mr. Nuttall did not specify which firms he was talking about, but we can be pretty sure **Penn West Petroleum Ltd.** (TSX:PWT)(NYSE:PWE) is one of them.

One big mess

Even before oil prices started collapsing, Penn West was struggling badly. The company made a big acquisition in 2008 that didn't pan out, and this left the company heavily indebted. Then in early 2014 the company faced fierce criticism after selling some assets for what seemed like a bargain price. Later that year the company had to make $400 million worth of accounting restatements.

Then when oil prices fell, Penn West was hit especially hard. Not only did cash flow plummet, but the company was trying to sell non-producing assets, which, of course, is extremely difficult in this kind of environment.

A look at the numbers

Here's the good news: if oil prices do recover, then Penn West's shares will absolutely take off.

To illustrate, the value of the company's reserves—assuming a robust oil recovery—was approximately $5.8 billion. After subtracting net debt of $2.2 billion, that leaves $3.6 billion of equity value, or just over $7 per share. That's a big jump from the current share price, which sits at just over $1.

But oil is showing no signs of a recovery, and this spells big trouble for Penn West. Roughly 55% of its reserves come from non-producing assets, and these assets are probably uneconomic at today's oil prices. And in any case, Penn West does not have the funds required to develop these assets.

Even the producing assets are looking a lot less attractive at today's oil prices. Just last quarter Penn West generated less than $80 million in funds flow from operations, and free cash flow was severely negative. To help raise cash, the company sold over $400 million worth of assets, but this isn't a viable long-term strategy.

To put it bluntly, it's difficult to imagine Penn West's remaining reserves being worth more than $2.2 billion. That leaves the company with an equity value of zero.

A lottery ticket

Just like a lottery ticket, Penn West is almost certainly worthless, but could be worth a ton in an ideal scenario.

So, if you're thinking of buying the stock, don't commit more money than you're willing to lose. For most of us, that means avoiding the shares entirely. A far better option is revealed in the free report below.

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