Crescent Point Energy Corp. Shares Are Down 22%: Is it 2016's Best Opportunity?

Description

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The past month has been rough for **Crescent Point Energy Corp.** (TSX:CPG)(NYSE:CPG)—not only did Crescent Point suffer a 22% decline, but a slew of analysts downgraded shares. These types of market overreactions often represent the best opportunities, and investors who missed the chance to buy Crescent Point shares earlier in the year may have a fairly rare opportunity now, especially since oil stocks have been surprisingly resilient amid recent oil-price weakness.

Analysts at **TD Bank** downgraded Crescent Point from $30 to $28, and analysts at **CIBC** downgraded shares to $22 from $26 (one of the more dramatic downgrades). The main catalyst for the downgrades was Crescent Point's decision to issue $650 million worth of equity on September 8, and shares are currently 16% below September 8th levels. Even assuming the most pessimistic downgrade is accurate, its 15.3% downgrade is entirely offset by the 16% decline in shares, still giving Crescent Point around 28% of upside.

There is good reason to believe, however, that the overall impact from the equity issue will have a fairly minor effect on Crescent Point's outlook a year from now (perhaps closer to what analysts at TD forecast), meaning Crescent Point could represent tremendous value at these levels.

Why Crescent Point shares plunged

There are two reasons, and neither say much about the company's medium- or long-term growth prospects.

The first was weakness in oil prices that was evident throughout August and September. While there were some fundamental points of concern that could affect the long-term oil-price trajectory (the IEA downgraded demand forecast for 2017 and inventories remain large), much of the weakness was due to normal seasonal weakness (September is the worst month of the year for oil), and the end of a massive cycle of short covering that started in August.

The second reason was due to Crescent Point's $650 million equity issue, which shareholders see as being dilutive. Crescent Point issued 33 million shares and plans to use the proceeds to accelerate drilling and organic growth. The proceeds will be used to bump 2016 capex from $950 million to $1.1 billion, and 2017 capex from $950 million to $1.4 billion. This in turn will bump production guidance from 165,000 bpd for both years to 167,000 bpd in 2016 and 177,000 bpd for 2017 (the high end).

The market's problem with this move stems from the fact that Crescent Point has been a serial issuer of equity to fund acquisitions for the most part, which has led to dilution and has largely been blamed for why Crescent Point shares traded in a range for the years before the oil-price crash.

The market, in many ways, prefers to see Crescent Point grow only though internal cash flow and have growth be dictated by oil prices and the company's hedge book. The company recently committed to funding growth through cash flow, so the equity issue came as a surprise.

Nonetheless, should the company remain disciplined for the most part in terms of funding growth internally and watching the share count, the market will likely forgive this the recent equity issue over time as the oil price recovers and as the company successfully executes its new organic-growth-focused platform.

The recent financing, while dilutive for now, has the potential to be accretive going forward should a bullish oil outlook prevail. Crescent Point is not only protecting its balance sheet through this move, but it is also aggressively positioning itself for higher oil prices by engaging in drilling now. Once prices move higher, Crescent Point will be in a position to deploy free cash flow to even more growth, while enjoying more leverage to the higher prices.

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Crescent Point is trading at an attractive valuation

Currently, Crescent Point is trading at a 2017 EV/DACF (enterprise value to debt-adjusted cash flow: a common valuation measure) of 5.85. This compares to its peer group average of 8.8. This is an extremely wide gap, especially since Crescent Point leads the industry in terms of netbacks, payback periods, and risk management.

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Author
amancini

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