

Perpetual Energy Inc. Reports Second Quarter 2020 Financial and Operating Results

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CALGARY, AB, July 31, 2020 /CNW/ - (TSX: PMT) [Perpetual Energy Inc.](#) ("Perpetual" or the "Company") herein releases its second quarter 2020 financial and operating results. A complete copy of Perpetual's unaudited condensed interim consolidated financial statements and related Management's Discussion and Analysis ("MD&A") for the three and six months ended July 31, 2020 can be obtained through the Company's website at www.perpetualenergyinc.com and SEDAR at www.sedar.com.

EAST EDSON TRANSACTION

On April 1, 2020, the Company sold a 50% working interest in its East Edson property in West Central Alberta to a third party purchaser for consideration including a cash payment of \$35 million and the carried interest funding of the drill, completion and tie-in costs for an eight-well drilling program (the "East Edson Transaction"). A minimum of two horizontal wells targeting development of the Wilrich formation are required to be drilled, completed and tied-in during the third quarter of 2020. The purchaser is required to complete the eight-well horizontal drilling program by April 1, 2022. The cash proceeds from the East Edson Transaction will be used to repay bank debt. The eight-well development capital carry at East Edson is anticipated to restore gross production to more fully utilize the existing processing capacity, improve operating netbacks given the largely fixed operating cost structure and result in improved capital spending efficiency.

SECOND QUARTER 2020 HIGHLIGHTS

Capital Spending, Production and Operations

- In response to the significant decline in global oil prices which began in early-March, all capital investment for the second quarter of 2020 was deferred, resulting in nominal exploration and development capital spending. Expenditures on decommissioning obligations were also suspended, enabled by the Alberta Energy Regulator's ("AER") cancellations of area-based closure expenditure requirements for 2020.
- Second quarter production averaged 3,662 boe/d, down 61% from 9,370 boe/d in the comparative period of 2019, primarily to the temporary suspension of heavy oil production in response to low oil prices, and the sale of a 50% interest in the East Edson property in West Central Alberta, effective April 1, 2020. Compared to the first quarter of 2020, production declined by 51% or 3,817 boe/d. The closing of the East Edson Transaction on April 1, 2020, combined with natural declines at East Edson of 6%, reduced West Central production by 3,062 boe/d or 80% of the total production from the first quarter. The shut-in of Eastern Alberta heavy oil production due to low oil prices contributed the remaining 755 boe/d decrease. As Western Canadian Select prices improved materially from their April lows, the Company began reactivating certain low-cost heavy oil production in mid-May 2020 and has continued to ramp up production as oil prices recover. By mid-July, Perpetual had restarted all heavy oil production with the exception of approximately 250 bbl/d of cost production in certain pools at Mannville.
- Total production and operating expenses were down 5% on a unit-of-production basis to \$5.50/boe for the second quarter of 2020, compared to \$5.76/boe for the comparable period of 2019. On an absolute dollar basis, production and operating expenses were down by \$3.1 million (63%) due to the temporary shut-in of heavy oil production, the East Edson Transaction and mitigation initiatives.

Financial Highlights

- Realized revenue was \$13.15/boe in the second quarter of 2020, 38% lower than the comparative period of 2019 (\$21.26/boe). The decrease was due largely to the 88% decrease in Perpetual's realized natural gas price to \$0.24/bbl by hedging losses, combined with a 66% decline in realized NGL prices.

- ● Perpetual's realized natural gas price, including derivatives, decreased 88% to \$0.28/Mcf for the second quarter of 2020, from \$2.25/Mcf in the comparative period of 2019, and represented only 14% of the AECO Daily Index price, down 218% in the prior year period. Lower realized natural gas prices were the result of AECO-NYMEX basis hedge positions which have occurred as NYMEX prices weakened relative to AECO prices during the second quarter. During the second quarter of 2020, the remaining AECO-NYMEX basis hedge positions were closed out by entering into offsetting arrangements for the remainder of 2020 (\$5.1 million unrealized loss) and 2021 (\$3.4 million unrealized loss).
- Perpetual's realized oil price of \$67.56/bbl was 35% higher than the second quarter of 2019, and included realized hedging gains on crude oil derivative contracts of \$2.3 million or \$44.32/bbl (Q2 2019 – realized hedging losses of \$1.2 million or \$11.30/bbl) on second quarter production. Excluding realized hedging gains and losses, Perpetual's realized oil price was \$23.24/bbl in the second quarter of 2020, down 62% from \$61.31/bbl in the prior year period. During the second quarter of 2020, WTI and WCS hedge positions for the remainder of 2020 were substantially closed out by similar arrangements, resulting in a \$6.5 million unrealized gain as at June 30, 2020. WTI-WCS differential hedges will remain in place for the remainder of 2020 on an average of 567 bbl/d at a fixed differential of US\$19.50/bbl.
- Perpetual's realized NGL price for the second quarter of 2020 was \$17.35/bbl, down 66% from the second quarter of 2019, reflecting a decrease in all NGL component prices which moved lower in concert with lower WTI light oil prices. Realized prices in the second quarter of 2020 were also impacted by realized hedging losses of \$1.15/bbl (Q2 2019 – realized losses of \$0.15/bbl) on Perpetual's 350 bbl/d basis differential hedge between WTI and Edmonton condensate pricing that expired on June 30, 2020.
- Cash costs were down 49% to \$7.3 million (Q2 2019 – \$14.4 million), but up 30% on a unit-of-production basis to \$21.93/boe (Q2 2019 – \$16.93/boe) due to the impact of the 61% decrease in production. Cash costs decreased \$7.1 million from the prior year period and \$5.3 million from the first quarter of 2020 due to the temporary shut-in of production from late-March to mid-May, the closing of the East Edson Transaction on April 1, 2020, the reduction in compensation and work hours to 80% effective April 1, 2020, and payments received from the Canada Emergency Student Subsidy ("CEWS") program. Managing through the COVID-19 pandemic saw Perpetual's corporate staff working from home the second quarter before transitioning back to a hybrid office protocol in late June. Field employees have continued to work on site, following strict social distancing and other health and safety measures.
- Net loss for the second quarter of 2020 was \$8.8 million (\$0.15/share), compared to a net loss of \$36.3 million (\$0.57/share) in the comparative period of 2019. The decrease in net loss from the prior year period was due primarily to an impairment charge of \$22.6 million and the \$6.6 million decrease in the fair value of the TOU share investment recognized during the second quarter of 2019.
- Cash flow used in operating activities in the second quarter of 2020 was \$2.8 million (\$0.05/share), down \$7.1 million from the prior year period (Q2 2019 – cash flow from operating activities of \$4.3 million and \$0.07/share) due to the impact of the 38% decrease in realized revenue per boe and the 61% decrease in production caused by heavy oil shut-ins and the sale of East Edson production.
- Adjusted funds flow in the second quarter of 2020 was negative \$3.3 million (\$0.05/share), down \$7.0 million (19% of prior year period of \$3.6 million (\$0.06/share)) due primarily to lower commodity prices and hedging losses, as well as lower production as a result of the East Edson Transaction and heavy oil shut-ins. Compared to the first quarter of 2020, funds flow improved by \$0.3 million or 8% (Q1 2020 – negative adjusted funds flow of \$3.6 million).
- At June 30, 2020, Perpetual had total net debt of \$98.5 million, down \$30.1 million (23%) from March 31, 2020 and \$108.6 million (17%) from December 31, 2019. The decrease in net debt was attributable to the closing of the East Edson Transaction on April 1, 2020 for consideration including a cash payment of \$35 million. The cash proceeds from the East Edson Transaction were used to repay bank debt.
- Perpetual has a first lien, reserve-based credit facility (the "Credit Facility"). Perpetual had available liquidity at June 30, 2020 of \$6.6 million, comprised of the Credit Facility's \$20 million Borrowing Limit, less current borrowings and letters of credit of \$11.1 million and \$2.3 million, respectively. Subsequent to quarter end, Perpetual has reduced its outstanding letters of credit to \$1.3 million. The next Borrowing Limit redetermination has been extended from July 31, 2020 to August 10, 2020 to provide the lenders additional time to complete their review. If not extended, the Credit Facility will cease to revolve and outstanding advances will be repayable on November 30, 2020.

SEQUOIA LITIGATION UPDATE

On January 13, 2020, the Court of Queen's Bench (the "Court") issued its written decision related to the Statement of Claim filed on August 3, 2018 against Perpetual and its President and Chief Executive Officer ("CEO") with respect to the Company's disposition of shallow gas assets in Eastern Alberta to an unrelated third party on October 1, 2016 (the "Sequoia Litigation"). The Court's decision dismissed and struck all claims against the Company's CEO and all but one of the claims filed by PricewaterhouseCoopers Inc. LIT in its capacity as trustee in bankruptcy (the "Trustee") against Perpetual. The Court's decision is final and not subject to appeal.

that the test for summary dismissal relating to whether the transaction was an arm's length transfer for purposes of section 96 of the Bankruptcy and Insolvency Act (the "BIA") was met, on the balance of probabilities. Accordingly, the BIA claim was dismissed or struck and only that part of the claim can continue against Perpetual. The Trustee filed a notice of appeal with the Court of Appeal of Alberta, challenging the entire decision, and Perpetual and its CEO filed a similar notice of appeal with the BIA claim portion of the decision. The appeal proceedings are scheduled to be heard in December 2020.

On September 24, 2019, Perpetual filed an application for security for costs of the appeal. On January 28, 2020, the Court of Appeal issued its decision with respect to Perpetual's security for costs application, requiring the Trustee to post security for costs of the appeal in the amount of \$0.2 million. Applications filed by the Trustee to appeal the security for costs decision with the Court of Appeal in the amount of \$0.2 million were dismissed at a hearing held on June 18, 2020. Costs of \$0.1 million were awarded by the Court of Appeal on July 1, 2020.

On February 25, 2020, Perpetual filed a second application to strike and summarily dismiss the BIA claim on the basis that there was no transfer at undervalue, and Sequoia was not insolvent at the time of the transaction nor caused to be insolvent by the transaction. Applications for security for costs for future litigation were also filed at that time. In July 2020, the Orphan Vendors Association ("OVA"), certain oil and gas companies, and six municipalities applied to intervene in the second BIA dismissal application proceedings. The OVA and certain oil and gas companies will be permitted to intervene in the proceedings which are scheduled to take place on October 1 and 2, 2020.

Management expects that the Company is more likely than not to be completely successful in defending against the Sequoia Litigation such that no damages will be awarded against it, and therefore, no amounts have been accrued as a liability in Perpetual's financial statements.

OUTLOOK

Perpetual currently anticipates that five wells of the eight-well carried interest drilling program at the 50% owned East Edson property will be drilled in the second half of 2020, with two wells tied-in to production late in the third quarter followed by commencing production early in the first quarter of 2021. While oil prices have recovered from their second quarter low, expenditures for the remainder of 2020 in Eastern Alberta at Ukalta have been deferred, pending a sustained recovery in oil prices to the US\$45.00/bbl level.

With the reactivation of shut-in heavy oil production and the contribution from the first two carried interest wells at East Edson in late-September, production is forecast to increase in the third quarter to 4,500 to 4,700 boe/d (32% liquids). Fourth quarter production is anticipated to increase to 5,200 to 5,400 boe/d (28% liquids) with the full impact of the two East Edson wells. An additional 250 bbl/d of heavy oil production could be re-started if WTI oil prices increase above the US\$45.00/bbl level.

Abandonment and reclamation expenditures will also remain suspended for the second half of the year, enabled by the cancellation of area-based closure expenditure requirements for 2020. We are optimistic that funding from the Alberta Surface Rehabilitation program may facilitate the advancement of abandonment and reclamation projects previously planned for 2020. \$0.3 million of applications approved to date.

Minimization of operating and corporate costs will remain a priority, as will ensuring employees remain safe and healthy during the COVID-19 pandemic.

Financial and Operating Highlights	Three months ended		Six months ended	
	June 30		June 30	
(Cdn\$ thousands,	2020	2019	Change 2020	2019
except volume and per share amounts)				
Financial				
Oil and natural gas revenue	3,722	19,235	(81%)	14,219
Net loss	(8,831)	(36,276)	76%	(68,549)

Per share – basic and diluted ⁽²⁾	(0.15)	(0.60)	75%	(1.13)	(0
Cash flow from (used in) operating activities	(2,777)	4,295	(165%)	(5,891)	1
Adjusted funds flow ⁽¹⁾	(3,328)	3,649	(191%)	(6,929)	1
Per share – basic and diluted ⁽²⁾	(0.05)	0.06	(183%)	(0.11)	0
Total assets	132,772	292,827	(55%)	132,772	2
Revolving bank debt	11,080	37,806	(71%)	11,080	3
Term loan, principal amount	45,000	45,000	–	45,000	4
TOU share margin demand loan, principal amount –		13,515	(100%)	–	1
Senior notes, principal amount	33,580	33,580	–	33,580	3
TOU share investment	–	(27,635)	(100%)	–	(2
Net working capital deficiency ⁽¹⁾	8,873	10,251	(13%)	8,873	1
Net debt ⁽¹⁾	98,533	112,517	(12%)	98,533	1
Capital expenditures	(11)	5,200	(100%)	5,222	6
Net proceeds on acquisitions and dispositions	(34,661)	–	100%	(34,661)	&
Net capital expenditures	(34,672)	5,200	767%	(29,439)	6
Common shares outstanding (thousands) ⁽³⁾					
End of period	60,894	60,337	1%	60,894	6
Weighted average – basic and diluted	60,776	60,154	1%	60,725	6
Operating					
Daily average production					
Natural gas (MMcf/d)	16.9	44.5	(62%)	25.2	4
Oil (bbl/d)	573	1,207	(53%)	946	1
NGL (bbl/d)	268	754	(64%)	437	7
Total (boe/d)	3,662	9,370	(61%)	5,570	9
Average prices					
Realized natural gas price (\$/Mcf)	0.28	2.25	(88%)	0.86	2
Realized oil price (\$/bbl)	67.56	50.01	35%	43.18	4
Realized NGL price (\$/bbl)	17.35	51.34	(66%)	30.62	4
Wells drilled – gross (net)					
Natural gas	– (–)	– (–)		– (–)	&
Oil	– (–)	3 (3.0)		4 (4.0)	3
Total					

– (–)

(1) These are non-GAAP measures. Please refer to "Non-GAAP Measures" below.

(2) Based on weighted average basic common shares outstanding for the period.

(3) All common shares are net of shares held in trust (June 30, 2020 – 0.6 million; June 30, 2019 – 0.8 million). See "Note 14 to the condensed interim consolidated financial statements".

ADDITIONAL INFORMATION

"available liquidity", "cash costs", "net working capital deficiency", "net debt", "net bank debt", "net debt to adjusted funds flow ratio", "operating netback", "realized revenue" and "enterprise value" which do not have standardized meanings prescribed by GAAP. Management believes that in addition to net income (loss) and net cash flows from (used in) operating activities, these measures should not be construed as an alternative to net income (loss) or net cash flows from (used in) operating activities determined in accordance with GAAP as an indication of Perpetual's performance and may not be comparable with the results of similar measurements by other entities.

Adjusted funds flow: Adjusted funds flow is calculated based on cash flows from (used in) operating activities, excluding changes in non-cash working capital and expenditures on decommissioning obligations since Perpetual believes the timing of cash payment or incurrence of these items is variable. Expenditures on decommissioning obligations may vary from period to period depending on capital programs and the maturity of the Company's operating areas. Expenditures on decommissioning obligations are managed through the capital budgeting process which considers available adjusted funds flow. The Company has a significant amount of non-cash oil and natural gas revenues in-kind, equal to retained East Edson royalty obligation payments taken in-kind, the equivalent amount of cash revenue generated. The Company has also deducted payments of the gas over bitumen royalty obligation financing from adjusted funds flow to present these payments net of gas over bitumen royalty credits received. These payments are indexed to gas over bitumen royalty credits and are recorded as a reduction to the Corporation's gas over bitumen royalty obligation financing in accordance with IFRS. Additionally, the Company has excluded payments of restructuring costs and employee downsizing costs, which management considers to not be related to cash flow from operating activities. Management uses adjusted funds flow and adjusted funds flow per boe as key measures to assess the ability of the Corporation to generate the funds necessary to finance capital expenditures, expenditures on decommissioning obligations, and meet its financial obligations.

Adjusted funds flow per share is calculated using the same weighted average number of shares outstanding used in calculating net income (loss) 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 the period.

Available Liquidity: Available Liquidity is defined as Perpetual's reserve-based credit facility (the "Credit Facility") borrowed under the Credit Facility (the "Borrowing Limit"), less borrowings and letters of credit issued under the Credit Facility. Management uses available liquidity to assess the ability of the Corporation to finance capital expenditures and expenditures on decommissioning obligations, and to meet its financial obligations.

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

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

Operating netback: Operating netback is calculated by deducting royalties, production and operating expenses, and transportation costs 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 Corporation's operating areas. Perpetual considers operating netback to be an important performance measure as it demonstrates its profitability relative to current commodity prices.

Net working capital deficiency: Net working capital deficiency includes total current assets and current liabilities excluding short-term derivative assets and liabilities related to the Corporation's risk management activities, Tourmaline Oil Corp. share investment, TOU share margin demand loan, revolving bank debt, term loan, current portion of royalty obligations, current portion of lease liabilities, and current portion of provisions.

Net bank debt, net debt and net debt to adjusted funds flow ratio: Net bank debt is measured as current and long-term debt including net working capital deficiency. 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 demand loan and the principal amount of senior notes, reduced by the mark-to-market value of the TOU share investment. Net debt, net bank debt, and net debt to adjusted funds flow ratio are used by management to assess the Corporation's overall debt position and borrowing capacity. Net debt to adjusted funds flow ratios are calculated on a trailing twelve-month basis.

Enterprise value: Enterprise value is equal to net debt plus the market value of issued equity, and is used by management to analyze leverage.

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 Company's MD&A filed on SEDAR.

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 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 natural gas and crude oil is significantly different from the energy equivalency of 6:1, utilizing a conversion on a 6:1 basis is 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

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