



Will the Oil Rout Bankrupt Pacific Rubiales Energy Corp.?

Description

If you believe recent headlines, **Pacific Rubiales Energy Corp.** (TSX:PRE) appears to be doomed to failure because of the oil rout. It loaded up on debt when it acquired fellow Colombian operator Petrominerales Ltd. in 2013, leaving it with a weak balance sheet that makes it vulnerable to the sharp decline in oil prices. This has created consternation among some analysts that it will breach its debt covenants.

Now what?

Pacific Rubiales debt totals US\$4 billion, leaving it highly leveraged with debt of three times forecast 2015 cash flow and 2.7 times EBITDA. This is below the 3.5 times EBITDA limit set by its restricted covenant, but these forecasts are based on an estimated average West Texas Intermediate (WTI) price for 2015 of US\$55 per barrel.

However, it now appears likely that WTI will average a far lower price for the year, increasing the likelihood that Pacific Rubiales will breach its restricted covenant. This is because WTI prices remain depressed and will continue to trade at under US\$50 per barrel for the remainder of 2015.

Though U.S. rig counts continue to fall to their lowest level since October 2009, U.S. oil production continues to grow. For February 2015, it shot up by 1% compared to January and 15% year over year. U.S. oil inventories have also hit their highest level on record.

If WTI averages US\$50 per barrel for the year, Pacific Rubiales EBITDA will fall by around 13%, causing the debt-to-EBITDA ratio to increase to three times EBITDA, but this is still below the 3.5 times EBITDA limit. For that limit to be breached, WTI would need to average less than US\$45 per barrel for the year. Despite the global supply glut, I believe this is highly unlikely.

Furthermore, if Pacific Rubiales breached that covenant, it is highly unlikely the company would be bankrupted. The most likely outcome would involve restrictions being placed on its ability to take on additional debt and an accelerated payment plan for lenders.

However, the likelihood of a breach occurring is slim, even if WTI prices remain stubbornly low. This is

because Pacific Rubiales has a number of levers that will allow it to reduce debt, including raising cash through the sale of non-core oil properties and midstream assets.

The company has already stated that almost half of its midstream assets are on the auction block and it has received an offer of \$200 million for 30% of those assets. It can also further reduce capital expenditures to match its cash flow requirements and negotiate with lenders to relax its debt covenants if WTI falls lower.

So what?

I believe it is extremely unlikely that Pacific Rubiales will go bankrupt. The company has range of levers at its disposal that will allow it to reduce debt and manage its financial position. Plus, the consequences of breaching its covenants are not life threatening. That being said, if significantly lower crude prices persist, it will be some time before Pacific Rubiales is capable of bouncing back and delivering value for investors.

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1. Energy Stocks
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1. Editor's Choice

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Author

mattsmith

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