2 Reasons Crescent Point Energy Corp. Shares Will Be Higher One Year from Now

Description

While **Crescent Point Energy Corp.** (TSX:CPG)(NYSE:CGP) shares are up 73% this year, thinking that the rally is over (or even close to being over), may be very misguided. This is especially true if you believe analysts at **TD Bank**, who see more than 50% (with a price target of $31) upside remaining in the stock from current levels.

Crescent Point is about to benefit from a perfect storm of opportunities, and at the core of these is a recent shift by the company from its old model of excessively issuing shares to both fund acquisitions and pay part of its dividend. Recently, Crescent Point made two big decisions to reverse this model, and the end result will be improved per share growth, and more favourability among shareholders.

First, Crescent Point has stated it now intends to fund its acquisitions through internally generated free cash flow, rather than equity issues. This will enhance per share growth. Secondly, Crescent Point eliminated its DRIP program. Crescent Point at one point paid out a dividend that exceeded its free cash flow, and it did so by issuing up to 18 million shares annually. This was equal to around 5% of the shares outstanding, and was a major headwind to share price growth.

Crescent Points new focus on tightly managing its share count eliminates one of the largest barriers institutional and U.S. shareholders had to buying the stock, and this should allow these 2 factors to take the share price higher.

1) Oil prices are almost certain to move higher

Going into 2016, there was a global crude oversupply of 1.5 to 2 million barrels per day. This surplus is now eroding — analysts at **Scotiabank** expect nearly flat balances for the second half of 2016 (which is in-line with the IEA's outlook). Going into 2017, the surplus will turn into a deficit, with a small stock draw of 0.1 million bpd expected for the year.

Oil prices have currently pulled back from around US$50 to US$45, and it is difficult to imagine a scenario where a global deficit exists and oil prices are in the US$40 range. Global supply will need to increase in order to prevent a constant draw down of global inventories, and there is little supply growth globally expected outside of the U.S. going forward. Eric Nuttall of Sprott Asset Management sees non-OPEC, non-U.S. production declining from 2.4 million bpd in 2017 to 0.5 million bpd in 2019. OPEC itself is limited as well with Saudi Arabia near capacity, and Iran is unlikely to increase production further in the near-term, which leaves the U.S. to contribute a substantial portion of the estimated 5 million bpd of production growth that will be needed annually going forward to meet demand growth and offset declines.

With U.S. producers needing at least US$60 to break-even, oil is going higher, and Crescent Point shares will follow.

2) Free cash flow is set to rise substantially

Recently, Crescent Point made two dividend cuts (bringing its dividend down from $0.23 per share in August 2015 to $0.03 monthly today). These cuts should save over $1 billion annually, which will provide a huge contribution to free cash flow. Currently, Crescent Point anticipates it will earn $300 million of free cash flow in 2016 at US$45 per barrel, and $200 million in 2017 at US$50 per barrel (the lower number is due to hedges coming off).

Crescent Point is continually improving its capital efficiency (which means it can bring on more production for less) through its water-flooding initiatives. These technological improvements allow Crescent Point to reduce the rate at which its well production declines, which means Crescent Point can get more production for the same amount of capital, or maintain its capital for less production.

This means that the $500 million in free cash flow over the next year Crescent Point can efficiently deploy to ramp its production up (Crescent Point estimated that a small $100 million hike in capital would boost its 2016 production from 165,000 to 170,000 barrels per day for example).

If oil prices rise higher than Crescent Point is modelling, Crescent Point will have a huge surplus of free cash flow on its hands, and this will almost certainly drive much higher returns.

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