Why Crescent Point Energy Corp.'s 70% Dividend Cut Could Send Shares Soaring

Description

For years, **Crescent Point Energy Corp.'s** (TSX:CPG)(NYSE:CPG) dividend was a key part of its overall strategy. Since the company started, it has always had a dividend yield above 6%, and at times this yield climbed as high as 15%.

This will change, however, since Crescent Point announced a 70% cut of its dividend with its Q4 2015 results. This would bring its monthly dividend down from $0.10 to $0.03. The recent cut marks the second major dividend cut for Crescent Point in the last 12 months; the dividend was cut by 57% back in August from $0.23 to $0.10 monthly.

While a dividend cut may sound bad for income-focused investors, Crescent Point shares actually rose the day the cut was announced (shares actually jumped $1.23 the next day). This means investors are feeling positive about the dividend cut, and there is good reason for this.

The cut should protect the balance sheet

The reason Crescent Point cut its dividend back in August was to protect the balance sheet, and Crescent Point's CEO said he was unwilling to risk the balance sheet to pay the dividend. At that point, Crescent Point committed to a strategy of funding its dividend entirely through cash flows, and this commitment was further emphasized by the decision to eliminate the DRIP program (which basically allowed Crescent Point to pay its dividend by issuing shares).

The recent cut is a continuation of this strategy, and investors seem to appreciate the decision to maintain balance sheet strength. In other words, at this stage in the oil-price cycle, investors would rather have a solid balance sheet than dividend income.

The recent dividend cut means that Crescent Point's balance sheet will be completely protected should oil prices average US$35 per barrel in 2016 (Crescent Point states it will be cash flow neutral at these prices) and will only be put under mild stress in a US$30-per-barrel environment.

Crescent Point already has one of the stronger balance sheets in the business with a net debt of $4.3

billion. For 2015, this worked out to a net debt to cash flow of about 2.3 times, which is significantly below the average of 3.6 times for junior and intermediate producers. The dividend cut means that Crescent Point's net debt will likely stay the same (or perhaps improve depending on what happens to oil prices) rather than deteriorate in 2016.

Crescent Point stated that the dividend cut will save $430 million annually going forward and about $356 million this year. If oil prices average around $35 for the year, Crescent Point will not need to borrow any money to fund its overall operations, which means its net debt will stay about the same, but its cash flow will fall. This will lead to a net debt to cash flow of around three according to **RBC**, which is still very healthy compared with the peer group.

The dividend cut will give Crescent Point plenty of cash as prices rise

Crescent Point stated that one of the major advantages of the dividend cut is that the company now has plenty of flexibility. As oil prices rise, Crescent Point will start to see tons of free cash flow (rising significantly as oil prices move above $35 per barrel). In fact, should oil prices hit $55 per barrel by 2017, Crescent Point will generate $600 million of annual free cash flow.

This will give Crescent Point a variety of options. Firstly, Crescent Point could choose to pay down debt to further improve its balance sheet. It could also choose to raise its dividend. Most likely, however, is that Crescent Point will use the extra funds to increase its capital expenditures or fund acquisitions with cash flow.

This is excellent news for investors, since it means Crescent Point will see plenty of low-cost production growth, which will lead to share-price growth.

CATEGORY

1. Energy Stocks
2. Investing

TICKERS GLOBAL

1. NYSE:VRN (Veren)
2. TSX:VRN (Veren Inc.)

Category

1. Energy Stocks
2. Investing

Date
2025/08/25
Date Created
2016/03/16
Author
amancini