



Is Crescent Point Energy Corp.'s Monster Dividend Yield Truly Sustainable?

Description

The recent plunge in oil prices has created considerable concern among investors as to whether the monster dividend yields paid by a number of Canadian oil companies are truly sustainable. One company that continues to garner attention in this respect is **Crescent Point Energy Corp.** (TSX: CPG)(NYSE: CPG).

With a dividend yield of 7% it pays the third largest yield in the **S&P TSX 60 Index** behind **Penn West Petroleum Ltd.** (TSX: PWT) (NYSE: PWE) and **Canadian Oil Sands Ltd.** (TSX: COS). But with this dividend payment at five times Crescent Point's net income, there are growing concerns that softer crude prices will threaten its sustainability.

The key ratio for measuring dividend sustainability is the dividend payout ratio, which measures the proportion of a company's net income paid out as a dividend. Typically, if this is over 100% then the dividend is deemed to be unsustainable.

But there are other methods that more accurately measure dividend sustainability.

A more precise means of measuring sustainability is to use funds flow from operations in place of net income. This is because oil exploration and production is a capital-intensive industry where cash flow is king. Furthermore, the calculation of net income includes a number of non-cash line items, distorting the true amount of funds available to meet liabilities. When using this method, Crescent Point's average dividend payout ratio for the last two years falls to a very sustainable 52%. Even after allowing for the deduction of production sustaining capital expenditures, there is sufficient funds flow to meet other key financial obligations.

Strong balance sheet, solid operating margins

Crescent Point continues to maintain a solid balance sheet with \$30 million cash on hand at the end of the second quarter and a low degree of leverage, with net debt of 1.2 times funds flow from operations. It also remains in compliance with its debt covenants and has a syndicated unsecured credit facility with an accordion feature, which allows it to increase the facility by up to \$500 million.

This leaves Crescent Point well positioned to weather any sustained weakness in oil prices and able to increase debt as and, when required, to fund any shortfall in funds flow.

One of Crescent Point's strengths is the quality of its oil assets, which allows it to generate a solid operating margin, or netback per barrel of crude sold. Its netback is among the best in the patch at \$54.75 per barrel for the second quarter of 2014. This is significantly higher than both **Penn West Petroleum Ltd.**'s \$39.37 per barrel and **Canadian Oil Sands Ltd.**'s \$46.62 per barrel for that period.

This netback highlights there is sufficient juice to absorb low oil prices without impacting Crescent Point's funds flow from operations or the dividend. The company is also well positioned to continue to grow production with oil reserves of 640 million barrels of crude, around 40% of which are developed.

Are shareholders being diluted?

One of the key accusations leveled at Crescent Point is that it's a serial issuer of shares, diluting value for existing investors, particularly those who take their dividends as cash. By the end of the second quarter, Crescent Point's shares outstanding has only grown by 3% compared to the previous quarter and 6% against the equivalent period in 2013.

I don't believe this is a significant increase in the company's float and the dilutive impact of such small increases would be negligible. This is clearly the case with the majority of those shares issued used to fund capital acquisitions, boosting Crescent Point's underlying value and funds flow from operations.

Shares issued in lieu of dividends each quarter represent less than 1% of the total float, which, with only 30% of total dividends payable issued as shares, significantly minimizes the dilutive effect. For these reasons, it is difficult to see any validity in the claims that Crescent Point's dividend is under threat or that investors are being significantly diluted because of shares issued in place of dividends.

CATEGORY

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