Will Penn West Petroleum Ltd. Dig Deeper into its Core to Stay Afloat?

Description

Financially strapped oil producer **Penn West Petroleum Ltd.** (TSX:PWT)(NYSE:PWE) has its back against the wall. Two years of persistently weak oil prices have the company on pace to breach its debt covenant by the end of the current quarter. The company is in a race against time to address the situation, so it doesn't default just when things are finally starting to look up for the oil patch.

All options appear to be on the table, including selling off another part of its core in order to pay down debt and get its leverage under control.

Viking on the block

One of the options the company is reportedly considering is the sale of its Dodsland Viking light oil assets in Saskatchewan. According to a report last week from *Bloomberg*, Penn West Petroleum has hired bankers to sell the asset in an effort to quickly address its fast-approaching debt deadline. It's an asset that could fetch at least $400 million thanks to its high-margin netbacks and strong growth opportunities.

That said, those were the very two reasons why Penn West Petroleum had labeled Viking one of its three core assets in the first place, which initially also included the Cardium and its recently sold Slave Point assets.

However, with $1.7 billion in net debt to address and a debt-to-EBITDA ratio that's expected to breach its five times leverage covenant at the end of this quarter, Penn West Petroleum really doesn't have too many other options at the moment other than to dig deeper into its core to address the issue.

What's left?

If Penn West Petroleum did part with some or all of Viking, it would potentially be selling an asset that's currently producing 19,500 barrels of oil equivalent per day (BOE/d). For perspective, that's about 30% of the company's current output. Further, the company estimates that it potentially has more than 500 future drilling locations in the play, which, at last year's drilling pace, would be enough to last it nearly a decade.

If the company was forced to part with the entirety of Viking to stay afloat, it would effectively be down to just one core asset: the Cardium oil play. The company views the rest of its assets, outside of Viking and Cardium, as non-core and had been seeking to sell those assets to pay down debt.

The problem is that those are lower-margin assets that also don't have the imbedded growth options, which makes them less valuable during the current downturn. That being said, these could eventually be sold to further improve the company's balance sheet as conditions improve.

Cardium accounts for just less than half of its projected 2016 output, meaning Penn West Petroleum could end up shrinking itself by half in the future just to survive. That being said, aside from being the company's largest current asset, Cardium's margins are the strongest in its portfolio with its netbacks currently at $14 per BOE vs. $9.50 per BOE for Viking.

In addition to that, the Cardium does have more than 2,500 potential future drilling locations, which gives Penn West Petroleum a long growth runway ahead of it when oil prices improve. In other words, the company would be rebuilding itself on its current crown jewel asset.

Investor takeaway

With a debt deadline looming, Penn West Petroleum appears willing to do whatever it takes to survive, including parting with another one of its core assets. While that would clearly sting given Viking's current margins and growth potential, Penn West Petroleum would at least be able to hold on to its crown jewel. While that does provide it with a strong foundation for future growth, a one-asset company is a very risky bet.

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