

Why Crescent Point Energy Corp. Shareholders Hate its Latest \$650 Million Transaction

Description

On Friday September 8, **Crescent Point Energy Corp.** (TSX:CPG)(NYSE:CPG) shocked the markets by resorting to an old (and unpopular) playbook—the company announced bought-deal financing to raise approximately \$650 million worth of equity. In other words, Crescent Point is once again expanding its outstanding shares.

More specifically, Crescent Point will be selling 33.7 million common shares at a value of \$19.30 per share, and the deal includes an over-allotment option that would allow the company to sell an additional five million shares at the same price, which would bring the total funds raised from the deal to \$748 million.

Why is Crescent Point doing this? According to the press release, the company plans to expand its capital expenditures for 2016 and 2017 well above the \$950 million that was previously guided for both years (and also the capital level that Crescent Point claims is necessary to hold its production flat at about 165,000 bpd).

Crescent Point now expects to spend \$1.1 billion in 2016 and \$1.4 billion in 2017. Over the two years, this represents an increase of \$600 million over the initial \$900 million. Crescent Point estimates this will lead 2016 and 2017 production to be 167,000 bpd and 175,000 bpd, respectively (up from the current guidance of 165,000 bpd).

Why shareholders are upset

Shareholders are generally unhappy because Crescent Point has historically been known as a “serial issuer” of equity, mostly to fund acquisitions to rapidly ramp up its production. In fact, Crescent Point has raised equity every year since 2002 (basically the entire life of the company) with the only exception being 2013.

Shareholders have largely criticized Crescent Point for this approach, since it dilutes them. When the float of outstanding shares expands at a much faster rate than earnings, it leads to weak per-share growth, which in turn affects valuation.

Analyst Norm Levine recently attributed the fact that Crescent Point's share price was basically flat from 2010 all the way through to the crash in 2016 to the company's excessive focus on issuing equity. Levine also stated that the recent move to issue equity would make him re-think purchasing the shares, despite having the company on his radar. Many other money managers and analysts likely have the same sentiment.

The reason shareholders reacted particularly harshly to this equity issue is because Crescent Point, over the past year or so, has explicitly stated it was taking a strategic shift. This shift would be away from constantly issuing equity to fund acquisitions (and the dividend) and towards living within cash

flow.

Crescent Point recently stated that it would be focused on smaller, internally funded acquisitions. Crescent Point has made steps in this direction—it eliminated its DRIP program and is now funding its dividend entirely from cash flow, and it recently made two small acquisitions entirely through its free cash flow.

The recent equity issue, however, violates Crescent Point's promise to live within its cash flow, and with many investors waiting to see if Crescent Point will be disciplined with its new strategy, the recent move will be unpopular.

Is it as bad as shareholders think?

Levine stated that Crescent Point's decision to issue equity "broke its covenant with shareholders" in a recent *BNN* interview, and while this may be true and is largely a negative, there is a silver lining.

Unlike previous equity issues, this one is being used to fund organic growth. Crescent Point stated that this deal will be the first phase of a strong organic growth plan. The deal indicates that Crescent Point is taking an aggressive position towards production growth and is likely underpinned by a bullish outlook on oil prices.

If oil prices move up to the US\$55-60 range, Crescent Point could be getting ahead of the curve, and at those price levels the company will have adequate free cash flow to ramp up production even further from internal cash flow.

While the recent deal is not great news, it could pay off if oil prices recover strongly.

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