



Why Did Penn West Petroleum Ltd. Shares Surge 35%?

Description

While the rest of the market was focusing on **Suncor Energy's** hostile bid to acquire **Canadian Oil Sands**, another one of Canada's energy producers was surging.

Shares of **Penn West Petroleum Ltd.** (TSX:PWT)(NYSE:PWE) were having their best day in months, going up as much as 35% and briefly hitting \$1.17 each. Volume was huge, too; on a normal day, Penn West normally does about 2.5 million shares in volume on the TSX. By 12:30 eastern time, 3.7 million shares had already exchanged hands.

That's a nice move for beleaguered shareholders. Penn West has been one of the worst performers on the TSX this year, as the company has had to deal with trying to strengthen its balance sheet in a very trying time. Thus far in 2015, shares are down more than 55%, even after today's big move.

Should investors get excited about this recent move? Or is Penn West poised to disappoint again?

The bull case

Since there's no specific news on why Penn West shares have surged, we're forced to guess. Fortunately, it's not a terribly difficult guess.

One only has to look at Suncor's hostile takeover offer for Canadian Oil Sands to see why investors are excited. If Suncor sees value in the sector, chances are that other major oil producers like **Imperial Oil**, **Canadian Natural Resources**, or others also see cheap assets.

From an asset basis, Penn West is probably the cheapest energy company in Canada. Back when the energy sector was booming, Penn West's previous management team loaded the company up with debt to acquire all sorts of assets. Even after accounting for the debt needed to acquire them, Penn West has a book value of more than \$10 per share.

Needless to say, that's a huge premium compared to the \$1.10 share price.

Penn West's big issue is the debt. While the company has been fairly successful selling off assets to

pay it down—to the tune of almost \$1 billion over the last year or so—the debt hasn’t budged a whole lot because it’s primarily priced in U.S. dollars. As the Canadian dollar has declined, Penn West’s debt has increased—at least, in Canadian dollar terms.

But for a company with deep pockets, taking on Penn West’s \$2.2 billion in debt isn’t the end of the world. The acquirer could either keep all the assets and develop them internally, or wait until prices recover and then piecemeal the assets out to interested buyers.

The bear case

The big question Penn West investors need to ask themselves is this: What happens if the company doesn’t get acquired?

The big danger is bankruptcy. The company’s management was aggressive in negotiating with lenders earlier in the year when it became evident the company would be in trouble during a prolonged weak oil market. That move bought it time, but the company needs crude to recover to avoid some sort of restructuring.

There’s also Penn West’s troubling production declines. Some of the assets the company is selling are currently producing, which means production going forward will decline. At the beginning of the year, Penn West’s management guided that the company would get close to 100,000 barrels per day of production. Now? The production forecast has been cut several times to the latest level of 84-88,000 barrels per day.

It’s hard to get the cash flow needed to pay back debt when production keeps going down.

There’s certainly the possibility that Penn West could be taken over, and it sure does make sense. But that doesn’t mean it’ll happen. Investors should buy the stock because they think a combination of oil’s recovery and a successful turnaround effort will lift shares higher, rather than because they think the company will be acquired.

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1. Energy Stocks
2. Investing

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