PrairieSky Royalty Ltd. (PREKF) CEO Andrew Phillips on Q3 2021 Results - Earnings Call Transcript

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PrairieSky Royalty Ltd. (OTCPK:PREKF) Q3 2021 Earnings Conference Call October 26, 2021 8:30 AM ET

Company Participants

Andrew Phillips - President & Chief Executive Officer

Pamela Kazeil - Vice President of Finance & Chief Financial Officer

Conference Call Participants

Aaron Bilkoski - TD Securities

Elias Foscolos - Industrial Alliance Securities

Operator

Good day, and thank you for standing by. Welcome to the PrairieSky Royalty Ltd. announces their third quarter 2021 financial results conference call. [Operator Instructions]

I would now like to hand the conference over to your speaker today, Mr. Andrew Phillips, President and CEO. Please go ahead.

Andrew Phillips

Thank you, Randy. Good morning, everyone, and thank you for dialing into the PSK Q3 conference call. On the call from PrairieSky are Cam Proctor, COO; Pam Kazeil, CFO; and myself, Andrew Phillips. I'll provide an operational update then turn the call over to Pam to walk through the financials. Before we start, I will preface our comments by reminding investors to review our forward-looking statements qualified in our press release and MDA for Q3 2021.

We've achieved excellent financial results this quarter, including the highest product revenue since Q3 2014. More importantly, activity continues to climb across the entire basin. PrairieSky saw 193 wells spud on its acreage in the quarter. Activity was spread broadly across the entire Western Canadian Sedimentary Basin. Highlights include 51 Clearwater wells from six distinct operators and 84 Viking light oil wells. Recent success in the Duvernay light oil shale play in Central Alberta saw operators add five new wells on PSK lands. Natural gas volumes of 58.4 million cubic feet per day contributed $15.6 million in revenues. Volumes were impacted by two large turnarounds at facilities. The majority of the Clearwater Viking programs drilled in Q3 will come on stream shortly or just start increasing.

Strong industry cash flows have spurred operators to make capital funds at higher levels for 2022. The benefit for shareholders of having 16.3 million acres of royalty lands is starting to be observed in an inflationary capital cycle. On Friday, there were 173 rigs operating in Western Canada, 100% higher than the previous year on October 21 at 86 rigs. In addition to our previously announced Marten Hills Clearwater acquisition in July, at the end of August, we added 264,000 acres of predominantly fee title lands and 200 BOE per day. Our first one section lease on the acquired lands will be closed shortly and could add 50% to the royalty production of this asset and is developmental in nature. The full benefit of this acquisition will be recorded in our Q4 financials. A significant differentiation between PSK and its peers is a very low payout ratio. This allows us to make acquisitions such as the one I just described and pay it off in months without issuing equity. This should provide shareholders with strong per share growth, stronger per share growth than our peers and industry-leading dividend growth as we look into the future.

Our early investments in the Clearwater undeveloped lands are also starting to show significant potential. There are now multiple discoveries and extensions that will provide growth in royalty oil volumes well into the future. An active exploration campaign this winter could uncover future development opportunities. In the more mature areas of this play, operators continue to work on secondary recovery opportunities. As a reminder, PSK owners will get their share of the increased recovery factors at no additional cost.

The Viking light oil play is starting to see increased licensing in spuds and is providing operators with quick-cycle, low-cost light oil and strong recycle ratios. We believe that the strong underlying economics of this play will incur stronger 2022 activity on our acreage in both Saskatchewan and Alberta. There are numerous small start-ups that have been recently capitalized or have plans to raise capital. This is encouraging as this is the groups that explore and/or examine existing assets with fresh eyes on our lens. Lastly on the operational front, we are seeing strong service rig activity in the field as operators look to optimize their existing assets.

I'll pass the call over now for Pam to walk through the financials. And then we will open up to Q&A.

Pamela Kazeil

Thank you, Andrew. Good morning, everyone. It was another strong quarter for PrairieSky. Total revenues grew to $78.1 million, which was made up primarily of royalty production revenue of $76 million generated from average production volumes of 19,871 BOE per day. With our low-cost structure and no maintenance capital, we were able to once again convert 85% of revenue into free cash flow. We generated funds from operation of $66.2 million or $0.30 per share in the quarter, which was up 17% from Q2 2021 and 75% above Q3 2020.

Oil royalty revenue totaled $50.3 million, 17% above Q2 2021 and more than double of Q3 2020. The increase was due to strong WTI benchmark pricing and increased oil volumes, which averaged 7,535 barrels per day and represented an increase of 7% from Q2 and 15% over Q3 2020. We added 429 barrels a day of incremental production from acquisitions, in particular, the Marten Hills Clearwater acquisition, with remaining volumes from organic growth offsetting declines. This is very encouraging for oil production growth in Q4 and into Q1 as Q3 is generally our lowest production quarter as it follows breakup.

Natural gas revenues totaled $15.6 million, which was 14% above Q2 and 79% above Q3 2020, due primarily to strong AECO and Station two benchmark pricing. Natural gas volumes totaled 58.4 million a day, which were 3% above Q2 and flat with Q3 2020 as third-party downtime impacted volumes by two million a day. NGL royalty revenue of $10.1 million was up 22% from Q2 due to strong benchmark pricing and flat average NGL royalty production volumes of 2,603 barrels a day. NGL royalty revenue was up 106% from Q3 2020 due to a 5% increase in volume, combined with strong pricing.

There were 1,040 BOE a day of prior period adjustments, which were 52% liquids and included 276 BOE a day from compliance activities and an additional 764 BOE a day of other prior period adjustments related to new wells on stream and better well performance. The compliance group recovered missed and incorrect royalties through forensic accounting, collecting $900,000 in the quarter. There were 193 wells spud in Q3, which were 98% oil wells. The Viking was the most active play with 84 wells spud followed by the Clearwater with 51 spuds. Additional activity took place across the basin with well spuds in the Duvernay, Cardium, Charlie Lake, Mannville, Mississippian, Nisku, Bakken and Spirit River.

Other revenue totaled $2.1 million and included $700,000 of bonus consideration for entering into 24 new leases with 24 different counterparties. We also earned $1.1 million in lease rentals and $300,000 of other income. Cash administrative expenses totaled $4.3 million or $2.35 per BOE. Cash administrative expense was 10% lower than Q2 and it is expected to be well below $3 per BOE for 2021.

In July, PrairieSky completed the Marten Hills acquisition for cash consideration of $155 million. And in late August, we closed the acquisition of a royalty portfolio in Central Alberta for a cash consideration of $34.8 million. On September 29, 2021, PrairieSky extended our credit facility from $225 million to $425 million with a permitted increase to $500 million, and we extended the maturity date to February 28, 2025. We believe this additional capacity provides PrairieSky with liquidity for business opportunities and financial flexibility. In addition, the credit facility now incorporates a pricing mechanism which may increase or decrease pricing based on our environmental, social and governance performance, creating a sustainability-linked loan. Our ESG performance will be measured by the third-party ratings agency, Sustainalytics.

During the quarter, PrairieSky declared dividend of $20 million or $0.09 per share, our second increase this year and a cumulative 50% increase over the Q3 2020 dividend. The resulting payout ratio for Q3 was approximately 30%. Year-to-date, PrairieSky has generated $171.6 million in funds from operations, which were used to fund the dividend of $49 million, repurchase shares of $21.2 million, with remaining cash flow put towards acquisition. At September 30, 2021, PrairieSky had net debt of $187.7 million, which at current commodity prices can be paid within one year. Since IPO, PrairieSky has generated approximately $1.6 billion 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 comes from Aaron Bilkoski from TD Securities. Your line is open.

Aaron Bilkoski

Thanks. Good morning, everyone. I guess my first question is on the drilling side. Of the wells drilled in the quarter, do you have any sense or are you able to share how many of them would be driven by private operators versus public operators? And I guess what I'm getting at is how should we think about the pace and development of some private operators versus the public operators going forward.

Andrew Phillips

Yes. Thanks for the question, Aaron. And it's -- there are two very different pieces of development. I think the privates have really ramped up at a far faster pace than the publics have. It's -- over 40% of the spuds in the quarter were conducted by private operators. If you go back five years, it would have been less than 25%. So it's a big bump up. And actually, we've seen the biggest increases in capital budgets this year as well as into 2022 from the private operators as well. So that number could even go higher. And a lot of them don't require equity given their strong cash flows. So they're able to self-fund and not have the requirement to go public.

Aaron Bilkoski

Thanks, Andrew. If I could ask a different question on the balance sheet. So under your prior credit facility, you have the capacity to add more on a turn of leverage on the balance sheet if you wanted to use it to make acquisitions. With the revised credit facility, that can obviously go higher. I guess my question is how much debt would you be comfortable adding to the balance sheet on a temporary basis in acquisitions.

Andrew Phillips

Yes. I don't know that I've given an absolute number. I guess we'd always look at it, Aaron, in the sense that we could pay it off in a reasonable amount of time. And unlike most E&Ps or companies that have significant capital requirements as a big chunk of their cash flow, if you look out into 2022, for example, with $79 million in total capital requirements for the dividend, you have a huge amount of excess cash flow. So you can pay these numbers off in a very short period of time. So we're fortunate to have the excess liquidity to help us with acquisition opportunities without having to issue outsize amount of shares. So it's a great way to compound the business for us. And without giving you an absolute number, it's just definitely something that we can pay off large chunks of it in a single year with our low payout ratio. Thanks for the questions, Aaron.

Aaron Bilkoski

Thanks.

Operator

[Operator Instructions] Your next question comes from Elias Foscolos from Industrial Alliance. Your line is open.

Elias Foscolos

Hi, good morning and thanks for taking my questions. I'm going to focus on opportunities sort of beyond the drill bit. About 1.5 weeks ago, the Canadian chartered banks signed off on COP26. I understand the credit facility for you has increased. But are you seeing a reluctance maybe amongst the public producers to tap into credit facilities? And will that create some expanding opportunities? Do you see that? Or is that just way too early to tell?

Andrew Phillips

Yes. It's a great question, Elias. And I think we've -- without getting too deep into what we're seeing with a lot of the public and private operators, I think one of the unique things about this cycle is there's -- given gas, oil and NGLs are all at very high prices is they're generating a huge amount of excess cash and actually are paying down a lot of these facilities and not requiring excess capacity. So -- and the sustainability-linked loan is a really interesting piece of business for us because if you look into Europe, I think 60% of the corporates in Europe have these sustainability-linked loans. It helps the lenders lend to you because there's a tie to your ESG performance. And so I do think it's something that's important going forward. But when you think about the producer universe, to answer your first question, they have a lot of excess liquidity right now. So I don't know that there's a requirement for large amounts of debt leverage right now on their side.

Elias Foscolos

Okay, that's it for me. Thanks very much.

Andrew Phillips

Thanks for the question.

Operator

[Operator Instructions] There is no further question at this time. You may continue.

Andrew Phillips

Thank you, everyone, for dialing into the PrairieSky Q3 2021 conference call. And please feel free to call either Pam or myself if you have any additional questions.

Operator

This concludes today's conference call. Thank you all for joining. You may now disconnect.