Why Crescent Point Energy Corp.'s Dividend Cut Is Good News for Investors

Description

It wasn't long ago that **Crescent Point Energy Corp.** (TSX:CPG)(NYSE:CPG) was explaining that it didn't intend to cut its dividend because it had plenty of levers at its disposal to manage the fallout from the oil rout.

Nonetheless, in mid-2015 Crescent Point slashed its dividend by 57% as it fought to prevent the deterioration of its balance sheet in an operating environment where significantly weak crude had become the new normal.

Now it has revised its dividend downward yet again, cutting it by 70% in response to the ongoing sustained weakness of crude. Despite the usual negative perception that a dividend cut attracts, this was a positive for investors and doesn't change the optimistic outlook for one of Canada's best upstream oil producers.

Now what?

The dividend cut will help shield Crescent Point's rock-solid balance sheet and cash flows from what has become an extremely difficult operating environment where sub-US$40 oil has become the new normal.

You see, in order to sustain its dividend at the previous level, West Texas Intermediate (WTI) needed to average US$50 per barrel, and with crude dipping below US$30 per barrel earlier this year, this clearly would not occur.

For the last quarter of 2015, the average price for its basket of products crude, natural gas liquids and natural gas only averaged $41.98 per barrel, well below the amount required to sustain the dividend. There are indicators that this average basket price can only fall further because WTI has remained under US$40 per barrel since early December of last year.

However, Crescent Point estimates that the new dividend and revised capital-spending program only requires WTI to average US$35 per barrel for it to live within projected cash flow. This is particularly important in the current operating environment because it will allow Crescent Point to preserve its pristine balance sheet where cash flow from operations remains at a conservative 2.2 times debt.

More importantly, Crescent Point will not have to assume more debt in order to fund the dividend. This frees funding for it to potentially make acquisitions in what is a buyers' market.

Let's not forget that Crescent Point holds some of the best quality light and medium oil assets in Canada. And despite slashing its 2015 capital expenditures for exploration and development by 25% compared with 2014, it had a reserve-replacement ratio of 109% after excluding acquisitions. Impressively, it was also able to boost oil production by a healthy 16% for the same period.

These assets have some of the lowest operating costs in Canada, which have fallen even further in U.S. dollar terms because of a weaker loonie. After running the numbers, Crescent Point's variable or cash costs come to about $24 per barrel, which amounts to US$18 per barrel, or less than half of the current price for WTI.

So what?

The recent dividend cut may be disappointing for investors, but in reality this is a positive move. Not only will it help to preserve Crescent Point's cash flows and solid balance sheet, but it gives the company the additional financial flexibility required to take advantage of weak asset prices, and it can contemplate reducing its debt.

Crescent Point will emerge from the oil crisis in solid shape and will be well positioned to take advantage of the long-awaited rebound in crude.

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