Pengrowth Energy Corp.'s Outlook Is Downgraded: Is This a Signal to Sell?

Description

This article has been updated to correct an error regarding Pengrowth Energy's dividend.

The current operating environment is proving to be exceptionally challenging for Canada's energy patch, with a number of oil companies forced to slash dividends and capital expenditures because of the rout in crude prices.

One company that has yet to cut its dividend is intermediate oil producer **Pengrowth Energy Corp.** (TSX:PGF)(NYSE:PGH). However, because West Texas Intermediate is trading at US$46 and Brent at US$49 per barrel, TD Securities has downgraded the outlook for Pengrowth from "buy" to "hold".

Is this a signal that now is the time to sell Pengrowth?

So What?

Like many of its peers Pengrowth is coming under increased pressure because of the decline in crude prices. This is of considerable concern with the company committed to making further substantial investment in its flagship Lindbergh thermal heavy oil project. Along with its mountain of debt totalling $1.5 billion, it raises a number of red flags for investors.

The company is heavily leveraged with net debt of 2.8 times estimated 2015 cash flow. Furthermore, markedly lower crude prices will cause Pengrowth's EBITDA to fall, and if it falls too far, the company may breach the lending covenants on its existing debt. This would certainly make it near impossible for Pengrowth to raise additional debt to meet any shortfall in cash flow and its funding requirements.

As a result, Pengrowth has taken the sensible step of slashing its 2015 dividend by 50% and capital expenditure by 74%, while projecting 2015 cash flow using a forecast oil price of US$50 per barrel.

This revised budget reflects a balance between Pengrowth's financial obligations and internally generated cash flow that should see cash flow exceed dividend payments and capital expenditures. The company plans to use any excess cash flow generated over the course of 2015 to pay down itspile of debt. These decisions bode well for Pengrowth to weather the rout in crude prices.

Pengrowth now appears very attractively priced with an enterprise value of a mere six times its estimated 2015 EBITDA and eight times its oil reserves. Furthermore, on completion in 2018, the Lindbergh project has the potential to add 50,000 barrels of crude daily to its total daily oil production. This certainly positions Pengrowth nicely to take advantage of the rebound in crude prices that analysts envisage will occur around the start of 2016.

Now what

With Pengrowth's share price having plunged 60% over the last six months, investors selling now would incur substantial loses. Nonetheless, with its portfolio of quality assets and the potential of the Lindbergh project, the company offers considerable promise if crude prices rebound.

Its low valuation also make it incredibly attractive, but this investment does come with risks, including considerable short-term downside should oil prices fall further. I believe the long-term prospects appear strong, making Pengrowth a worthwhile speculative play on crude prices for the patient risk tolerant investor.

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1. Dividend Stocks
2. Energy Stocks
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