



## How Will the Impending Oil Price Crunch Impact Crescent Point Energy Corp.?

### Description

I have been a tremendous fan of **Crescent Point Energy Corp.** (TSX: CPG) (NYSE: CPG) for some time as it continues to expand its assets and production through accretive acquisitions. These have allowed it to keep growing funds flow while sustaining the juiciest dividend yield of any large cap in the patch, at 6.4%.

But analysts are concerned the dividend may not be sustainable if there is a significant and sustained drop in the price of crude, with Crescent Point's average payout ratio over the last five years of more than five times net earnings.

Let's take a closer look at what weaker industry fundamentals could mean for Crescent Point.

### High-quality, low-decline assets support ongoing growth

Crescent Point has time and again proven itself to be one of the best operators in the patch, building a solid, high-quality, low-decline rate asset base, giving it net oil reserves of 640 million barrels, of which only around 38% is developed and producing. This highlights that it has considerable oil assets at its disposal for development, reducing the need for further acquisitions.

The quality of those assets is emphasized by Crescent Point's second-quarter 2014 drilling success rate of an incredible 100%, coupled with an impressive margin or netback of \$54.75 per barrel, which is among the best in the energy patch.

### Accretive acquisitions continue to boost production and funds flow

But the key to Crescent Point's success has been its ability to consistently make quality accretive acquisitions that boost its higher-margin light oil production. Year to date, it has made three acquisitions — the latest being 76 sections of land purchased from **Lightstream Resources Ltd.** (TSX: LTS) in southeast Saskatchewan and Manitoba for \$378 million, adding production of 3,300 barrels of oil daily weighted to 95% higher-margin light oil at a netback of \$62 per barrel.

As a result of these acquisitions, Crescent Point revised its 2014 guidance with fund flow from

operations boosted by an impressive 23% from the original guidance issued in December 2013 to \$6.13 per share on the back of significantly higher production.

### **But do they guarantee the sustainability of the dividend?**

Despite these acquisitions and significant growth in funds flow, there are still doubts as to whether the dividend is truly sustainable. A key concern is an increasingly softer price for WTI, which is well off its June peak and has softened 3% year to date. Fears of a looming WTI price crunch continue to grow, with U.S. light sweet crude production from the shale oil boom surging ahead and already significantly offsetting supply disruptions in the Middle East.

This is a growing issue for Crescent Point, with its dividend plus growth model predicated on strong commodity prices and growing crude production. The company's dividend payout ratio is already over five times net income, but is an average of only 53% of funds flow from operations over the last eight quarters, which should mean it is sustainable.

But when production sustaining capital expenditures are deducted from funds flow from operations, the dividend becomes unsustainable, with average capex over that period exceeding funds flow. All of this has created a working capital shortfall, which Crescent Point has funded through debt.

For the second-quarter 2014, net debt grew 23% against the previous quarter and 55% compared to the equivalent period in 2013, and I expect this trend to continue — particularly with management relying on an estimated WTI price of \$100 per barrel when forecasting its growth in funds flow. The price of WTI has softened significantly since its June 2014 peak, to now trading at \$92 per barrel and I anticipate its price to soften further, which will significantly impact Crescent Point's funds flow.

But even with the meaningful growth in debt, Crescent Point's level of leverage remains quite low with a very manageable net debt of 1.3 times funds flow, indicating it can more than adequately service its existing debt and with \$1.1 billion undrawn on its credit facility can comfortably increase its debt to fund any shortfalls.

### **What are the key concerns for investors?**

The most worrying issues for shareholders are any sustained softening of WTI prices, which will have a demonstrable impact on Crescent point's share price, with the company being a leveraged play on the price of crude.

Another problem for shareholders, particularly those who elect to take their dividend in cash, is Crescent Point's rising share count, with around 29% of all dividends paid issued as additional shares through its Drip. This has caused Crescent Point's share count to grow by 6.5% over the last year, diluting those investors who take their dividends as cash and I expect this to continue.

Clearly, Crescent Point is well positioned to continue to fund its dividend, even if there is a sustained downturn in the price of crude. But its share price will more than likely fall at a greater rate of knots than many of its peers as crude prices slide further south. The issue of dilution continues to mount, and it is becoming increasingly clear the current dividend yield may be unsustainable over the long term if crude prices fall even further.

### **CATEGORY**

1. Investing

## TICKERS GLOBAL

1. NYSE:VRN (Veren)
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## Category

1. Investing

## Date

2025/09/10

## Date Created

2014/09/15

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