Pacific Rubiales Energy Corp. Downgraded: Is it Time to Sell?

Description

The rout in crude is taking its toll in the energy patch, forcing oil companies to cut expenses, capital expenditure, and dividends. It has also triggered a sharp sell-off of oil stocks that has seen **Pacific Rubiales Energy Corp.'s** (TSX:PRE) share price plunge by a massive 81% over the last six months. This leaves it with a monster dividend yield of 17%, which is one of the highest on the TSX. However, there are signs that Pacific Rubiales is in trouble and may have to slash its dividend in order to weather the rout in crude prices.

What's happening?

It is not only the collapse in crude prices that has driven this savage sell-off of Pacific Rubiales shares. There are a number of red flags that continue to create concern among investors, the most prominent being its considerable pile of debt totalling US$4.4 billion. This gives it net debt of 3.5 times its projected 2015 cash flow, indicating that it is heavily leveraged and making the company extremely vulnerable to any further fall of oil prices. Of greater concern is that Pacific Rubiales's net debt is 2.6 times its forecast 2015 earnings before interest, taxes, depreciation, and amortization (EBITDA) and this is close to its restricted debt covenant of 3.5 times EBITDA.

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While this doesn't indicate that Pacific Rubiales is in breach of its debt covenants, it does highlight that the company is heavily leveraged. This makes it difficult to raise additional debt to fund its financial commitments in the current operating environment.

Pacific Rubiales has also seen its share price hammered because it is a given that it will lose its 42% working interest in the Piri Rubiales oil field when the lease with Colombian government-controlled **Ecopetrol S.A.** ends in 2016. This oil field has the lowest production costs of any of Pacific Rubiales's oil assets and accounts for just over half of its oil production and a fifth of its oil reserves. Its loss will be a large blow to the company and will have a significant negative impact on its operational performance.

Going forward

However, the company has established a firm road map to replace these lost oil reserves and production, and the plans in place to do so remain on track. Nonetheless, with crude prices having fallen so low, funding for some of these projects is under threat as Pacific Rubiales cuts capital expenditures and operating costs to preserve its cash flow and shore up its heavily leveraged balance sheet.

This leaves a distinct risk that Pacific Rubiales will have to further cut expenses to preserve cash flow and funding for key capital expenditures as well as reducing debt. The easiest means for the company to do this would be to cut its dividend, or even terminate it, generating savings of up to US$200 million annually.

Is it time to sell?

Clearly, Pacific Rubiales is coming under increasing pressure in the current operating environment, not only because of its mountain of debt and extremely high leverage, but also because it will lose its flagship oil asset in the near future. These factors, coupled with the rout in crude prices that is expected to last for at least the remainder of this year, leave Pacific Rubiales particularly vulnerable, and a dividend cut appears extremely likely. Stock investors are best cautioned to avoid Pacific Rubiales, with a number of other companies in the energy patch offering far greater potential when oil prices rebound.

CATEGORY

1. Investing

TICKERS GLOBAL

1. TSX:FEC (Frontera Energy Corporation)

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