3 Things Every Crescent Point Energy Corp. Investor Needs to Know About its Latest Buy

Description

In late May **Crescent Point Energy Corp.** (TSX:CPG)(NYSE:CPG) announced its latest acquisition—the purchase of Legacy Oil and Gas for total consideration of $1.53 billion. Somewhat surprisingly, Crescent Point shares fell on news of the purchase despite the fact that most analysts view the acquisition favourably.

Why did Crescent Point shares fall? There are a few potential reasons. Firstly, Crescent Point, in typical fashion, is financing the acquisition by issuing what works out to be a total of approximately 43 million new shares. This raises concerns of shareholder dilution, a frequent criticism of Crescent Point. The company frequently issues shares, and increases in per-share earnings and cash flow are difficult to realize under a constantly rising share count.

Investors may have also been concerned by the fact that Crescent Point is taking on Legacy's $967 million in debt, and that shares were issued at $28.50, below the share price at the time. Fortunately, these concerns are mostly invalid, and Crescent Point's latest acquisition creates enormous value in multiple ways. Here are three.

1) The latest acquisition actually reduces overall indebtedness.

Crescent Point purchased Legacy for about $563 million and acquired its $967 million in debt, bringing the total consideration up to $1.53 billion. Legacy's debt was one of the key reasons the company decided to sell, as it was becoming more at risk of exceeding key debt covenants set by its creditors.

Fortunately, thanks to the large degree of shares Crescent Point is issuing, the company is barely adding on any net debt, and the increased cash flow from Legacy's assets should keep its debt-to-cash flow ratio neutral for 2015, according to the company.

Crescent Point is paying for Legacy's equity by issuing 18.97 million shares to Legacy shareholders. In addition, rather than taking on all of Legacy's debt, Crescent Point is issuing 21 million shares as part of a bought-deal offering, which should result in proceeds of $600-690 million. Crescent Point will use this to reduce its debt, bringing the total debt down to only $277 million. This will actually reduce Crescent Point's debt-to-equity ratio overall because most the purchase is equity.

2) Crescent Point is acquiring high-return assets.

Crescent Point is picking up 20,000-25,000 bpd of production, 1,000 net sections of land, and 940 new drilling locations to add to its overall inventory. Most importantly, however, is that about 200 of these net sections of land are in the extremely economic, high-return Midale play in southeastern Saskatchewan.

In addition, about half the drilling locations are located in this play, and three-quarters of its current production comes from southeast Saskatchewan overall. Southeast Saskatchewan is a key operating area for Crescent Point, and the company gets most of its production from its Viewfield Bakken assets. These assets are extremely low cost and high return, and currently have the lowest breakeven point in North America at only US$44.30 WTI per barrel as of 2013.

Crescent Point has been using water-flooding technology to reduce decline rates and costs in these wells, and wells in the Viewfield region could pay back capital costs in as low as nine months, allowing the company to reinvest cash elsewhere. Legacy's assets are of similar quality, with estimated netbacks of $31 per barrel at WTI prices of US$58 per barrel. These netbacks are in the top three of its 18-company peer group, and synergies with Crescent Point, as well as the addition of Crescent Point's operational expertise and technology, should only enhance these.

3) The acquisition improves the sustainability of the dividend.

Analysts estimate that the acquisition will be 3-4% accretive to cash flow, which will have the effect of lowering Crescent Point's payout. While the company will have more shares to pay the dividend (costing about $119 million extra annually), the increased production should easily cover the cost. Legacy generated $12.50 per barrel of profit after all costs were factored in while oil prices were at US$48. At current prices, this would work out to $164 million in extra cash flow, well exceeding the extra dividend cost.

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