Freehold Royalties Ltd. Announces Second Quarter Results & Increases Production Guidance

01.08.2019 | GlobeNewswire

CALGARY, Aug. 01, 2019 - Freehold Royalties Ltd. (Freehold) (TSX:FRU) announced second quarter results for the period ended June 30, 2019.

RESULTS AT A GLANCE

	Three Months Ended June 30			Six Months Ended June 30		
FINANCIAL ($000s, except as noted)	2019	2018	Change	2019	2018	Change
Royalty and other revenue	35,333	39,961	-12 %	70,942	79,118	-10 %
Net income (loss)	3,430	5,386	-36 %	(3,649)	9,809	-137 %
Per share, basic and diluted ($)	0.03	0.05	-40 %	(0.03)	0.08	-138 %
Funds from operations	30,095	34,540	-13 %	59,443	66,924	-11 %
Per share, basic ($)	0.25	0.29	-14 %	0.50	0.57	-12 %
Acquisitions and related expenditures	30,313	3,516	762 %	31,242	35,912	-13 %
Dividends declared	18,660	18,625	-	37,311	36,651	2 %
Per share ($) (1)	0.1575	0.1575	-	0.3150	0.3100	2 %
Net debt	98,310	77,908	26 %	98,310	77,908	26 %
Shares outstanding, period end (000s)	118,513	118,293	-	118,513	118,293	-
Average shares outstanding (000s) (2)	118,458	118,238	-	118,431	118,211	-
OPERATING						
Royalty production (boe/d) (3)	10,311	11,052	-7 %	10,226	11,124	-8 %
Total production (boe/d) (3)	10,664	11,721	-9 %	10,646	11,860	-10 %
Oil and NGL (%)	55	54	2 %	55	54	2 %
Average price realizations ($/boe) (3)	35.88	36.96	-3 %	36.08	35.73	1 %
Operating netback ($/boe) (3) (4)	35.36	35.94	-2 %	35.79	35.39	1 %

(1) Based on the number of shares issued and outstanding at each record date.
(2) Weighted average number of shares outstanding during the period, basic.
(3) See Conversion of Natural Gas to Barrels of Oil Equivalent (boe).
(4) See Non-GAAP Financial Measures.

President's Message

The second quarter marked another strong period for Freehold as we were able to provide a sustainable dividend and per share production growth quarter-over-quarter while remaining opportunistic with acquisitions. Royalty production averaged 10,311 boe/d for the quarter, a 2% improvement versus the previous quarter as strong activity through the first half of 2019 drove volume growth. Funds from operations for the quarter totaled $30.1 million or $0.25/share, comfortably ahead of current dividend levels of $0.1575/share and at the low end of our payout range.

Freehold completed $30.3 million in acquisitions over the quarter. We acquired a diversified royalty package with near-term growth driven by a Canadian intermediate with planned multi-year drilling on the lands. Subsequent to quarter-end, we also completed our first royalty acquisition in the United States which should provide Freehold an additional 200 boe/d in production by year-end 2019.

It is our objective to drive oil and gas development on our lands, generate per share production growth, acquire royalties with acceptable growth and risk profiles and provide a sustainable dividend to our shareholders. During the quarter, we have achieved these mandates.

Tom Mullane
President and CEO

Dividend Announcement

The Board has declared a dividend of $0.0525 per common share to be paid on September 16, 2019 to shareholders of record on August 31, 2019. The dividend is designated as an eligible dividend for Canadian income tax purposes.

2019 Second Quarter Highlights

- Dividends declared for Q2-2019 totaled $0.1575 per share, unchanged from Q2-2018 and Q1-2019.
- Our payout ratio (1) (dividends declared/funds from operations) for Q2-2019 totaled 62%, compared to 64% in the previous quarter and 54% in Q2-2018.
- Freehold's royalty production averaged 10,311 boe/d during Q2-2019. This represents a 7% decrease over Q2-2018 while increasing 2% from the previous quarter. Growth in volumes sequentially was driven by increased third-party drilling.
- Royalty interests accounted for 97% of total production and contributed 100% of operating income (1) in Q2-2019.
- Q2-2019 funds from operations totaled $30.1 million, or $0.25 per share, representing an increase of 3% compared to Q1-2019. Quarter-over-quarter funds from operations was relatively unchanged as the decrease in natural gas pricing was offset by production growth and strength in oil prices.
- Current quarter free cash flow (1) also equaled $30.1 million, a decrease of 13% compared to Q2-2018. Using Freehold’s closing share price as at June 30, 2019 of $8.47, this represents an annualized free cash flow yield of 12% based on the average shares outstanding in the quarter.
- Net income for Q2-2019 was $3.4 million versus $5.4 million in Q2-2018 and a $7.1 million net loss in Q1-2019. Earnings in the previous quarter was impacted by a non-recurring impairment charge of $14.1 million offset by a related deferred tax recovery of $3.8 million.
- Exited Q2-2019 with net debt totaling $98.3 million, representing an increase of $20.8 million from the previous quarter. The increase in leverage quarter-over-quarter reflects acquisitions completed during the quarter.
- On June 28, 2019, Freehold closed a $30 million acquisition of a gross overriding royalty (GORR), with drilling commitments on the part of the vendor on certain light and medium oil reservoirs in central and northern Alberta and southwest Saskatchewan. At the time of closing, the properties collectively were producing 214 boe/d with 94% of production being liquids. Annualized funds from operations in 2019 under actual and strip pricing associated with the acquired assets is estimated at $3.8 million.
- Wells drilled on our royalty lands totaled 127 (2.9 net) in the quarter compared to 85 (1.2 net) in Q2-2018. We saw strong activity levels associated with our light oil portfolio, particularly in the Viking in Saskatchewan and Alberta, and Mississippian plays in southeast Saskatchewan.
- In Q2-2019, Freehold issued 16 new lease agreements with 13 companies, compared to 20 leases issued in Q1-2019 and 18 leases issued in Q2-2018.
- Cash costs (1) for the quarter totaled $5.05/boe, down from $6.39/boe in Q1-2019 and proximal to $4.99/boe in Q2-2018.
- Our inaugural environmental, social, and governance (ESG) report has been published and is available on our website.

(1) See Non-GAAP Financial Measures.

United States Entry and Subsequent Event

Subsequent to June 30, 2019, through its newly incorporated subsidiary Freehold Royalties (USA) Inc., Freehold closed a US$9.8 million acquisition of certain royalty assets located in North Dakota, United States. As part of this transaction, a US$0.5 million acquisition deposit was paid in June 2019. Production and funds from operations in 2020 associated with the acquired assets is forecasted to be approximately 200 boe/d and US$2.3 million, respectively.

We have deliberately and pragmatically developed our U.S. entry strategy, which will initially focus on selective royalty opportunities in the Williston basin. We understand the Williston basin geology and play types very well as it is an extension of the Bakken/Three Forks plays on our existing southeast Saskatchewan royalty acreage.

Drilling Activity

In the first six months of 2019, 274 (10.2 net) wells were drilled on our royalty lands. Of these, 127 (2.9 net) wells were drilled in the second quarter of 2019. This represents a 34% improvement on a net measure and a 15% decrease on a gross measure over the same period in 2018. Typically, the second quarter represents a period of slowed drilling activity, however activity on our royalty lands outpaced expectations, particularly when compared to the same period in 2018.

Activity through the first six months of 2019 was evenly distributed across our royalty lands. Saskatchewan and Manitoba activity focused on oil prospects, including the Viking in west central Saskatchewan (71 gross wells), Mississippian plays in southeast Saskatchewan and southwest Manitoba (47 gross wells), and Cantuar and Shaunavon in southwest Saskatchewan (19 gross wells). Together, Saskatchewan and Manitoba wells represented approximately 51% of our gross drilling in the first half of 2019. Alberta activity has again been concentrated in the Viking in east central Alberta (74 gross wells), as well as the Cardium in west Alberta (25 gross wells). Moderate activity continues for Mannville oil plays throughout the basin (13 gross wells). We continue to see activity emerging in the Duvernay and Clearwater, with 12 gross wells drilled between these two new plays in the first half of 2019. Our top payors continue to represent some of the most well capitalized upstream companies in Canada.

ROYALTY INTEREST DRILLING

	Three Months Ended June 30				Six Months Ended June 30			
	2019		2018		2019		2018	
	Gross	Net (1)	Gross	Net (1)	Gross	Net (1)	Gross	Net (1)
Total	127	2.9	85	1.2	274	10.2	324	7.6

(1) Net wells are the equivalent aggregate of the number obtained by multiplying each gross well by our royalty interest percentage.

2019 Guidance Update

Below are details of some of the changes made to our key operating assumptions for 2019 based on results for the second quarter and expectations for the remainder of the year.

- We are increasing our 2019 average royalty production range to 10,000 boe/d to 10,500 boe/d (previously 9,900 boe/d to 10,300 boe/d). Volumes are expected to be weighted approximately 55% oil and natural gas liquids and 45% natural gas. We continue to maintain our royalty focus with royalty production accounting for 96% of forecasted 2019 production and virtually all of our operating income.
- We are lowering our expected oil price assumptions for WTI to US$57.50/bbl (previously US$62.50/bbl) and for Edmonton Light Sweet prices to $66.00/bbl (previously $71.00/bbl). Our C$/US$ currency exchange assumption remains at US$0.75 per Canadian dollar.
- Our 2019 AECO natural gas price assumption remains at $1.60/mcf.

- Based on our current $0.0525/share monthly dividend level, we expect our 2019 payout ratio (dividends declared/funds from operations) to be 60% to 65% (previously 60%).
- General and administrative costs remain at $3.00/boe reflecting lower costs in the second to fourth quarters versus the first quarter rate.
- Due to the revision in our commodity price assumptions and factoring in acquisition activity, we currently estimate year-end net debt to funds from operations to exit 2019 at approximately 0.8 times (up from 0.3 times).

Key Operating Assumptions

		Guidance Date		
2019 Annual Average		Aug. 1, 2019	May 7, 2019	Mar. 7, 2019
Royalty production (excludes working interest production)	boe/d	10,000-10,500	9,900-10,300	9,900-10,300
West Texas Intermediate crude oil	US$/bbl	57.50	62.50	55.00
Edmonton Light Sweet crude oil	Cdn$/bbl	66.00	71.00	61.00
AECO natural gas	Cdn$/Mcf	1.60	1.60	1.60
Exchange rate	Cdn$/US$	0.75	0.75	0.76
Operating costs	$/boe	1.00	1.00	1.00
General and administrative costs	$/boe	3.00	3.00	3.00
Weighted average shares outstanding	millions	119	119	119

Recognizing the cyclical nature of the oil and gas industry, we continue to closely monitor commodity prices and industry trends for signs of deteriorating market conditions. We caution that it is inherently difficult to predict activity levels on our royalty lands since we have no operational control. As well, significant changes (positive or negative) in commodity prices (including Canadian oil price differentials), foreign exchange rates, or production rates may result in adjustments to the dividend rate.

Based on our current guidance and commodity price assumptions, and assuming no significant changes in the current business environment, we expect to maintain the current monthly dividend rate through the next quarter. We will continue to evaluate the commodity price environment and adjust the dividend levels as necessary (subject to the quarterly review and approval of our Board of Directors).

Conference Call Details

A conference call to discuss financial and operational results for the period ended June 30, 2019 will be held for the investment community on Friday, August 2, 2019 beginning at 7:00 am MT (9:00 am ET). To participate in the conference call, approximately 10 minutes prior to the conference call, please dial 1-800-696-5894 (toll-free in North America) participant passcode is 6745430#.

Availability on SEDAR

Freehold’s 2019 second quarter interim unaudited condensed consolidated financial statements and accompanying Management’s Discussion and Analysis (MD&A) are being filed today with Canadian securities regulators and will be available at www.sedar.com and on our website at www.freeholdroyalties.com.

Forward-looking Statements

This news release offers our assessment of Freehold’s future plans and operations as at August 1, 2019, and contains forward-looking statements that we believe allow readers to better understand our business and prospects. These forward-looking statements include our expectations for the following:

- expected additional production and funds from operations associated with our Canadian and U.S. acquisitions;
- our expected area of focus for future U.S. acquisitions;
- our outlook for commodity prices including supply and demand factors relating to crude oil, heavy oil, and natural gas;

- light/heavy oil price differentials;
- changing economic conditions;
- our intention to allocate free cash flow towards a combination of debt repayment, value enhancing acquisitions and our dividend, with the goal of maximizing returns for our shareholders;
- 2019 cash costs forecasted at approximately $5.25/boe;
- foreign exchange rates;
- forecast 2019 average royalty production, including product mix and percentage of total production and operating income from royalties;
- forecast 2019 payout ratio;
- forecast 2019 year-end net debt to funds from operations;
- key operating assumptions including forecast operating costs and general and administrative costs;
- our dividend policy and expectations for future dividends;
- treatment under governmental regulatory regimes and tax laws; and

By their nature, forward-looking statements are subject to numerous risks and uncertainties, some of which are beyond our control, including the impact of general economic conditions, industry conditions, volatility of commodity prices, currency fluctuations, imprecision of reserve estimates, royalties, environmental risks, taxation, regulation, changes in tax or other legislation, competition from other industry participants, the lack of availability of qualified personnel or management, stock market volatility, and our ability to access sufficient capital from internal and external sources. Risks are described in more detail in our annual information form dated March 7, 2019, which is available at www.sedar.com and on our website at www.freeholdroyalties.com.

With respect to forward-looking statements contained in this news release, we have made assumptions regarding, among other things, future commodity prices, future capital expenditure levels, future production levels, future exchange rates, future tax rates, future legislation, the cost of developing and producing our assets, our ability and the ability of our lessees to obtain equipment in a timely manner to carry out development activities, our ability to market our oil and gas successfully to current and new customers, our expectation for the consumption of crude oil and natural gas, our expectation for industry drilling levels, our ability to obtain financing on acceptable terms, shut-in production, production additions from our audit function and our ability to add production and reserves through development and acquisition activities. The key operating assumptions with respect to the forward-looking statements referred to above are detailed in the body of this news release.

You are cautioned that the assumptions used in the preparation of such information, although considered reasonable at the time of preparation, may prove to be imprecise and, as such, undue reliance should not be placed on forward-looking statements. Our actual results, performance, or achievement could differ materially from those expressed in, or implied by, these forward-looking statements. We can give no assurance that any of the events anticipated will transpire or occur, or if any of them do, what benefits we will derive from them. The forward-looking information contained in this document is expressly qualified by this cautionary statement. To the extent any guidance or forward looking statements herein constitute a financial outlook, they are included herein to provide readers with an understanding of management's plans and assumptions for budgeting purposes and readers are cautioned that the information may not be appropriate for other purposes. Our policy for updating forward-looking statements is to update our key operating assumptions quarterly and, except as required by law, we do not undertake to update any other forward-looking statements.

You are further cautioned that the preparation of financial statements in accordance with International Financial Reporting Standards (IFRS), which are the Canadian generally accepted accounting principles (GAAP) for publicly accountable enterprises, requires management to make certain judgments and estimates that affect the reported amounts of assets, liabilities, revenues, and expenses. These estimates may change, having either a positive or negative effect on net income, as further information becomes available and as the economic environment changes.

Conversion of Natural Gas to Barrels of Oil Equivalent (BOE)

To provide a single unit of production for analytical purposes, natural gas production and reserves volumes are converted mathematically to equivalent barrels of oil (boe). We use the industry-accepted standard conversion of six thousand cubic feet of natural gas to one barrel of oil (6 Mcf = 1 barrel). The 6:1 boe ratio is based on an energy equivalency conversion method primarily applicable at the burner tip. It does not represent a value equivalency at the wellhead and is not based on either energy content or current prices.

While the boe ratio is useful for comparative measures, it does not accurately reflect individual product values and might be misleading, particularly if used in isolation. As well, given that the value ratio, based on the current price of crude oil to natural gas, is significantly different from the 6:1 energy equivalency ratio, using a 6:1 conversion ratio may be misleading as an indication of value.

Non-GAAP Financial Measures

Within this news release, references are made to terms commonly used as key performance indicators in the oil and gas industry. We believe that operating income, operating netback, payout ratio, free cash flow and cash costs are useful supplemental measures for management and investors to analyze operating performance, financial leverage, and liquidity, and we use these terms to facilitate the understanding and comparability of our results of operations and financial position. However, these terms do not have any standardized meanings prescribed by GAAP and therefore may not be comparable with the calculations of similar measures for other entities.

Operating income is calculated as royalty and other revenue less operating expenses. It shows the profitability of our revenue streams as it provides the cash margin for product sold after directly related expenses. Operating netback, which is calculated as average unit sales price less operating expenses, represents the cash margin for product sold, calculated on a per boe basis.

Free cash flow is calculated by subtracting capital expenditures from funds from operations. In periods where Freehold has no capital expenditures, this figure is interchangeable with funds from operations. Free cash flow is a measure often used by dividend paying companies to determine cash available for the payment of dividends, reducing debt or available for investment.

Payout ratios are often used for dividend paying companies in the oil and gas industry to identify its dividend levels in relation to the funds it receives and uses in its capital and operational activities. Our payout ratio is calculated as dividends declared as a percentage of funds from operations.

Cash costs is a total of all recurring costs in the statement of income deducted in determining funds from operations. For Freehold cash costs are identified as operating expense, general and administrative expense, interest expense and share based compensation payments. It is key to funds from operations, representing the ability to sustain dividends and/or repay debt.

We refer to various per boe figures which provide meaningful information on our operational performance. We derive per boe figures by dividing the relevant revenue or cost figure by the total volume of oil, natural gas liquids and natural gas production during the period, with natural gas converted to equivalent barrels of oil as described above.

For further information related to these non-GAAP terms see our most recent MD&A.

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Die URL für diesen Artikel lautet:
https://www.rohstoff-welt.de/news/331547--Freehold-Royalties-Ltd.-Announces-Second-Quarter-Results-und-Increases-Production-Guidance.html

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