Will Penn West Petroleum Ltd. Double?

Description

After making a ground-breaking deal that virtually assured its survival, upstream oil and gas producer **Penn West Petroleum Ltd.** (TSX:PWT)(NYSE:PWE) is generating considerable interest among investors. There is considerable speculation that it is well positioned to benefit from higher oil prices and can deliver outsized returns for investors.

Now what?

It was only a decade ago when Penn West was being hyped as being the next big thing in oil, and its shares peaked at over $40.

Since then it has all been downhill as the company has rolled from one disaster to the next.

The sharp decline in crude coupled with its heavily over-levered balance sheet forced it to embark on a massive asset-divestment program. This has seen it reduce debt to a very manageable $470 million, or less than a quarter of what it was at the end of 2015.

As a result, Penn West is a much smaller company with oil reserves and production now less than a third of what they were when the divestments began.

However, the company has a solid balance sheet and the financial flexibility to grow its remaining operations in a meaningful way. Operations are currently centred around its prized Cardium acreage and Peace River heavy oil operations.

Even after the sale of its prized Saskatchewan Viking oil assets, it has retained a substantial acreage located in the Albertan segment of the Viking formation. While management believes this acreage will be as prolific and profitable as the Saskatchewan Viking area, it remains unproven as it currently only produces about 1,000 barrels of crude daily.

In order to develop its full potential and boost production to economic levels, a considerable investment from Penn West is required.

Nevertheless, because of its efforts to cut costs, Penn West is now one of the lowest-cost oil producers in Canada and has forecast company-wide operational expenses of $7 per barrel. After some rough calculations, these low operating expenses mean that it has full-cycle cash costs that come to just over $34 per barrel, meaning that with West Texas Intermediate at about US$50 per barrel, its core production is cash flow positive.

This will allow it to internally generate the required funds to develop its core assets, including the Alberta Viking acreage, allowing it to achieve the targeted 10% annual growth in oil output.

So what?

Penn West's planned growth may appear ambitious, especially when the risks associated with oil exploration and development are considered. However, its solid financial position and low costs make it highly likely that it can deliver the planned growth. Whether this will be enough to cause its share price to double in coming months is difficult to determine, but if oil moves higher and there is hard evidence of the success of its drilling program, then that is a likely outcome. This makes Penn West an attractive contrarian play on the price of crude.

CATEGORY

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