What Would $20 Oil Mean for Crescent Point Energy Corp. and its Dividend?

Description

In a report last week, **Goldman Sachs** said that oil supply is higher than they originally thought and that prices will average US$45 over the next year. Goldman also said that prices could fall as low as US$20 per barrel if supply isn't curtailed quickly enough. Such a number should send shivers down the spine of every energy investor.

To illustrate what effect US$20 oil would have on Canada's energy sector, we take a look at **Crescent Point Energy Corp.** (TSX:CPG)(NYSE:CPG).

The current situation

Crescent Point is one of the strongest companies in Canada's energy patch, mainly because it has a solid balance sheet, a robust hedging program, and relatively low-cost operations. But if oil dips to US$20 per barrel, changes will have to be made.

Crescent Point's second-quarter report tells the story. In the quarter, the company produced oil at an average cost—including royalties and transportation expenses—of nearly $25 per barrel. If oil prices dropped to US$20 per barrel, then Crescent Point's royalty expense would fall as well, so the company would roughly break even in this scenario.

But this quick calculation excludes some big expenses. Corporate expenses are not included. Neither is interest. Most importantly, Crescent Point must keep drilling new wells just to sustain production. This cost is accounted for as an investment, but it is effectively an expense.

When accounting for all of these costs, Crescent Point needs oil prices in the US$40s just to sustain itself. If the company wants to sustain the dividend as well, then it likely needs oil prices to be well into the US$50s.

What happens if oil prices plunge?

If oil prices fall to US$20 per barrel, the first thing Crescent Point would do is suspend its dividend. After all, there's no point making payments to shareholders when the company is posting losses. And

Crescent Point showed last month it is willing to slash its payout.

From there, Crescent Point has a number of options, all of which have serious drawbacks. It could fire workers and cut back on drilling. It could try to raise more debt or equity. It could slash production.

But Crescent Point already has $4 billion in debt, and its hedges (which currently provide some much-needed relief) will eventually run out. If oil prices fall much further, and stay there, then the company's equity value will fall to zero.

Does this mean you should avoid Crescent Point shares?

There are some top energy portfolio managers who have bought Crescent Point shares recently, and believe it's a great way to bet on a modest oil-price rebound. And when looking at the state of many other energy companies, Crescent Point is actually in relatively good shape.

But if you're looking primarily for a stable dividend, this is certainly not the stock for you.

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