



Why Penn West Petroleum Ltd. Is Still Struggling to Survive

Description

Every time oil rallies, a wave of optimism sweeps energy stocks as investors believe that many of the companies that are struggling to survive the sustained rout in crude will bounce back. One such company that has experienced considerable optimism for this reason is beleaguered oil producer **Penn West Petroleum Ltd.** (TSX:PWT)(NYSE:PWE).

Over the last year, each time crude has rallied, Penn West has garnered considerable attention from investors and analysts alike who believe it is one of the best stocks to play the rally in oil.

However, that couldn't be further from the truth. The company is facing headwinds that could eventually cause it to fail.

Now what?

The most pressing issue facing Penn West is its deteriorating financial position and high level of debt.

You see, at the height of the oil boom, it loaded up on debt with little concern over the cyclical nature of oil prices, which it used to acquire a range of assets of questionable quality. The sharp collapse in crude has caused its financial position to deteriorate markedly with 2015 cash flow plunging by 80% compared with 2014 and the value of its total assets plummeting by 40%.

This made it extremely difficult for Penn West to meet its financial commitments and meant that it was unable to whittle down its huge pile of debt, which, even after assets sales, remains at almost \$2 billion.

As a result, Penn West was forced to renegotiate its financial covenants because it seemed increasingly likely that it would breach them for as long as crude remained under US\$60 per barrel. While this provided Penn West with considerable relief, those covenants will revert back to their original levels later this year.

Penn West's senior-debt-to-EBITDA and total-debt-to-EBITDA ratios will move to less than or equal to 4:1 for the quarter ending December 31, 2016. Now with both ratios equal to 4.6:1 and no signs of any sustained rally in crude to boost cash flow or any means of substantially reducing debt, there are signs

that Penn West will breach these covenants when the ratios fall.

This may lead to Penn West being unable to survive.

The next major issue is that Penn West's oil production continues to fall, which can be attributed to the sale of assets, the shuttering of non-economic production, and its lack of sufficient cash resources to fund drilling and exploration. In fact, Penn West has forecast a 26% reduction in production for 2016, which will see revenues fall even further and cause its cash flow to continue deteriorating.

Meanwhile, the lack of drilling and exploration activity means that Penn West will find it difficult to replace that production lost through natural declines. This will see its production, and hence revenues, remain under pressure for the foreseeable future.

It is important to note that any decline in revenue will make it even more difficult for it to generate sufficient cash flow to meet its financial commitments, thereby increasing the chance that it could breach its financial covenants.

So what?

Even after the recent rally in crude which sees it up by over 60% from its February lows, the outlook for Penn West remains bleak. This makes it one energy stock that investors should avoid.

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1. Energy Stocks
2. Investing

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