Will Penn West Petroleum Ltd. Survive This Oil Rout?

Description

Penn West Petroleum Ltd. (TSX:PWT)(NYSE:PWE) has been one of the hardest-hit energy stocks.

Even before this crisis started, the company was dealing with an excessive debt load and a minor accounting scandal. These days, the company is in a fight for its very survival as its management team struggles to get top dollar by selling non-core assets in a weak market.

With shares of Penn West currently trading at $1.16 per share, many investors think bankruptcy will happen sometime in 2016. That much is reflected in the share price. Short of a miracle rally for crude, many investors don't think there's anything the company can do to avoid that fate.

But are things really that dire? Let's take a closer look.

Progress is being made

On March 21, Penn West announced its latest asset sale, getting $148 million for properties in the Slave Point area of northern Alberta. It also announced approximately $80 million in proceeds for a few smaller assets.

These sales are the latest in a program that has now raised more than $1 billion in cash since management made it a priority in 2015. The company hasn't been giving these assets away either; overall prices have been surprisingly firm considering the environment surrounding the sector.

The $230 million raised from the latest asset sale will go towards paying down Penn West's massive debt pile, which stood at $2.1 billion at the end of 2015.

Another thing is helping Penn West's debt, and that's the strengthening of the Canadian dollar versus the U.S. dollar. Much of the company's debt is denominated in American currency. So even though the company was throwing every dollar from asset sales towards paying down debt, by the time it was converted back to Canadian dollars it didn't look like much progress was being made.

Finally, that trend is reversing. At the end of 2015 it cost US$0.7225 to buy one Canadian dollar. These days, that number is closer to US$0.77. This means that the company will get relief once it converts the U.S. dollar debt back into local currency when it releases its next quarterly results.

The company is focusing production in two main areas: the Cardmium and Greater Viking fields in Alberta. These areas do have attractive economics, even in today's pricing environment, with operating costs of below US$18 per barrel. Approximately 60% of Penn West's production in 2016 will come from these two core assets; the rest could potentially be sold off.

The company has also instituted a hedging program with approximately 8,000 barrels of crude per day locked into prices of about US$55 per barrel. That's a little under 20% of the company's projected production for 2016. It's not enough to save the company alone, but it's a nice start.

Is this enough?

Penn West's management team has been doing their best to ensure the company survives what's looking like the worst oil rout in decades. They've made prudent moves. Unfortunately, it might not be enough.

The company is looking at a total debt load of approximately $1.8 billion at the end of the first quarter. That's still too much. With oil at $35 per barrel, it simply doesn't generate enough internal cash flow to make a dent in the debt. The longer the weakness persists, the less likely it'll be that Penn West can get good prices for its non-core assets.

Management could soon have a very difficult decision to make. The company could declare bankruptcy sometime soon and eliminate much of the debt, but that could cause the current top execs to lose their jobs. Or management could sell off one of the two core assets.

But without the core assets, is there really a reason to own Penn West shares in the first place?

The bottom line is this: if oil doesn't rally significantly sometime soon, Penn West is in danger of going bankrupt. At this point, the company is nothing but a risky play on the price of oil. If crude heads higher in the near term, Penn West could survive and shares could end up much higher. If it doesn't, I fear bankruptcy is the inevitable conclusion.

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