



Is it Time to Invest in Pengrowth Energy?

Description

Troubled Canadian intermediate oil producer **Pengrowth Energy** (TSX: PGF)(NYSE: PGH) continues to show signs of having turned the corner, with its turnaround strategy gaining further traction. But with Pengrowth reporting some mixed first quarter 2014 operational results, it is unclear whether now is the time to invest, even with it having a range of attractive industry specific valuation ratios.

First quarter financials improved; operational results were mixed

Despite crude production continuing to fall, Pengrowth has delivered some solid and improving financial results, which is reflected in its bottom line. For the first quarter of 2014, Pengrowth reported an adjusted net-loss of \$2.8 million. This was a significant improvement on fourth quarter 2013's adjusted net-loss of \$37.3 million, though it was more than double first quarter 2013's net loss of \$1.1 million.

More importantly in an industry where cash is king, Pengrowth reported for the same period funds flow from operations had shot up a healthy 32% quarter-over-quarter to \$139.5 million, although it was 5% lower than the first quarter 2013. The significant quarter-over-quarter growth can be primarily attributed to higher realized crude prices during the quarter and narrowing price differentials between Canadian light crude and the West Texas Intermediate benchmark.

The slight decrease in funds flow from operations year-over-year can be primarily attributed to a 16% decline in production resulting from the disposition of a range of oil and gas assets over the last year. However, more importantly, Pengrowth reported a significant improvement in its netback per barrel of oil produced, which is an important measure of the profitability of an oil company's operations. Its netback per barrel shot up a very healthy 43% quarter-over-quarter and an impressive 20% year-over-year to \$29.61. But this netback is still significantly lower than many of its Canadian light oil peers.

Fellow troubled intermediate producer **Lightstream Resources** (TSX: LTS) reported a first quarter 2014 netback of \$56.11. Light oil heavyweight **Crescent Point Energy** (TSX: CPG)(NYSE: CPG) reported a netback of \$52.65 per barrel for the same period. Even smaller producer **Whitecap Resources** ([TSX: WCP](#)) reported an impressive netback of \$45.80 for the equivalent period.

As such, Pengrowth's netback per barrel is almost half of Lightstream's, 46% lower than Crescent Point's and 35% lower than Whitecap's, indicating its oil production is not as profitable as those companies'. This can be primarily attributed to Pengrowth having higher operating expenses per barrel of oil produced than many of its peers.

When compared to Lightstream, Pengrowth's operating expenses per barrel are 11% higher, whereas they are 23% higher than Crescent Point's and a massive 60% higher than Whitecap's. Furthermore, Pengrowth's operating expenses continue to grow, up 0.5% quarter-over-quarter and 5% year-over-year. More worryingly for investors is the proportion of Pengrowth's production comprised of lower margin natural gas continues to grow. For the first quarter 2014, natural gas made up 26%, which is a 6% increase quarter-over-quarter.

While Pengrowth's turnaround is gaining additional traction, there is still a long way to go before the company is operating as efficiently or as profitably as many of its Canadian peers. But there are a number of added incentives for investors to consider investing in Pengrowth.

Attractively priced on a range of industry valuation ratios

These include the company being attractively valued with an enterprise-value of 9 times EBITDA and 11 times its oil reserves. While Lightstream appears cheaper than Pengrowth on the basis of its enterprise-value of 7 times EBITDA it appears more expensive when its EV of 20 times oil reserves is considered. Crescent Point and Whitecap also appear more expensive, with EVs of 11 and 17 times EBITDA as well 30 and 21 times oil reserves respectively.

In conjunction with being attractively priced, Pengrowth also continues to pay a monthly dividend with a tasty yield of almost 7%, which is one of the better yields in the patch. Even better is despite Pengrowth continuing to report net losses is the dividend has a sustainable payout ratio of 34%, when calculated using funds flow from operations rather than net income.

Clearly Pengrowth is starting to reap the benefits of a much needed turnaround program. But while financial results are improving, there is still significant room for operational improvement, with Pengrowth lagging many of its peers across a range of key operational metrics. Yet despite this, now may just be the time for high conviction investors willing to bet on the successful completion of the turnaround strategy to dip their toes in the water.

CATEGORY

1. Investing

TICKERS GLOBAL

1. NYSE:VRN (Veren)
2. TSX:VRN (Veren Inc.)
3. TSX:WCP (Whitecap Resources Inc.)

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Date

2025/07/26

Date Created

2014/05/15

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