Is the Newly Transformed Penn West Petroleum Ltd. a Buy?

Description

About a month ago **Penn West Petroleum Ltd.** (TSX:PWT)(NYSE:PWE) appeared to be just weeks away from defaulting on one of its debt covenants. However, after obtaining a much higher sale price for an asset, the company has eliminated its financial worries for the foreseeable future. With those worries gone, the company is a much more appealing buy than it has been in years.

Foundation repaired

Before the downturn in oil prices, Penn West Petroleum prided itself in providing investors both growth and income. That income stream, however, evaporated as oil prices slumped and it had to cut its dividend all the way to zero. Meanwhile, the company's deteriorating financial position forced it to cut investment spending to the point where it was no longer even able even to maintain its production rate, let alone grow it.

However, after selling a boatload of assets, Penn West Petroleum's financial concerns are in the past after it cut its debt from $2.1 billion to start the year to $600 million. This debt reduction has pushed its debt-to-EBITDA ratio from a covenant breaching five times to less than three times. That ratio implies that the company's financials are now on solid ground.

Ready to restart its growth engine

Now that its balance sheet worries are in the rear-view mirror and oil is back around $50 a barrel, the company is in the position to start generating excess cash flow. In fact, the company projects that it will generate enough cash flow at current commodity prices that it will have the capital to grow its production by 10% per year with plenty of money left over.

In other words, the company could once again be a growth and income investment. Further, if oil rebounds to $60 a barrel the company estimates that it can grow its production by 15% per year while still generating excess cash flow.

That said, Penn West has spent the better part of the past couple of years shrinking its portfolio. After producing more than 100,000 barrels of oil equivalent per day (BOE/d) in 2014, the company will have shrunk down to a base that produces 25,500 BOE/d by the time it completes its final slate of asset sales. That smaller asset base certainly makes it easier to drive double-digit production growth going forward.

A great recipe for the long-term success

The newly transformed Penn West Petroleum is in its best financial shape in years. Further, it is in a position to restart its growth engine at current prices, which is something few of its rivals can match these days.

These traits make Penn West Petroleum a compelling oil stock to own for the long term. While it still has its share of risks, investors who buy today are potentially getting their hands on a turnaround stock right before it begins to turn.

CATEGORY

1. Dividend Stocks
2. Investing

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Date
2025/08/24
Date Created
2016/07/11
Author
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