3 Reasons to Play an Oil Recovery With Crescent Point Energy Corp.

Description

This year has been a roller coaster for energy-sector investors. Oil prices plunged to US$26/bbl (the lowest since 2003) in February, then rebounded 12% the next day to $29/bbl on news of an OPEC supply cut.

Going forward, US$30/bbl oil is not sustainable. The world needs higher-cost, non-OPEC production (such as U.S. production) to meet demand, but at US$30/bbl, most U.S. production cannot cover their costs. This means that budgets are being cut, more companies are filing for bankruptcy, and credit is being tightened by banks. The end result is that U.S. production is set to decline by another 500,000-600,000 b/d (potentially more) this year.

Crescent Point Energy Corp. (TSX:CPG)(NYSE:CPG) shareholders have been along for the ride, but thanks to its excellent balance sheet and hedging strategy, Crescent Point shares are down 9.8% year-to-date compared to nearly 20% for WTI crude.

While prices may recover over the medium term, several headwinds are still present, and investors need an oil stock such as Crescent Point that is both prepared to gain big when prices rise and withstand further pricing pressure. Here are three traits that make Crescent Point one of the best bets to play a long-term oil recovery.

1. Crescent Point has a strong balance sheet and solid hedging strategy

Currently, Crescent Point has an estimated net debt of $4.6 billion. It is important to compare this number to the company's cash flows to see how large it is, and doing this shows that Crescent Point's net debt is 2.4 times its cash flow (based on its estimated 2015 cash flows, since the company has not released results yet).

These are very low debt levels compared with its peers. Crescent Point's overall peer group of similar-sized producers has net debt of 3.9 times cash flow. Crescent Point also has plenty of available liquidity. As of the third quarter, Crescent Point was 60% drawn on its credit facilities, which left them with $1.4 billion of available liquidity if necessary. This is enough to cover Crescent Point's funding gap even in a US$30/bbl environment.

Crescent Point also has 34% of its 2016 production hedged at about US$60/bbl. Crescent Point also has the option of monetizing its 2017 and 2018 hedges, which could give it around $130 million (potentially even more) to help fund any cash flow shortfall it has this year.

2. Crescent Point is cash flow neutral at US$40/bbl

Crescent Point expects that it could be cash flow neutral at US$40/bbl (that is to say, it can fund its current dividend as well as its capital program). While US$40/bbl seems optimistic by today's prices, assuming prices average US$35/bbl in 2016, Crescent Point would see very little debt build.

At US$35/bbl, Crescent Point would see cash flow of about $1.3 billion according to **TD Bank** (assuming production of 164,000 bpd). Crescent Point has a flexible capital program, and in a bearish situation it could spend $950 million. Adding its current dividend of $610 million to its capital expenses would lead to a shortfall of $260 million.

Fortunately, Crescent Point has the option to monetize its hedges, which could add $130 million and reduce that shortfall to only $130 million. This means that Crescent Point can fund its capital program and dividend while building very little debt at prices only slightly above today's.

3. Crescent Point has some of the best returning assets in the business

It's clear that Crescent Point can survive a downturn, but what if prices rise? This is where Crescent Point should truly shine. Crescent Point has nearly 7,500 potential drilling locations located in some of North America's highest-returning oil plays.

Crescent Point's key area is the Viewfield Bakken, which has extremely short payout periods of seven to 15 months. While other plays may take two to three years to pay out, Crescent Point's Viewfield wells pay out capital costs quickly, which allows Crescent Point to reinvest the cash to fund further production growth without relying on debt.

Crescent Point has been using new waterflooding technology to further enhance the return from these wells, and this technology allows Crescent Point to recover three times the oil per well (for a similar cost), which greatly improves Crescent Point's return on capital.

A large production inventory and excellent economics means that once oil prices recover, Crescent Point is set to see its cash flows explode.

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