3 Major Surprises From Penn West Petroleum Ltd. This Quarter

Description

Earlier this year there were grave concerns that Alberta-focused oil and gas producer **Penn West Petroleum Ltd.** (TSX:PWT)(NYSE:PWE) might not make it past the second quarter. Those concerns stemmed from the fact that the company was dangerously close to breaching its financial covenants. However, thanks to a boatload of surprisingly strong asset sales, the company is back on solid ground. Not only that, but it unveiled several more pleasant surprises in its recent second-quarter report.

1. Surprise! We sold even more assets

Penn West secured its survival during the quarter by delivering a buzzer-beating sale of its core Slave Point assets for $975 million, which was more than twice what analysts were anticipating. That transaction dramatically delevered the company’s balance sheet and removed the concerns surrounding its financial situation. The company then further muted concerns by signing agreements for another $75 million in asset sales right after the quarter ended.

With these transactions, the company has reduced its net debt from the worrisome $2.1 billion at the end of last year to a pro-forma level of $491 million. Further, it still anticipates that it will sell another $100-200 million of assets by year-end to further bolster its balance sheet and give it ample capital to invest in its future.

2. Surprise! Our production exceeded guidance

While most of the company’s focus was on efforts to repair its balance sheet, Penn West Petroleum’s operational teams remained focused on delivering the best operational results they could amid the turbulent operating environment. The result was stronger-than-expected production, which averaged 63,585 barrels of oil equivalent per day, or BOE/d.

Three factors drove this expectation-beating result.

The company continues to see strong performance from Cardium wells drilled last winter.

In addition to that, it is experiencing an improvement in the overall reliability of its base production.

Finally, the company's cost-reduction efforts have enabled it to continue to produce volumes that it initially had anticipated would be shut in due to the currently weak price environment.

Those volumes are substantial; the company originally planned to shut in 4,000 BOE/d of uneconomic production during the first quarter, while another 2,500 BOE/d would eventually be shut in because the company would have to defer equipment repairs because it lacked the capital. Instead, the company has been able to keep this production flowing.

3. Surprise! We are boosting capex spending

Due to Penn West's deteriorating financial situation to start the year, the company cut its capex budget all the way down to $50 million. That represented a reduction of more than 90% from the prior year. However, with its balance sheet now on solid ground, the company is in the position to boost spending.

For 2016 it plans to spend another $40 million, bringing its budget up to $90 million, which is 80% higher than its initial budget. That capital will enable the company to increase production by 3,000 BOE/d by the end of the year.

In addition, its preliminary plan for 2017 is to spend $150 million, which will boost next year's production by 10% over its 2016 exit rate. That is right in line with the company's plan to grow production by at least 10% annually for the foreseeable future now that its balance sheet is on solid ground and oil prices have started to stabilize.

Investor takeaway

It is becoming clear that Penn West Petroleum has turned a corner. Its balance sheet went from a significant liability to an actual asset. That strong financial position combined with its operational successes and cost reductions has it in the position to restart production growth well before its peers. That certainly makes it an energy growth stock to watch in the years ahead as the oil market begins to improve.

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