



Does Penn West Petroleum Ltd. Have Enough Breathing Room Now?

Description

To say **Penn West Petroleum Ltd.** (TSX:PWT)(NYSE:PWE) has struggled over the past year would be a significant understatement as its stock price is down 91%. To a large degree, that steep drop is due to the concern that Penn West has too much debt for the currently low oil price. Having said that, the company has made a lot of progress to reduce its debt, and announced just last week the sale of another \$192.5 million in assets.

That certainly increases its breathing room, but is it enough?

Another step forward

In Penn West's latest non-core asset sale, the company is jettisoning properties in the Greater Mitsue area of central Alberta. Those properties were producing an average of 4,500 barrels of oil equivalent per day (BOE/d), and that production was primarily liquids. The company received a pretty compelling price as the \$192.5 million sales price implied a 14 times net operating income multiple, which is rather generous.

The company intends to use the cash to reduce debt. With this sale, the company will have parted with \$1.7 billion in assets since it started its turnaround plan in 2013. It has used that cash to reduce its debt by \$1.4 billion, which is a 40% reduction from the peak. While that's a large chunk of its debt, the problem lies in the fact that the company started from a position where it had too much debt when oil prices were much higher.

To put it another way, with oil prices down more than 50%, a 40% reduction in debt just might not be enough.

Still a lot of work to do

As of the end of the second quarter, Penn West had roughly \$2.2 billion in debt outstanding. So, this sale should pare that number by roughly 9%. That will help push the company's leverage ratio, which is currently at 3.2 times senior debt-to-EBIDTA, a bit lower. That ratio isn't all that bad, though a ratio that's well below three times would be ideal given the current oil price and overall market uncertainty.

To get to that point, the company will need to continue to shed non-core assets. It certainly has plenty to choose from as it has roughly 30,000 BOE/d of production that it has deemed as non-core. That gives it plenty of dry powder to continue to chip away at its debt.

Those future asset sales combined with the company's [recent cost reductions](#) will certainly help increase the company's breathing room. In fact, its plan going forward is to completely live within its means, so that its cash flow will completely cover its capex. That cash flow is being widened because the company suspended its dividend while also reducing its headcount by 35%.

Those two moves should save the company \$65 million per year, which, like asset sales, helps it to keep its head above water.

Investor takeaway

Penn West's current single-digit stock price would seem to indicate that the company isn't going to make it. While that's certainly possible if oil prices head lower and stay there for a few years, the company has made a lot of progress to eliminate debt while also reducing its costs to improve its cash flow.

It now has a lot more breathing room than it did when oil prices started to tumble, but given the potential for oil prices to remain really weak, especially in Canada, it's not out of the woods just yet; however, more assets sales will certainly help.

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Author
mdilallo

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