



2 Big Surprises From Pengrowth Energy Corp.'s 2nd-Quarter Report

Description

Struggling heavy oil producer **Pengrowth Energy Corp.** (TSX:PGF)(NYSE:PGH) recently reported its second-quarter results. While it was not a great release, the company did show surprising progress in two key areas. That said, Pengrowth still has significant problems to overcome, and it is running out of time to address the situation.

Costs are plunging

Pengrowth's primary focus during the downturn is to drive its costs lower to mute the impact of low oil prices. The company has done a great job towards that end with its operating expenses down \$63 million year over year to \$136.8 million, or down 12% on a barrel-of-oil-equivalent (BOE) basis. That is well below the company's initial expectations, which is leading it to reduce its full-year operating-cost guidance by \$65 million.

In addition to the significant reduction in operating expenses, Pengrowth has also trimmed its general and administrative expenses by \$9 million year over year and cut its transportation charges. The net result of these lower costs when combined with its strong commodity price hedges was a 6% increase in operating netbacks per BOE to \$25.46. Meanwhile, funds from operations were only down 20% over the year-ago period despite a 45% plunge in sales.

The balance sheet is improving

Pengrowth's ability to cut costs enabled it to generate excess cash flow, which it used to chip away at its debt. Thus far the company has reduced its debt by \$225 million, pushing debt down to \$1.63 billion. Further, the company has nearly \$55 million in cash on hand, which it projects will grow to between \$150 million and \$200 million by year-end given its current oil and gas hedges.

That cash is important because it gives the company a head start on 2017 when it has more than \$500 million in maturing debt. That debt is a concern because it is unlikely that Pengrowth will be able to refinance its debt unless oil prices rebound sharply. Because of that, it will need to figure out other ways to deal with those maturities ahead of time.

Unfortunately, that is not the only balance sheet concern the company needs to contend with next year.

Given its current projections, Pengrowth might not remain in compliance with some of its financial covenants during the second half of next year. That would trigger a clause where its senior unsecured notes and credit facilities become due on demand. To avoid that situation, the company is seeking to obtain a relaxation waiver from its creditors.

However, there are no assurances it can get a waiver. Those credit concerns could force the company to sell prized assets to pay down debt and regain compliance, which is something rival **Penn West Petroleum Ltd.** did to avoid a similar fate.

Investor takeaway

Pengrowth made remarkable progress to reduce costs, which enabled it to pay down some more debt. That said, the company is not in the clear just yet. With a large looming debt maturity next year and the projection to breach its financial covenants if conditions do not improve, the company still has a lot of work left to do.

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Date

2025/08/14

Date Created

2016/08/11

Author

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