Will Crescent Point Energy Corp. Cut its Dividend in 2016?

Description

In 2015 dividend stalwart **Crescent Point Energy Corp.** (TSX:CPG)(NYSE:CPG) slashed its dividend by 38% as it sought to ensure the sustainability of its operations in an operating environment dominated by weak oil prices. Now there are signs that weak oil prices are here to stay and could in fact fall even lower over the course of 2016. Therefore, it is increasingly likely that Crescent Point will have to cut its dividend once again.

Now what?

The decision by Crescent Point to cut its dividend went against earlier claims by CEO Ian Saxberg that the company would use every lever at its disposal to maintain its dividend.

However, the dividend cut made complete sense at the time.

This is because it allowed Crescent Point to retain much-needed cash that it could use to protect its balance sheet in an increasingly difficult operating environment or even fund the acquisition of quality oil assets in what is definitely a buyers' market.

Since the dividend cut, the price of crude has fallen even further.

West Texas Intermediate, the Northern American benchmark price, is now trading at about US$37 per barrel, 24% lower than the average market price of US$49 per barrel obtained by Crescent Point during the third quarter 2015.

There are signs that the price of West Texas Intermediate will fall even further. Some analysts claim it could go as low as US$20 per barrel. Crescent Point's hedging position is also unwinding, and this is applying considerable pressure to its cash flow and places the dividend under threat, which was already unsustainable when crude was trading at over US$40 per barrel.

You see, for the first nine months of 2015, Crescent Point's dividend payments totaled $868 million, or 16 times free cash flow for that period. Then consider that Crescent Point recorded a net loss of $488 million for the same period. This means that dividend payments were funded by a mix of capital raised through the issuance of shares and debt.

Clearly, this is not sustainable, especially when Crescent Point's cash flow and revenue will drop even further because of the marked decline in oil prices since the end of the third quarter.

In fact, the only way that Crescent Point could maintain its dividend is to slash its capital expenditures, raise additional capital by issuing shares, or significantly increase its debt. All three options are extremely unappealing in the current operating environment.

Any substantial decrease in capital expenditures would have a marked impact on future production because of the rapid rate at which operational wells deplete, making it imperative to invest in developing new oil wells. The dilutive impact of a share issuance on existing investors would be unacceptable, particularly as Crescent Point has been a serial issuer of shares in the past.

Finally, any significant increase in debt could endanger Crescent Point's financial covenants, making it more difficult to borrow.

So what?

With the price of crude having declined sharply since the third quarter 2015 and with the prospects of it falling even further, it is difficult to see how Crescent Point can maintain its dividend. I would expect to see it cut its dividend once again in order to maintain the financial flexibility to not only survive in the current operating environment, but also to boost its cash reserves so as to take advantage of substantially lower asset prices.

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