Perpetual Energy Inc. Releases First Quarter 2018 Financial and Operating Results

08.05.2018 | CNW

CALGARY, May 8, 2018 /CNW/ - (TSX:PMT) - Perpetual Energy Inc. ("Perpetual", the "Corporation" or the "Company") is pleased to release its first quarter 2018 financial and operating results. A complete copy of Perpetual's unaudited condensed interim consolidated financial statements and related Management Discussion and Analysis ("MD&A") for the three months ended March 31, 2018 can be obtained through the Company's website at www.perpetualenergyinc.com and SEDAR at www.sedar.com.

FIRST QUARTER 2018 HIGHLIGHTS

- Cash flow from operating activities in the first quarter of 2018 was $11.2 million ($0.19/share) compared to cash flow used in operating activities in the prior year period of $2.3 million. After adjusting for changes in non-cash working capital amounts which are impacted by changes in the timing of collection or payment, cash flow from operating activities increased by 119% over the prior year period.
- Adjusted funds flow in the first quarter of 2018 was $9.1 million ($0.15/share), up 78% over the prior year period of $5.1 million ($0.09/share) due to increased production and lower cash costs, partially offset by lower revenue per boe. Adjusted funds flow per boe was $7.94/boe in the first quarter of 2018, up 14% over the prior year period.
- Production averaged 12,742 boe/d in the first quarter of 2018, up 8% over the fourth quarter of 2017 and 56% over the first quarter of 2017 due to the completion and tie-in of the East Edson drilling program during the second half of 2017 and first quarter of 2018.
- Cash costs were $12.82/boe in the first quarter of 2018, down 31% compared to the prior year period due to diligent cost management combined with the impact of increased production at East Edson on a substantially fixed cost base.
- Perpetual's exploration and development spending in the first quarter of 2018 totaled $14.8 million. Capital expenditures included drilling 4 (4.0 net) wells, with 1 (1.0 net) horizontal natural gas well at Edson, as well as 3 (3.0 net) horizontal heavy oil wells at Mannville.

Production and Operations

- Spending at East Edson represented 60% of total exploration and development expenditures in the first quarter of 2018. East Edson capital activity included the drilling of one (1.0 net) extended reach horizontal ("ERH") Wilrich horizontal well and frac and tie-in operations of two wells drilled in the fourth quarter of 2017. The two wells that were frac'd and tied-in to production during the first quarter commenced production in February. Frac and tie-in of the one ERH well drilled during the first quarter was deferred to the fourth quarter of 2018 to align high initial production rates with higher anticipated winter natural gas prices.
- Spending in Eastern Alberta consisted of a three well (3.0 net) multi-lateral horizontal drilling program in the Company's Mannville heavy oil property, one waterflood injector well conversion, one water disposal well conversion and associated facilities. The three oil wells came on production in late March with one infill well producing at type curve expectations and two pool extension wells producing at lower rates than targeted. The disposal facility is working well and the Company expects this to translate into future netback improvements. Pressure response is already apparent from the injector conversion completed in December of 2017, further validating the success of the Mannville waterfloods. Summer drilling plans include the drilling of two (1.3 net) wells, with a third development well planned late in the year if positive pressure response from the new injector continues.
- First quarter production averaged 12,742 boe/d, up 8% from the fourth quarter of 2017 and 56% from 8,143 boe/d produced in the prior year period, reflecting a 79% increase in natural gas and associated natural gas liquids ("NGL") production at East Edson driven by the 2017 and Q1 2018 capital program. Production at East Edson is expected to decline through the summer months before increasing in the fourth quarter when the well drilled in the first quarter is frac'd and tied-in to production. Heavy oil production at Eastern Alberta was maintained at 2017 first quarter levels as positive waterflood response in several pools restored pressure support and offset production declines. Production increases from wells drilled and tied in were not impactful on the first quarter of 2018 as the wells were brought on production at the end of the quarter.
- Perpetual's oil and natural gas revenue, before derivatives and marketing contracts, for the three months ended March 31, 2018 of $23.3 million increased 29% from the first quarter of 2017 due to a 56% increase in average daily production, partially offset by lower natural gas prices.

- Natural gas revenue, before derivatives and marketing contracts, of $15.5 million in the first quarter of 2018 comprised 66% (Q1 2017 - 69%) of total petroleum and natural gas revenue and 86% (Q1 2017 - 83%) of production. Natural gas revenue increased 23% from $12.6 million in 2017 reflecting the impact of the 62% increase in production volumes driven by the 2017 and Q1 2018 East Edson capital program, partially offset by lower AECO natural gas prices. Perpetual's average realized gas price, including derivatives and adjusted for heat content was $2.65/Mcf compared to an AECO Daily Index price of $2.08/Mcf. Perpetual's 35,000 MMBtu/d, five-year term market diversification contract contributed $2.4 million of incremental revenue and increased Perpetual's average realized natural gas price by $0.41/Mcf over the AECO Daily Index price in the quarter. The market diversification contract is priced based on daily index prices at five pricing hubs (Chicago, Malin, Dawn, Michcon and Empress) outside of Alberta that generally track North American NYMEX prices. Commencing April 1, 2018, volumes delivered to the market diversification contract increased to 40,000 MMBtu/d.

- Oil revenue in the first quarter of $3.5 million represented 15% (Q1 2017 - 19%) of total petroleum and natural gas revenue while oil production was 7% (Q1 2017 - 11%) of total Company production. Perpetual's average realized oil price for the first quarter was $48.31/bbl compared to $31.39/bbl in the first quarter of 2017. Oil revenue was comparable to the same period in 2017 due to similar production levels and WCS average prices, as increases in the WTI US$ benchmark prices were fully offset by the higher WCS differential and a stronger Canadian dollar compared to the prior year period.

- NGL revenue for the first quarter of 2018 of $4.4 million comprised 19% (Q1 2017 - 12%) of total petroleum and natural gas revenue while NGL production was just 7% (Q1 2017 - 6%) of total Company production. NGL revenue increased by 105% over the prior year period as production increased by 77%, tracking the Company's growth in natural gas production at East Edson, combined with a 16% increase in NGL prices compared to the prior year period, positively correlated to the increase in WTI light oil prices.

- Royalty expenses for the quarter ended March 31, 2018 were $3.1 million, comparable to the first quarter of 2017, as higher revenue in the current quarter was offset by a decrease in the combined average royalty rate on P&NG revenue from 17.1% in the prior year period to 13.1% in the first quarter of 2018. The decreased royalty rate is primarily due to a lower effective freehold and overriding royalty rate at East Edson, with the East Edson joint venture take-in-kind royalty effectively a fixed volume over the larger production base in the first quarter of 2018.

- Total production and operating expenses were $4.8 million for the first quarter of 2018, comparable to the prior year period despite the 56% increase in production over the comparable period, primarily from the low-cost East Edson area which averaged $2.05/boe in the first quarter of 2018. The first quarter of 2018 saw higher than average well servicing requirements in the Mannville assets which increased operating costs as well as negatively affected production volumes. Production and operating expenses on a unit-of-production basis were $4.16/boe, a decrease of 34% from the prior year period.

- Transportation costs in the first quarter of 2018 were $1.4 million, up 42% from the prior year period due to increased production from West Central where transportation costs averaged $1.13/boe compared to $2.10/boe for production from Eastern Alberta. Transportation costs were $1.26/boe in the first quarter, down 9% from the prior year period largely due to a higher percentage of production from West Central properties where pipeline tariffs are less than half of transportation rates in Mannville in Eastern Alberta.

- Perpetual's operating netback of $14.8 million in the first quarter of 2018 increased 45% from $10.2 million in the comparative period of 2017 driven by higher production. On a unit-of-production basis, operating netbacks per boe decreased 7% to $12.87/boe due to lower realized commodity prices.

Financial Highlights

- Total G&A expense was $2.89/boe in the first quarter of 2018, down 32% from the prior year period due to reductions in office lease costs, staffing levels and diligent expense management, combined with increased production.

- Total cash interest expense of $2.1 million for the three months ended March 31, 2018 was 11% higher than the prior year period (Q1 2017 – $1.9 million) due to increased debt levels, partially offset by lower interest rates and the initial dividend income of $0.1 million received from the TOU share investment in late March.

- Net loss for the first quarter of 2018 was $6.5 million ($0.11/share), compared to a net loss of $14.2 million ($0.26/share) in the comparative 2017 period. The improvement from the prior year period reflected stronger operational and capital performance including a 56% increase in production, a 31% reduction in cash costs per boe and a 9% reduction in depletion expense per boe, partially offset by a 19% decrease in realized revenue per boe.
- At March 31, 2018, Perpetual had total net debt of $115.1 million, up $9.1 million from December 31, 2017. The increase reflects the first quarter capital expenditures and lower market value of the TOU share investment, partially offset by the reduction of the net working capital deficiency.
- As at March 31, 2018, 55% of net debt outstanding was repayable in 2021 or later. Perpetual's net debt to trailing twelve months adjusted funds flow improved slightly during the first quarter of 2018 to 3.3 times at March 31, 2018 (December 31, 2017 – 3.4 times).

2018 OUTLOOK

Perpetual has lowered its 2018 capital expenditure guidance from a range of $23 to 27 million provided in a press release dated February 7, 2018 ("Prior Guidance") to $21 to 25 million ($6 to 10 million for the remainder of 2018) and reduced its Mannville heavy oil drilling in the second half of 2018 to two wells (1.3 net) from the previous range of six to ten wells. At East Edson, one horizontal well drilled in the first quarter will be completed and tied-in during the fourth quarter of 2018 to align high initial production rates with higher expected winter natural gas prices. Additional development drilling is ready to activate if AECO forward prices normalize above $2.00/Mcf. Capital spending plans at Mannville include $1.5 to $2.0 million to capture anticipated banked oil from waterflood operations. Decommissioning expenditures are budgeted to be $1.0 to $1.5 million for the remainder of 2018. Capital spending during the remainder of 2018 will be funded through adjusted funds flow.

Production for 2018 is expected to be 10,500 boe/d to 11,000 boe/d, down from prior guidance of 11,500 boe/d due to lower natural gas production in the first quarter due to freeze offs and shut-ins and lower heavy oil production anticipated over the balance of the year due to reduced capital spending.

For the April through October period, Perpetual has fixed the price on 20,000 GJ/d at $1.74/GJ AECO with the remainder of its production sold at daily index prices at the Chicago, Dawn, Empress, Malin and Michcon markets through its 40,000 MMBtu/d market diversification contract. If AECO prices temporarily weaken, Perpetual's fixed price AECO position provides the ability to shut-in production and purchase gas to deliver against pre-sold commitments while preserving reserves and future deliverability capability.

Cash costs of $14.00 to $15.00/boe are anticipated compared to prior guidance of $13.00 to $14.00/boe, due to the impact of the forecast decrease in production on unit costs. Royalty costs are estimated to be moderately lower for the balance of 2018 than in the first quarter, consistent with lower AECO forward natural gas prices for the remainder of 2018. Other cash costs for the remainder of 2018 are anticipated to be comparable to first quarter expense levels.

Adjusted funds flow for 2018 is forecast to be in the $25 to $28 million range ($16 to $19 million for the remainder of 2018), down from previous guidance of $34 to $37 million due to lower heavy oil production and modestly lower natural gas prices.

Guidance assumptions are as follows:

	Current Guidance	Prior Guidance
Exploration and development expenditures	$21 - 25 million	$23 - 27 million
2018 cash costs	$14.00 - $15.00/boe	$13.00 - 14.00/boe
2018 average daily production	10,500 - 11,000 boe/d	11,500 boe/d
2018 average production mix	15% oil and NGL	17% oil and NGL

Commodity price assumptions are consistent with current market price levels as follows:

	Current Guidance	Prior Guidance
2018 average NYMEX natural gas price	US$2.86/MMBtu	US$2.98/MMBtu
2018 average NYMEX to AECO basis differential	(US$1.73)/MMBtu	(US$1.77)/MMBtu
2018 average West Texas Intermediate ("WTI") oil price	US$65.55/bbl	US$63.54/bbl
2018 average Western Canadian Select ("WCS") differential	(US$22.30)/bbl	(US$23.83)/bbl
2018 average exchange rate	US$1.00 = $1.277	US$1.00 = $1.235

Year end 2018 net debt (net of the current market value of the Company's TOU share investment of approximately $40 million) is forecast at $105 - $110 million, consistent with prior guidance, based on the following assumptions:

- Net debt at March 31, 2018 of $115 million
- Adjusted funds flow for the remainder of 2018 of $16 to $19 million
- Capital spending for the remainder of 2018 of $6 to $10 million
- Decommissioning expenditures for the remainder of 2018 of $1.0 to $1.5 million
- Shallow gas property disposition – fixed marketing obligation payment of $7.6 million

On May 7, 2018, the revolving bank debt Borrowing Limit was decreased from $65 million to $60 million with the next Borrowing Limit redetermination scheduled on or prior to November 30, 2018. After giving effect to this Borrowing Limit reduction, Perpetual had available liquidity of $29.6 million. To improve liquidity, Perpetual plans to pursue additional asset sales in 2018 including the potential disposition of TOU shares.

Financial and Operating Highlights	Three months ended March 31,		
($Cdn thousands except volume and per share amounts)	2018	2017	Change
Financial			
Oil and natural gas revenue	23,340	18,158	29%
Net loss	(6,465)	(14,172)	54%
Per share – basic and diluted(2)	(0.11)	(0.26)	58%
Cash flow from (used in) operating activities	11,198	(2,289)	589%
Adjusted funds flow(1)	9,101	5,110	78%
Per share(1)(2)	0.15	0.09	67%
Total assets	363,273	389,739	(7%)
Revolving bank debt	46,912	–	100%
Term Loan, at principal amount	45,000	35,000	29%
TOU share margin loan, at principal amount	15,990	35,039	(54%)
Senior Notes, at principal amount	32,490	60,573	(46%)

TOU share investment	(36,434)	(49,440)	(26%)
Adjusted working capital deficiency (surplus)(1)	11,101	(16,714)	(166%)
Net debt(1)	115,059	64,458	79%
Net capital expenditures			
Capital expenditures	14,897	24,590	(39%)
Net payments on acquisitions and dispositions	926	163	468%
Net capital expenditures	15,823	24,753	(36%)
Common shares (thousands)(3)			
End of period	59,847	58,990	1%
Weighted average - basic and diluted	59,345	54,468	9%
Operating			
Daily average production			
Natural gas (MMcf/d)	65.9	40.7	62%
Oil (bbl/d)	900	877	3%
NGL (bbl/d)	848	479	77%
Total (boe/d)	12,742	8,143	56%
Average prices			
Realized natural gas price ($/Mcf)	2.65	5.04	(47%)
Realized oil price ($/bbl)	48.31	31.39	54%
Realized NGL price ($/bbl)	57.61	49.70	16%
Wells drilled – gross (net)			
Natural gas	1 (1.0)	6 (6.0)	
Oil	3 (3.0)	4 (3.3)	
Total	4 (4.0)	10 (9.3)	

(1) These are non-GAAP measures. Please refer to "Non-GAAP Measures" below.
(2) Based on weighted average common shares outstanding for the period.
(3) All common shares are presented net of shares held in trust.

About Perpetual

Perpetual is an oil and natural gas exploration, production and marketing company headquartered in Calgary, Alberta. Perpetual operates a diversified asset portfolio, including liquids-rich natural gas assets in the deep basin of west central Alberta, heavy oil and shallow natural gas in eastern Alberta, with longer term opportunities through undeveloped oil sands leases in northern Alberta. Additional information on Perpetual can be accessed at www.sedar.com or from the Corporation's website at www.perpetualenergyinc.com.

The Toronto Stock Exchange has neither approved nor disapproved the information contained herein.

Forward-Looking Information

Certain information regarding Perpetual in this news release including management's assessment of future plans and operations may constitute forward-looking information or statements under applicable securities laws. The forward looking information includes, without limitation, anticipated amounts and allocation of capital spending; statements pertaining to adjusted funds flow levels, statements regarding estimated production and timing thereof; statements pertaining to type curves being exceeded, forecast average production; completions and development activities; infrastructure expansion and construction; estimated FDC required to convert proved plus probable non-producing and undeveloped reserves to proved producing reserves; prospective oil and natural gas liquids production capability; projected realized natural gas prices and adjusted funds flow; estimated decommissioning obligations; commodity prices and foreign exchange rates; and commodity price management. Various assumptions were used in drawing the conclusions or making the forecasts and projections contained in the forward-looking information contained in this news release, which assumptions are based on management's analysis of historical trends, experience, current conditions and expected future developments pertaining to Perpetual and the industry in which it operates as well as certain assumptions regarding the matters outlined above. Forward-looking information is based on current expectations, estimates and projections that involve a number of risks, which could cause actual results to vary and, in some instances, to differ materially from those anticipated by Perpetual and described in the forward-looking information contained in this news release. Undue reliance should not be placed on forward-looking information, which is not a guarantee of performance and is subject to a number of risks or uncertainties, including without limitation those described under "Risk Factors" in Perpetual's Annual Information Form and MD&A for the year ended December 31, 2017 and those included in other reports on file with Canadian securities regulatory authorities which may be accessed through the SEDAR website (www.sedar.com) and at Perpetual's website (www.perpetualenergyinc.com). Readers are cautioned that the foregoing list of risk factors is not exhaustive. Forward-looking information is based on the estimates and opinions of Perpetual's management at the time the information is released and Perpetual disclaims any intent or obligation to update publicly any such forward-looking information, whether as a result of new information, future events or otherwise, other than as expressly required by applicable securities law.

Non-GAAP Measures

This news release contains the terms "adjusted funds flow", "adjusted funds flow per share", "adjusted funds flow per boe", "available liquidity", "annualized adjusted funds flow", "cash costs", "net working capital deficiency (surplus)", "net debt and net bank debt", "operating netback" and "realized revenue" which do not have standardized meanings prescribed by GAAP. Management believes that in addition to net income (loss) and net cash flows from operating activities as defined by GAAP, these terms are useful supplemental measures to evaluate operating performance. Users are cautioned however that these measures should not be construed as an alternative to net income (loss) or net cash flows from operating activities determined in accordance with GAAP as an indication of Perpetual's performance and may not be comparable with the calculation of similar measurements by other entities.

For additional reader advisories in regards to non-GAAP financial measures, including Perpetual's method of calculation and reconciliation of these terms to their corresponding GAAP measures, see the section entitled "Non-GAAP Measures" within the Company's MD&A filed on SEDAR.

Management uses adjusted funds flow and adjusted funds flow per boe as key measures to assess the ability of the Company to generate the funds necessary to finance capital expenditures, expenditures on decommissioning obligations and meet its financial obligations. Adjusted funds flow is calculated based on cash flows from operating activities, excluding changes in non-cash working capital and expenditures on decommissioning obligations since Perpetual believes the timing of collection, payment or incurrence of these items involves a high degree of discretion. Expenditures on decommissioning obligations may vary from period to period depending on capital programs and the maturity of our operating areas. Expenditures on decommissioning obligations are managed through our capital budgeting process which considers available adjusted funds flow. The Company has also deducted the change in gas over bitumen royalty financing from adjusted funds flow in order to present these payments net of gas over bitumen royalty credits. These payments are indexed to gas over bitumen royalty credits and are recorded as a reduction to the Corporation's gas over bitumen royalty financing obligation in accordance with IFRS. Additionally, the Company has excluded payments of restructuring costs associated with the disposition of the Shallow Gas Properties, which management considers to not be related to cash flow from operating activities. Restructuring costs include employee downsizing costs and surplus office lease obligations. Commencing in the first quarter of 2018, the Company no longer excludes 'exploration and evaluation – geological and geophysical costs' (Q1 2018 and 2017 – nil) from the calculation of adjusted funds flow as these costs are no longer significant to the Company's business. The calculation of adjusted funds flow for comparative periods has been adjusted to give effect to this change. Adjusted funds flow per share is calculated using the same weighted average number of shares outstanding used in calculating earnings per share. Adjusted funds flow is not intended to represent net cash flows from (used in) operating activities calculated in accordance with IFRS. Adjusted funds flow per boe is calculated as adjusted funds flow divided by total production sold in a period.

Available Liquidity: Available Liquidity is defined as Perpetual's Credit Facility Borrowing Limit, plus TOU share investment, less borrowings and letters of credit issued under the Credit Facility and TOU share margin loan. Management uses available liquidity to assess the ability of the Company to finance capital expenditures, expenditures on decommissioning obligations and meet financial obligations.

Cash costs: Management believes that cash costs assist management and investors in assessing Perpetual's efficiency and overall cost structure. Cash costs are comprised of royalties, production and operating, transportation, general and administrative and cash interest expense and net income. Cash costs per boe is calculated by dividing cash costs by total production sold in a period.

Net debt and net bank debt: Net bank debt is measured as current and long-term bank indebtedness including net working capital deficiency (surplus). Net debt includes the carrying value of net bank debt, the principal amount of the Term Loan, the principal amount of the TOU share margin loan and the principal amount of Senior Notes reduced for the mark-to-market value of the TOU share investment. Net bank debt and net debt are used by management to analyze borrowing capacity.

Net working capital deficiency (surplus): Net working capital deficiency (surplus) includes total current assets and current liabilities excluding short-term derivative assets and liabilities related to the Corporation's risk management activities, current portion of gas over bitumen royalty financing, TOU share investment, TOU share margin loan and current portion of provisions.

Operating netback: Perpetual considers operating netback an important performance measure as it demonstrates its profitability relative to current commodity prices. Operating netback is calculated by deducting royalties, operating costs, and transportation from realized revenue. Operating netback is also calculated on a per boe basis using production sold for the period. Operating netback on a per boe basis can vary significantly for each of the Company's operating areas.

Realized revenue: Realized revenue is the sum of realized natural gas revenue, realized oil revenue and realized NGL revenue which includes realized gains (losses) on financial natural gas, crude oil and foreign exchange contracts but excludes any realized gains (losses) resulting from contracts related to the disposition of the Shallow Gas Properties. Realized revenue, excluding foreign exchange contracts is used by management to calculate the Corporation's net realized commodity prices, taking into account monthly settlements on financial crude oil and natural gas forward sales, collars and basis differentials. These contracts are put in place to protect Perpetual's adjusted funds flow from potential volatility in commodity prices, and as such, any related realized gains or losses are considered part of the Corporation's realized price.

BOE Equivalents

Perpetual's aggregate proved and probable reserves are reported in barrels of oil equivalent (boe). Boe may be misleading, particularly if used in isolation. In accordance with NI 51-101 a boe conversion ratio for natural gas of 6 Mcf: 1 boe has been used, which is based on an energy equivalency conversion method primarily applicable at the burner tip and does not necessarily represent a value equivalency at the wellhead. As the value ratio between natural gas and crude oil based on the current prices of natural gas and crude oil is significantly different from the energy equivalency of 6:1, utilizing a conversion on a 6:1 basis may be misleading as an indication of value.

The following abbreviations used in this news release have the meanings set forth below:

bbls	barrels
boe	barrels of oil equivalent
Mcf	thousand cubic feet
MMcf	million cubic feet
MMBtu	million British Thermal Units
GJ	gigajoules

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