



Penn West Petroleum Ltd.: Another Zombie Energy Company?

Description

The bad news continues for investors in troubled energy company **Penn West Petroleum Ltd.** (TSX:PWT)(NYSE:PWE). Even the recent spike in oil prices that now has it trading more than 70% higher than its February lows has done little to help the company.

You see, the company announced this week that after the end of June 2016, it could breach its financial covenants. This has led to considerable concern among investors as this may herald the end of Penn West.

Now what?

The heart of Penn West's problem is its mountain of debt, which—even after an aggressive asset divestment and payment program—remains at over \$1.8 billion. This coupled with weak oil prices and declining production forced the company to renegotiate its financial covenants in 2015 as it struggled to survive in the harsh operating environment.

At the time the covenants were renegotiated, it was hoped that this would give oil sufficient time to rebound, throwing the company an important lifeline. Unfortunately, this hasn't occurred and its covenants are set to revert to their original levels later this year.

Then there is Penn West's declining financial situation, which is being exacerbated by ever-falling production and declining cash flow. For the first quarter 2016, oil production fell by 19% year over year and funds flow from operations were down by a massive 39%.

Even the supposed magic bullet of utilizing asset sales to continue aggressively paying down debt appears unlikely to succeed.

You see, the protracted weakness in crude, along with the sharp decline in investments in the oil industry, has created a buyers' market, making it extremely difficult to complete sales for all but the highest-quality assets.

Furthermore, additional asset sales will cause production to fall, further impacting cash flow and

increasing the likelihood that Penn West will breach its covenants, unless there is a sudden and sustained rally in crude.

At this time, Penn West is negotiating with its lenders to relax its financial covenants, but there is no guarantee that these efforts will be successful, particularly with creditors having little incentive to grant the company more time because of its deteriorating financial position.

While Penn West may not go bankrupt, there is the increasing likelihood of a debt restructuring. Penn West noted in its latest results, "... we will also continue to consider other options, such as pursuing additional sources of capital from strategic investors."

Any such restructuring has the potential to wipe out the value held by equity holders, as has already occurred with **Pacific Exploration and Production Corp.**

So what?

I have been quite pessimistic on the outlook for Penn West for some time, and rightly so. It is yet another zombie energy company that continues to cling to some form of life and shuffle along in the harsh operating environment regardless of its poor financial health. This is one energy stock that investors should avoid.

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