3 Reasons Why Penn West Petroleum Ltd. Should Be Taken Out

Description

For a while now, analysts have been calling for a wave of takeovers in Canada's energy patch. And while we've only seen a trickle so far, we should see more deals come as oil prices fall even further.

One company in particular that should get taken out sooner or later is **Penn West Petroleum Ltd.** (TSX:PWT)(NYSE:PWE). We look at three reasons why below.

1. High-quality assets

Even with such low oil prices, Penn West's core plays deliver strong economics. For example, with an oil price of $50 per barrel (the current WTI oil price equates to $51 in Canadian funds), the company's Cardium wells earns 26% returns. For the Viking wells, that figure is 16%.

This is partly due to Penn West's cost-cutting efforts. From 2013 to the third quarter of this year, cost per metre drilled at Viking have fallen by $30. Over at Cardium, that figure is over $200. Overall, operating costs at existing properties have fallen by more than 20%.

Best of all, Penn West has made very little imprint at its core plays, meaning there is plenty of potential for growth. Even with such low oil prices.

2. A cash shortage

As we all know by now, Penn West has a very levered balance sheet with roughly $2 billion in net debt. And this is despite a flurry of asset sales over the last couple of years.

To deal with this problem, Penn West has pledged that capital expenditures will not exceed funds from operations. As a result, the company is poised to make massive cuts to its capital program, and that's on top of some steep cuts already made.

Thus Penn West will not be able to fully exploit its assets, which is part of the reason why its share price is so low. But this story changes once an acquirer enters the fold. For this reason, you could reasonably say that Penn West's business is more valuable in another company's hands. Such a scenario often leads to an acquisition.

3. A depressed share price

This is the main reason why Penn West is ripe for a takeover. As of this writing, the company has a $550 million market capitalization, putting the total value of its business at $2.5 billion (after adding net debt). That’s equivalent to just over $30,000 per daily barrel of production.

This is an extremely cheap ratio, well below what Penn West received when selling its non-core assets (even though the company’s remaining core production has better economics). It’s also well below what the company’s larger rivals trade at.

This doesn’t necessarily mean you should buy Penn West. After all, the shares could easily sink to $0.50 before getting taken out at $0.70. But the company is certainly trading at a discount, so if you’re willing to take some risk, it may be worthy of a small investment.

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