Why Crescent Point Energy Corp Belongs in Every Income Investor's Portfolio

Description

Light and medium crude producer **Crescent Point Energy Corp** (TSX: CPG)(NYSE: CPG) continues to perform strongly and remains a favourite among income-hungry investors because of its monster dividend yield of 6.3%. Crescent Point's latest quarterly results were particularly solid, confirming that the company continues to go from strength to strength.

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These results also confirm that its dividend is still sustainable despite the claims of naysayers, with Crescent Point's payout ratio remaining well above 600%. Let's take a closer look at the latest results and see what they tell us.

Solid Q2 results bode well for a strong full-year performance

Crude production continued to climb for the third successive quarter, up a healthy 5% compared to the first quarter of 2014 and 17% compared to the equivalent quarter in 2013. The key driver for this is the company's history of successfully identifying and completing accretive acquisitions.

These transactions included the May acquisition of CanEra, which gave Crescent Point a large Torquay land holding with crude production of 10,000 barrels daily. The other significant acquisition was the Saskatchewan Viking oil assets of Polar Star Canadian Oil and Gas in June, adding 2,800 barrels of crude production daily.

As a result, Crescent Point revised its 2014 guidance upwards to 135,000 barrels of crude daily, or 13% higher than its total 2013 crude production.

Notably, Crescent Point's production remains heavily weighted towards higher-margin oil and natural gas liquids, with these making up 91% of total production during the second quarter. This is an impressive achievement, particularly with natural gas prices remaining volatile and continuing to soften as global supply grows.

Crescent Point Energy has one of the best production mixes in the patch, superior to many of its peers, including **Talisman Energy Inc.** (TSX: TLM)(NYSE: TLM), which has crude liquids making up only 39% of its total production. It is also superior to **Husky Energy Inc.'s** (TSX: HSE) 70% liquids production for the same period, as well as **Lightstream Resources Ltd's** (TSX: LTS) 80% and **Penn West Petroleum Ltd's** (TSX: PWT)(NYSE: PWE) 64%.

This allows Crescent Point to consistently generate a healthy margin, or netback for each barrel of crude it produces, ensuring that both its cash flow and bottom line will continue to grow. Crescent Point's netback also spiked a healthy 4% quarter over quarter and 8% year over year for the same period to $54.75 per barrel, which is among the best netbacks in the patch.

This figure is significantly higher than the average of $44 per barrel for oil producers operating in North America, as well as higher than many of its peers. For the same period, Talisman reported a dismal $27.18 per barrel, which is half of Crescent Point's margin per barrel of crude produced, while Husky's was $48.70, Lightstream's was a healthy $57.49, and Penn West's was a dismal $36.67 per barrel.

All of these factors contributed to significant growth in Crescent Point's bottom line, with earnings per share for the quarter tripling compared to the previous quarter and jumping a healthy 26% year over year to $0.24 per share. This underscores the strength of Crescent Point's operations and the quality of its assets in an operating environment where industry fundamentals continue to improve.

Despite the naysayers, the dividend yield remains sustainable

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By the end of the last quarter, Crescent Point's funds flow from operations had grown a healthy 7% quarter over quarter and 18% year over year to $636.7 million, and it this strong growth in funds flow that continues to support the sustainability of its dividend.

The rationale is that while the accepted method for calculating the dividend payout ratio is to divide dividends paid by net income, oil exploration and production is a capital-intensive industry where cash is king. Furthermore, the calculation of net income includes a number of non-cash items, distorting the true representation of the amount of cash available.

Thus, a more reliable indicator of dividend sustainability is to divide total dividends paid by funds flow from operations, which gives Crescent Point a sustainable payout ratio of 46%.

Future outlook remains positive

Despite crude prices softening somewhat of late, I expect Crescent Point Energy to continue performing strongly, with its solid production growth underpinning further funds flow growth and the sustainability of its dividend.

This is further supported by the strength of Crescent Point's balance sheet. It has a low degree of leverage, with net debt of merely 1.2 times its funds flow from operations, which is one of the lowest ratios in the patch. This gives it considerable operational and financial flexibility, as the company can increase its debt in order to make further accretive acquisitions. As a result, I think that Crescent Point should be an integral addition to any income-focused portfolio.

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