PrairieSky Royalty Ltd. (PREKF) CEO Andrew Phillips on Q2 2021 Results - Earnings Call Transcript

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PrairieSky Royalty Ltd. (OTCPK:PREKF) Q2 2021 Earnings Conference Call July 20, 2021 8:30 AM ET

Corporate Participants

Andrew Phillips - President and Chief Executive Officer

Pam Kazeil - Chief Financial Officer

Conference Call Participants

Aaron Bilkoski - TD Securities

Luke Davis - RBC

Jamie Kubik - CIBC

Elias Foscolos - Industrial Alliance

Operator

Good morning ladies and gentlemen, and welcome to the PrairieSky Royalty Limited announces their Second Quarter 2021 Financial Results Conference Call. At this time, all participants are in a listen-only mode. Later we will conduct a question-and-answer session and instructions will follow at that time. [Operator Instructions]. As a reminder this conference call is being recorded.

I'd now like to hand the conference over to your host, Mr. Andrew Phillips, President and CEO. Thank you, sir. Please go ahead.

Andrew Phillips

Thank you, Annie. Good morning and thank you for dialing into the PrairieSky Royalty Q2 earnings call.

On the call from PrairieSky are Cam Proctor, COO; Pam Kazeil, CFO; and myself, Andrew Phillips. While Q2 represents the traditionally slow activity quarter in the field due to spring break up, our team has been very busy in the office. Leasing remains strong as we entered into 34 new leases with 32 different counterparties. This generated 2.3 million in bonus consideration for both natural gas and oil opportunities.

We also executed on our largest acquisition since 2017. We stood in the batter's box for three years and finally saw the perfect pitch. This asset is the quickest payout, lowest cost oil asset in the basin. It currently produces 10,000 barrels per day and will double by 2024 without the need for external capital. Individual wells pay out months produced to 100% owned and operated battery and our pipeline connected. Secondary recovery initiatives are planned on this asset. The addition of this asset will see us exit 2021 and over 1000 barrels per day of Clearwater production. This is funded with our bank line and we'll write off the interest and can take leverage to zero at the end of 2022 with cash flow on top of the recently increased dividend.

The 38% dividend increase reward shareholders that have allowed us to make capital allocation decisions based on what is best for long-term shareholders. Our industry low payout ratio has allowed us to cancel 5% of the outstanding shares below $10 per share over the last 18 months, executed on an acquisition that will be 5% of our production in a few years, and become the dominant Clearwater royalty company in terms of both production and undeveloped land, which will provide future growth at no cost to PrairieSky.

The new dividend will still be a payout ratio below 50% in 2022 at $50 WTI. This will allow us to continue to pursue acquisitions that improve our business and cancel shares below intrinsic value, giving owners a bigger share in the company. PrairieSky is the best way to profit from increasing capital spending in the western Canadian sedimentary basin and we'll continue to work hard at leasing land, controlling costs, ensuring compliance, making quality acquisitions, improving our ESG scores, which will continue to differentiate our business.

I will now pass the call to Pam to walk through the financials.

Pam Kazeil

Thank you, Andrew. Good morning everyone.

PrairieSky generated funds from operations of 56.5 million or $0.25 per share in the quarter, up 16% from Q1. Royalty production revenue totaled 64.9 million generated from average production volumes of 19,723 BOE per day. Oil royalty revenue totaled 42.9 million, an 8% increase over Q1 primarily due to strong WTI benchmark pricing and narrowed light and heavy oil differential.

Revenue was generated from oil volumes at 7028 barrels per day which were down 3% from Q1 as new wells brought on stream and incremental production from the acquisition in Q1 only partially offset natural declines and downtime at Onion Lake due to a turnaround. Natural Gas revenue totaled 13.7 million which was 8% above Q1 due to increased production combined with strong AECO inflation to benchmark pricing. Natural Gas volumes totaled 60.5 million a day up 5% due to incremental volumes from the Q1 Deep Basin acquisition and the resumption of production that was shut in during Q1 due to cold weather freeze off.

NGL royalty revenue increased to 11% from Q1 due to strong benchmark pricing and a 4% increase in royalty production volumes to 2612 barrels per day. NGL volumes increased due to production from new wells on stream and incremental volumes from the acquisition. There are 919 BOE, per day of prior period adjustments, which were 38% liquids and included 163 BOE a day from compliance activities and an additional 756 BOE a day of other prior period adjustments related to new wells on stream and better well performance.

The compliance group continues to recover missed and incorrect royalties through a forensic accounting and collected 1.1 million in the quarter. There were 89 wells spud which were 98% oil. The Viking was the most active play with 47 wells spud. And in addition there were 13 Mississippian, 7 Lindbergh SAGD oil wells, 7 Clearwater oil wells, 3 Cardium wells and 2 Duvernay oil wells spud in the quarter. Other revenue totaled 4.9 million and included 2.3 million of bonus consideration. It was an active quarter and we entered 34 new leases with 32 different counterparties.

We also earned 2.3 million in lease rentals and 0.3 million of other income. Cash administrative expenses totaled 4.8 million or 267 per BOE, cash administrative expense was 16% lower than Q1, which included the annual long-term incentive expenses 700,000 that was paid to staff. There will be no incremental staff required to manage the new Marten Hills royalty acquisition that Andrew discussed. The additional production will reduce G&A per BOE go forward.

During Q2, PrairieSky declared dividends of 14.5 million with the resulting payout ratio of 26%. Year-to-date PrairieSky has generated 105.3 million in funds from operations, which were used to fund dividends of 29 million repurchase shares at 13.2 million makes acquisitions totaling 51.7 million and repay debt of 8.8 million. At June 30, 2021, PrairieSky's bank debt was 34.1 million. To fund the Marten Hills acquisition, we increased our revolving credit facility by 50 million using the permitted increase under our current agreement debt upon closing of the acquisition was approximately 190 million. Since IPO PrairieSky has generated approximately 1.5 million in funds from operations and returned 1.4 billion to shareholders through dividends and buybacks. We will now turn it over to the moderator to proceed with the Q&A.

Question-and-Answer Session

Operator

[Operator Instructions] Your first question is from the line of Aaron Bilkoski with TD Securities.

Aaron Bilkoski

I guess my first question comes on your growth expectations the acquired properties. I guess my question is what was the deal backstopped by a capital commitment or a well commitment? And if not, what are you using to underpin your growth assumptions?

Andrew Phillips

Yes. That's a good question, Aaron. There's no capital commitments on the deal we structured, these are the fast payout play in North America, the wells payout multiple times in a single year at $50 U.S. WTI. So we're very comfortable that the capital will be spent. And they've got a pretty conservative drilling program and have been very conservative in the way they've grown the asset to-date. So we're very comfortable with the 10,000 to 20,000 barrel growth profile, we actually didn't include any improvements in tight curves. And we've seen pretty significant increases in the EURs, and initial production rates of the wells with the new drilling fluids and drilling methods. So I think we probably actually see a better growth trajectory than that, and then a lower decline as well assuming some of the waterflood initiatives that are successful, we didn't factor any of that into the acquisition. So that's part of the optionality -- part of the acquisition.

Aaron Bilkoski

If I could follow up with another question. I'd be curious, your thoughts on what the pipeline looks like for potentially more Canadian deals with high growth, double-digit annual growth at comparable metrics? Do you think this was a one-off peak, obviously waited a long time to do something like this? Or are more opportunities emerging?

Andrew Phillips

Yes. I mean, it's pretty rare to find. I mean, when you look across the entire basin, it's pretty rare to find oil growth opportunities. This is one of the places that can grow at $45 oil, and they can grow even faster at 70. So this was very unique. I think there are a number of other smaller opportunities potentially out there. But this was a very unique asset. It was one of the few that exists out there. The other piece, it's very, very good as just to the south of this Canadian natural has a very similar thickness, similar payout asset, it's unlikely that they would do something like this.

Aaron Bilkoski

Thanks. Final question. You talked about the ability to pay down debt to zero while you're in 2022. Does this include the continuation of the NCIB at the current pace? Or if you continue the NCIB, sort of historical run rate that require exit in 2022 with some debt?

Andrew Phillips

Yes. So, on the NCIB, it definitely gets taken down to a lower level as we repay the bank line. I think it's structurally, we've never wanted to run the business with permanent debt we do. We are comfortable using it and it's a very low interest rate. Of course, we're taxable. so we can write off the interest. That was more just to show the period of time at which we could pay that off, but will have a lot of flexibility to execute on other acquisitions and/or continue along with the buyback. But I think the buyback probably sits in the backseat to the debt repayment over the next 18 months here.

Operator

[Operator Instructions] Your next question is from the line of Luke Davis with RBC.

Luke Davis

Just wondering what total Clearwater production is now on your land between [indiscernible] and other operators? And roughly where you'd expect that to grow to over the next couple of years?

Andrew Phillips

You bet. Thanks for the question, Luke. So our Clearwater accident last year at about 250 barrels per day, we expected that to grow at 100% CAGR. So that was going to exit this year at about 500. And then this, the Marten Hills acquisition will be in the range of 600 plus barrels per day of natural gas oil production, so will be over 1000 barrels per day total. We expect over the next five years for this asset to grow by about double to somewhere in the range of 2000 plus barrels per day. And we think the ultimate productive capacity in the Clearwater is north of 3000 barrels per day, the pace at which it gets to that level will be determined by oil price and availability of capital.

One unique thing about this play and part of the reason we've been so active in this play since 2017, is because of self-funding doesn't require external equity or debt. And that’s what really differentiates it because you can be very comfortable with the growth profiles when you look out 5, 10 and 15 years in a variety of different environments.

Operator

Your next question from the line of Jamie Kubik with CIBC.

Jamie Kubik

Just curious if you can talk about how much downtime impacted your oil volumes in the quarter. And how do you think oil volumes turned from here, given the drilling through Q2 and additional licensing that you're seeing unutilized, respecting you don't give guidance quickly. Can you give us a sense of directionally how you think oil volumes move from here?

Andrew Phillips

You bet, Jamie, I'll let Pam talk a little bit about the downtime in Q2. And then I can just talk about a little bit, although we don't give guidance a little bit about what we're seeing from a leasing and licensing perspective.

Pam Kazeil

Yes. For downtime in Onion Lake, that was approximately just under 50 barrels a day that impacted the quarter which really offset the acquisition volumes that were included in the quarter. And then, we have estimated about another 50 barrels a day that we're shutting so in aggregate about 100 barrels a day for the quarter was the impact of turnarounds and downtime.

Andrew Phillips

Yes. And when you think about Q3, traditionally, Q2 is a little slower just because of breakup, there were a few pad drilling sites on our lands where they drilled right through breakup, which is starting to happen, more and more we're seeing in the western Canadian basin. But I think, of course, there's downtime, both in terms of individual well, batteries where they couldn't haul oil, those sorts of things. So you should see modest recovery on that front. But I think the bigger impact is just kind of the overall leasing and we're seeing it on every play. And we're seeing drilling, not just on a concentrated number of plays, but in places like the Banff and the Nisku we're seeing drilling activity come back in the Valley River. So I think we're likely to see a more broad array of drilling in the back half of the year. And it should start to excluding this new acquisitions -- should start to positively impact oil volumes in the back half of the year, as we've talked about a little bit. And certainly excluding this acquisition saw some single-digit growth over the next 18 months.

Jamie Kubik

Okay, that's great. It leads to a bit of another question. Are you seeing increased activity coming through the private operators on your acreage or is it mostly public's that are increasing activity at this point?

Andrew Phillips

Yes. It's a great question. I think the privates have seen a far more substantial uptick in activity than the public's have. A lot of the privates that are operators on our land, put it in certain situations, we have land funds with them, or I've done a bunch of leasing with them. They came into this last downturn or into COVID with zero debt or very low debt levels. So their incremental cash flow that's coming in, they're typically using it in the field to grow. So one private operator that drilled two wells on our land last year has plans for 30 this year, on our royalty lands, they've already licensed 22. So I think the privates are seeing a much bigger uptick. I saw a chart yesterday on the U.S. and the U.S. is seeing a similar phenomena where the privates are increasing capital a faster rate than the public's for a number of different reasons and public market reasons as well.

Operator

Your next question is from the line of Elias Foscolos with Industrial Alliance.

Elias Foscolos

First of all, forgive me if this is a basic one-on-one type question, but I'll ask it anyway. Given the acquisition, and I believe you have no history of hedging. Would you consider some hedging right now?

Andrew Phillips

That's a good question, Elias. And I think when we look at hedging, because we don't have any structural bank debt or bank debt, it's going to be permanently on our balance sheet. And our capital program is zero over the next couple of years. We're very comfortable with the repayment of that. So I think we'll continue with our strategy of a no hedging policy going forward. I think, our belief in hedging, because we have very low debt levels. And because we don't have capital, that we'd rather not speculate with investors money and just take the spot market, which has been excellent this year. It's excellent right now for both NGLs, natural gas and oil. But certainly, if we were protecting capital programs, it would be a different discussion, but because we don't have those, we're comfortable being unhedged.

Elias Foscolos

Got it. Thanks. Maybe another question to -- today's call has been focused on Clearwater. Is there any other area that in the basin that we might set our sights to, that you think might be another focus area directly impact that directly impacts PrairieSky?

Andrew Phillips

Yes, that's a great question. I appreciate that question. Because there are kind of three other areas that we're seeing substantial up ticks and I think they will positively impact the business over three and five-year period, and certainly in the back half year, we should start to see the impact of them. So one is the Viking of course, it's our largest part of the Royalty land base, we have a 20-year inventory at 300 plus wells per year and that's all just pure development inventory. And the one change we've seen in the Vikings, there's a lot of people pursuing secondary recovery initiatives. So water floods, et cetera. And I think a lot of those have shown pretty good success, and they've moderated the decline rates and improved the recovery factors so that the Vikings is starting to up tick.

The second part of the portfolio that's becoming more active and we've actually been active leasing land on is the heavy oil portfolio, which has been very inactive over the last five years. We've been leasing in both Western Saskatchewan and Eastern Alberta, for a lot of heavy oil opportunities. And I think we're going to see the drilling coming in the next six to nine months on some of those leases. And that's a part of the portfolio that's been very important and traditionally.

And I think the last part is, we're seeing a lot of companies go after some of these older reservoirs for secondary and tertiary recovery schemes. I think one of the things that people have found and I think investors have caught on to this is part of the reason [indiscernible] can pay so many dividends, paid out so much data is because they have 11% corporate decline. And a lot of these assets are very conducive to returning capital to shareholders, because you need a very low amount of maintenance capital to maintain those assets. So we're seeing quite a bit of activity on that front. And that'll likely be a focus of our next Investor Day two years from now. I know we just had one but it is a very important part of the portfolio. And I think it's something that more and more companies are starting to pursue because it gives you a more sustainable business.

Operator

At this time, there are no further questions.

Andrew Phillips

Great. Well, thank you everyone very much for calling into the PrairieSky conference call and hope everyone has a great week.

Operator

Ladies and gentlemen, this concludes today's conference call. Thank you for your participation. You may all disconnect.