Why Penn West Petroleum Ltd. Should Be Bought Out for $2 Per Share

Description

Ever since **Suncor Energy Inc.** bid $4.3 billion for **Canadian Oil Sands Ltd.**, analysts have been expecting a wave of merger activity in Canada's energy patch. After all, languishing oil prices are putting serious pressure on the weaker players, meaning the stronger companies could easily scoop up some bargains.

One of these weaker players is **Penn West Petroleum Ltd.** (TSX:PWT)(NYSE:PWE), a company often cited as a takeover target. It's no coincidence that Penn West's stock price skyrocketed by 84% in the five days following Suncor's bid for COS.

But despite that rise in price, Penn West would still be a bargain for any acquirer. We take a closer look below.

A breakdown of the numbers

Penn West has been furiously selling assets to pay down debt, with the two most recent transactions coming in the past six weeks. Thanks to these efforts the company's net debt now stands at $1.8 billion.

If an acquirer paid $2 per share for Penn West, then that would mean paying $1 billion for the company's equity, or $2.8 billion including debt. For that price, the purchaser would receive 81,000 barrels per day of production. That equates to just under $35,000 per flowing barrel.

An absolute bargain

By practically any standard, $35,000 per flowing barrel would be a great price to pay.

To illustrate, Penn West's two recent asset sales carried price tags of $43,000 and $82,000 per flowing barrel. And those two assets actually had worse economics than the company's remaining production.

Penn West's peers also trade at higher multiples. Including debt, both **Crescent Point Energy Corp.** and **MEG Energy Corp.** trade for slightly more than $80,000 per flowing barrel. Crescent Point has a big dividend and MEG Energy has enticing growth prospects, but those alone don't explain such a price difference.

It doesn’t stop there. An acquirer should find some synergies with Penn West’s assets, which would generate even more value. And Penn West’s debt could even be renegotiated, assuming the acquirer had a decent credit rating.

Does this mean you should buy Penn West?

Penn West remains a very risky stock, one that could easily go bankrupt. Furthermore, there is still plenty more downside for oil prices. Therefore you shouldn’t invest more than a small slice of your portfolio in the name.

But if you’re looking for some oil exposure and aren’t afraid of taking some risk, then Penn West’s shares offer a nice risk/reward trade-off. Just don’t say you weren’t warned.

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