



Is Penn West Petroleum Ltd. Really Worth Nearly \$3 Per Share?

Description

It's safe to say that **Penn West Petroleum Ltd.** (TSX:PWT)(NYSE:PWE) has seen better days. Falling oil prices have put serious pressure on the company's balance sheet, and despite some drastic steps by the company, bankruptcy looms.

Thus, Penn West can be thought of as a "lottery ticket" stock—it will probably end up worthless, but there's tremendous upside if oil prices recover.

That doesn't answer one important question though: Is the stock overpriced or underpriced? Well, we take a look below.

A "back of the envelope" calculation

Before selling its Mitsue assets last week, Penn West's production totaled about 90,000 barrels per day. Assuming a valuation of \$40,000 per flowing barrel, it would yield a valuation of \$3.6 billion. One must then subtract the company's \$2.2 billion in net debt, leaving an equity value of \$1.4 billion, equivalent to nearly \$3 per share.

Or if one works backwards, Penn West's current valuation implies a value of \$28,000 per flowing barrel. This is far less than the \$43,000 per barrel the company received for its Mitsue assets. And **Canadian Natural Resources Ltd.** trades for close to \$50,000 per flowing barrel.

Why are the shares trading so cheaply?

There are multiple reasons for the discount, some more obvious than others.

Let's start with the simplest explanation: Penn West is an extremely risky stock, and investors demand extra reward to compensate for such risk.

But there's another reason. Because Penn West has so much debt, the company can only spend so much next year on its operations. As a result, Penn West cannot fully exploit its assets. Thus, a \$40,000 per flowing barrel valuation may be too large.

There's an obvious solution here: Penn West simply has to sell all of its assets, just like it did with its Mitsue properties. If the company could get a similar price tag, then presumably the transaction(s) would be beneficial for both the buyer and Penn West.

However, this is easier said than done. In the current oil environment, there are many sellers, but only a few buyers, so getting a fair deal isn't easy. And buyers know that if they wait, companies like Penn West may desperately sell assets for pennies on the dollar.

Should you buy Penn West?

If you're looking to spice up your portfolio and invest in a stock that could very well triple in value, then Penn West is an attractive option. Just make sure that you invest a very small amount, certainly not more than you're willing to lose. And then once you own the stock, you just have to hope for an oil recovery or for Penn West to act fast.

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1. Energy Stocks
2. Investing

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