



Is This Oil Sands Stock Vulnerable Because of Oil's Latest Pullback?

Description

Oil has [pulled back](#) sharply in recent days to see the North American benchmark West Texas Intermediate (WTI) plunging below the US\$60-a-barrel mark, sparking fears that another price collapse has commenced. This has had a sharp impact on many smaller upstream oil producers; while WTI has lost around 19% over the last month, intermediate upstream oil producer **Pengrowth Energy** (TSX:PGF) has only lost 17%. That can be attributed to the considerable optimism surrounding its operations and the company's solid third-quarter 2018 results.

Now what?

A key takeaway from Pengrowth's third-quarter 2018 results is that it achieved record quarterly production at its flagship Lindbergh asset of 16,408 barrels daily, and the operation is on track to reach 19,000 barrels daily during the fourth quarter. Pengrowth's Groundbirch assets experienced a 62% year-over-year surge in production with three new wells coming online in early April 2018, and that trend will continue into the fourth quarter with another well set to commence production.

Nonetheless, overall production fell by 38% year over year to 21,807 barrels daily, although this can be primarily attributed to asset sales completed during 2017.

An impressive aspect of these results was that despite the deep discount applied to Canadian heavy crude or Western Canadian Select (WCS), Pengrowth reported an operating netback of \$29.85, which was more than triple the \$9.91 for the same period a year earlier. That netback, which is an important indicator of operational profitability, underscores the tremendous earning potential of Pengrowth's assets, especially if WTI moves higher and/or the discount applied to WCS eases.

As a result of this strong operational performance, operating cash flow almost double year over year to \$22 million, while Pengrowth's quarterly net loss shrunk to \$1.6 million compared to \$145 million a year earlier. General and administrative expenses for the quarter fell by 22% year over year to \$9.7 million, further helping to boost profitability.

Another factor that will give Pengrowth's earnings a lift in 2019, if oil remains firm, is that the company's oil hedges expire at the end of 2018. These cover 10,000 barrels daily of production and

have crimped the upside available to Pengrowth over the course of 2018 because of higher crude.

Importantly, because of the deep discount applied to WCS, which is expected to continue for the [foreseeable future](#), Pengrowth has established risk-management contracts that will mitigate its impact until the end of 2019.

The only disappointment is that Pengrowth's debt remains high. As at the end of the third quarter it had debt totaling \$672 million with near-term maturities of \$57 million and \$122 million in 2019 and 2020, respectively. That debt a massive 14 times Pengrowth's trailing 12-month adjusted funds flow, indicating that the company is vulnerable to another collapse in oil prices. This is because Pengrowth is dependent on crude remaining firm over the coming year if it is to generate enough cash flow to meet those near-term repayments and maintain capital spending at an adequate level to sustain its current production profile.

So what?

For some time, Pengrowth has been a difficult stock to like, but the company's performance and balance sheet has improved significantly since the start of 2018. While there still are risks, principally oil's latest weakness and fears of a looming price collapse, the latest results indicate that the company is on track to deliver further credible results. That — along with firmer crude — should give its stock a healthy boost in coming months.

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