If You Want to Buy an Oil Stock, Make it Penn West Petroleum Ltd.

Description

For quite a while now, **Penn West Petroleum Ltd.** (TSX:PWT)(NYSE:PWE) has been one of the worst investments you could make. The oil producer has struggled with a heavy debt load, slumping oil prices, and even an accounting scandal last year. The stock is down nearly 50% in 2015 and nearly 95% over the past five years.

At first glance, the company still looks like an awful investment. Not only does it have a bad history, but its balance sheet is still in horrible shape (despite numerous asset sales), and bankruptcy is a legitimate possibility.

Yet despite all these issues, Penn West may be the best oil stock you could buy. We take a closer look below.

Quality assets

Penn West has some of the highest-quality assets in Canada's energy patch, which is easy to forget because of the company's past troubles.

For instance, Penn West's Pembina Cardium wells earn an internal rate of return of 16% at US$36 oil. Over at the Dodsland Viking play, that number is 26%. Part of the reason for such strong economics is the weak loonie.

A cheap stock

Based on Friday's closing price, Penn West has an enterprise value of roughly $2.7 billion, which equals just under $35,000 per flowing barrel.

This is an incredibly cheap multiple, especially given the strength of Penn West's assets. Just to putthis in perspective, the company recently sold its Mitsue and Weyburn assets for more than $60,000per flowing barrel. And those properties had far worse economics than Penn West's remainingproduction. Other producers, such as **MEG Energy Corp.** and **Crescent Point Energy Corp.,** alsotrade at far higher valuations.

How to control risk

Of course, there's a reason why Penn West has such a cheap stock price: it's because of the high risk that comes with an investment. In fact, there's a legitimate chance the company could go bankrupt, which would wipe out shareholders completely. So, in effect, Penn West is a highly levered bet on oil prices. There's simple way to adjust for that: buy less stock.

To give an example, let's say you're looking to put $5,000 into an oil stock. Instead, you should invest $2,500 in a company like Penn West. You'll get the same torque to oil prices, while at the same time getting a much better deal.

I don't own Penn West simply because I don't want to own *any* oil company. But if you're looking to bet on a turnaround in oil prices, this is the most effective way to do so.

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1. Energy Stocks
2. Investing

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