



What Crescent Point Energy Corp.'s Latest \$240 Million in Acquisitions Means for Investors

Description

Following a fairly quiet Q1 2016 on the acquisition front, **Crescent Point Energy Corp.** (TSX:CPG)(NYSE:CPG)—one of Canada's most acquisitive energy names—kicked off Q2 with two acquisitions totaling \$240 million. For Crescent Point a—\$10 billion firm—\$242 million is relatively small (especially considering the nearly the \$1.8 billion of acquisitions made in 2015).

The acquisitions came in the form of assets in their core Flat Lake area in Saskatchewan, which is its third-largest source of capital expenditures and one of its second most economic plays by total returns and payout time. The Flat Lake resource gives Crescent Point about 300 new drilling locations (a 30% increase) mostly in the Torquay region, which is the 10th most economic play in North America when looking at the payout period (or the time it takes to recoup capital costs).

In addition to this, Crescent Point also acquired low-decline conventional waterflood assets in southeastern Saskatchewan, which is the second most economic region in North America by payout period. The use of waterflooding on these assets means that Crescent Point can increase pressure in the reservoirs, which has the effect of slowing the rate at which production declines over time.

These are both highly economic assets, and they also reflect a broader strategy of Crescent Point consolidating its operations in its core Saskatchewan regions. In fact, Crescent Point sold \$31 million worth of northern Alberta assets and used the proceeds to fund the Saskatchewan acquisitions, which reduced the net consideration down to \$211 million.

While analysts at **TD Bank** estimate these acquisitions will only grow production by 1,250 bpd (for a company with estimated 2016 production of 165,000 bpd), the real benefit can be found by looking beneath the surface.

The acquisitions reflect a major shift in strategy

Crescent Point was—until recently—both known and criticized for a strategy that centred on making very large acquisitions and funding them by issuing equity. This had a negative effect on per-share

earnings growth due to the constantly growing amount of shares outstanding.

The company instead focused its available free cash flow on funding an outsized dividend (which was still partially funded through a DRIP program). This strategy was aimed at attracting a larger base of U.S. shareholders, which were an essential component of increasing the valuation of the stock.

The strategy was unpopular with U.S. investors, who were largely attracted by names that were growing production with internal cash flow and not equity-financed acquisitions. This was evident in the fact that U.S. ownership of the stock fell from 43% in 2012 to 24% in 2014. The share price also languished for the years leading up to the oil-price collapse.

Crescent Point has undergone a strategic shift in its approach to capital allocation. With a new focus on per-share earnings, Crescent Point recently stated its new objective is to focus on “smaller, internally funded opportunities.” At the same time, Crescent Point eliminated its DRIP program and slashed its dividend by 86% since August 2015.

Crescent Point’s latest acquisitions reveal the company is maintaining discipline with its new strategy. Q2 2016’s net \$211 million in acquisitions were funded entirely from the \$280 million of free cash flow generated during the quarter.

Going forward, Crescent Point has stated its capital-allocation strategy will be firstly focused on debt repayment, followed by investments in long-term capital (which would not necessarily affect the year-end production, but instead will improve the long-term upside for the company). Crescent Point will then focus on smaller tuck-in acquisitions funded by cash flow, followed by growth in drilling capital to effect year-end 2017 production. This would kick in at about US\$55 per barrel.

With a recovery in oil prices to above US\$55 widely expected (this is still below the breakeven price of about US\$60 for most U.S. producers, according to analyst Eric Nuttall), Crescent Point can expect an explosion of free cash flow over the next few years (as much as \$3 billion in cumulative free cash flow by 2020 with oil prices hovering between US\$60 and US\$70 after 2017, according to TD Bank).

With Crescent Point now largely focused on organic production growth and small acquisitions, the company’s leverage to these prices increases will be tremendous.

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Date

2025/08/24

Date Created

2016/08/22

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