2 Big Reasons to Avoid Crescent Point Energy Corp.

Description

Crescent Point Energy Corp. (TSX: CPG)(NYSE: CPG) is a favorite among dividend investors due to its large 6.7% yield. Over the past several years however, this yield has come at the expense of share performance, and investors holding since the beginning of 2012 would have only noted a 4.5% appreciation in share price.

This year, Crescent Point has returned about 7% including dividends, which is deeply lagging the almost 20% gain of the S & P/TSX Energy Index.

What explains these poor returns? I think it comes down to two major factors, both of which are reasons to be cautious when considering a purchase of Crescent Point shares.

1. Crescent Point has a strategy based on acquisitions and issuing equity

Crescent Point energy has a growth strategy centered on making expensive acquisitions, and paying with these acquisitions with equity, rather than out of cash flow. Recently, it acquired Lightstream Resources for $378 million, funded by issuing almost 20 million shares.

Rather than creating value for current shareholders by purchasing companies out of current cash flow and investing excess cash flow into maximizing production on current assets, Crescent Point is issuing equity and rapidly expanding its shares outstanding, which has a dilutive effect on Crescent Point's earnings-per-share (EPS), and therefore on its share price.

Crescent Point's share count has increased by 140% since 2009. To illustrate the effect of increasing share count on EPS, between 2012 and 2013, Crescent Point noted a 24% drop in net income. However, EPS dropped 35% for the same period, due to the fact that its shares outstanding increased by 16% during that period.

2. Crescent Point is having trouble attracting American investors

Crescent Point is seeing a steady decline in its American investor base, which it needs to grow its share price, since Canadian investors alone simply don't generate enough demand to do it. U.S investors hold less than a quarter of the stock currently, down from 43% in 2012.

Crescent Point's strategy so far has been to attract American investors using its large dividend yield, a strategy with questionable success. Many American investors are currently chasing the huge growth offered by U.S shale producers, and with Crescent Point focusing primarily on its dividend rather than production growth from cash flows, it may have difficulty attracting these investors.

Crescent Point is also attempting to attract American income investors, and CEO Scott Saxberg has compared the company to an MLP due its high yield and focus on distributing earnings to shareholders. This strategy is also problematic, due to the fact that there are many American oil and natural gas MLPs offering much higher yields (sometimes as high as 9%), with the favorable tax and currency benefits that MLPs offer.

Despite the high yield, Crescent Point Energy needs to expand its investor base beyond Canada and focus more on creating value for current shareholders. Until it does so, investors should be cautious, or risk the similar poor returns the last several years have brought.

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