Why Toronto-Dominion Bank Thinks Crescent Point Energy Corp. Is Bulletproof in 2016

Description

On March 9, **Crescent Point Energy Corp.** (TSX:CPG)(NYSE:CPG) released its full-year earnings for 2015 and outlook for 2016. These releases were eagerly anticipated since they would demonstrate how Crescent Point performed during the one of the worst-performing years for oil in history, when prices averaged the lowest they have been since 2004.

Despite the weak pricing, Crescent Point's results were impressive. Crescent Point posted netbacks (profit per barrel) of $36.19 including hedging and $25.43 without hedging. These are exceptional results; Crescent Point's overall peer group of junior and intermediate producers had an average netback of $15.84 per barrel.

Crescent Point has rolled out several major changes for 2016, including the largest dividend cut in its history and a reduction in capital spending (including a weighting of most spending in the second half of the year when prices are expected to improve)—all without reducing the production guidance.

In response, analysts at **Toronto-Dominion Bank** stated that this "sets the company up to be bulletproof over the next 24 months under current forward prices." Looking at the company's cash flow situation, it's obvious why TD analysts are correct.

Crescent Point is set up for prices as low as US$30/barrel

TD bank stated that Crescent Point is bulletproof under current forward prices for the next 24 months, which are currently $39.23 for 2016 and $44.91 for 2017. Crescent Point was even more optimistic—the company stated that it should be able to live within its cash flow for 2016 if oil prices were to average US$35 per barrel.

Nobody knows where oil will end up for 2016, but given the fact that there is still an oversupply of about 1.5 million barrels per day and over 500 million barrels sitting in U.S. storage, it is best to assume a worst-case scenario. This would be an average of US$30 per barrel for 2016 (an extremely unlikely scenario).

Would Crescent Point still be cash flow positive at these levels? It appears so.

At US$30 West Texas Intermediate (WTI) prices, Crescent Point could expect to earn revenue of roughly $33 per barrel of oil. The revenue per barrel Crescent Point gets is based off a discount to a blend known as Manitoba Light Sour Blend (LSB), and in 2015 this discount averaged about $3.17 per barrel. In January, when WTI prices averaged around US$31 per barrel, LSB prices were $36.14 per barrel, and using the $3.17 discount would mean Crescent Point earns about $33 per barrel.

The end result? With total costs per barrel of about $25 (according to TD Bank), Crescent Point can be expected to earn between $300 and $400 million of cash flow after deducting all of its operating and corporate expenses. This is without any hedging and shows that Crescent Point is still cash flow positive at US$30 per barrel.

Crescent Point has a strong hedging program

Unfortunately, Crescent Point is expecting to spend $950 million on capital expenditures, and will also need to spend about $250 million on their dividend. This means that $300-400 million of cash coming in is not nearly enough to cover its costs.

Fortunately, Crescent Point has a strong hedging program that allows it to basically sell a large portion of its oil at much higher prices. For 2016, Crescent Point has 39% of its crude production hedged at an average of $80 per barrel.

Crescent Point estimates the value of all its hedges to be about $500 million through to 2018. It is important to note that this is the value of the hedges as of March 4, 2016, when oil prices were US$36 per barrel. The value of these hedges would grow substantially as oil prices drop to US$30 per barrel, which would likely bring the value of the hedge book to about $700 million.

The end result? When you take Crescent Point’s cash flow of $300-400 million and add in the value of the hedge book (which Crescent Point would monetize), and Crescent Point could have cash flow of $1.1 billion, which could cover the capital expenses and most of the dividend, requiring very little borrowing.

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Date
2025/08/23
Date Created
2016/03/24
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