



Is Penn West Petroleum Ltd. Worth Buying?

Description

One-time investor darling **Penn West Petroleum Ltd.** (TSX:PWT)(NYSE:PWE) is attracting considerable attention because management is talking up the prospects of the company now that it has secured its future. It was only earlier this year that there were fears the oil producer would drown in its debt and fail to survive as it was dangerously close to breaching its financial covenants.

In an expected deal, it sold its Saskatchewan assets for a price that surprised many analysts, allowing it to use those proceeds to significantly reduce its debt to a manageable level. This has led to considerable speculation that Penn West is now substantially undervalued.

Now what?

An important attribute of the new Penn West, particularly in the difficult business setting now being experienced, is its low level of debt. It was only a year ago when it reported net debt of \$2 billion, and the company appeared close to failing because of the harsh operating environment dominated by sharply weak crude.

Now its net debt totals \$491 million, or merely a quarter of where it was a year ago. This turnaround in Penn West's fortunes can be attributed to management's aggressive divestment program, which has guaranteed its survival.

Nonetheless, the turnaround hasn't come without a price. Asset sales have left the company a mere shadow of its former self.

After all planned asset sales are completed, Penn West's oil reserves will fall to 136 million barrels, or less than half of what they were at the end of 2015. The significant decrease in oil reserves means the company is valued at about \$3 per share.

Penn West has also experienced a sharp reduction in oil production. Output is expected to fall to somewhere between 24,000 and 27,000 barrels daily, or less than a third of what it was a year ago. This sharp decrease will have a considerable impact on cash flow and earnings.

Despite these negatives, Penn West's remaining oil acreage is estimated to have some of the lowest operational expenses among its Canadian peers. In conjunction with substantially lower debt obligations, this means that Penn West can fund its planned \$150 million for exploration and development from its cash flow.

For these reasons, Penn West should be able to achieve the planned 10% annual growth in oil production and be cash flow positive with crude at about \$50 per barrel.

So what?

The emergence of the new Penn West is a great achievement. Management has turned around a company that was on the brink of bankruptcy, making it into a much smaller, low-cost oil producer that's focused on growth. Now that its balance sheet is under control, it will benefit from rising oil prices and its ability to grow oil production over the long term, thereby helping its share price to appreciate.

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2. Investing

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1. Editor's Choice

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Author

mattdsmith

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