Why Crescent Point Energy Corp. Is About to See an Explosion in Free Cash Flow

Description

It seems investors are still punishing **Crescent Point Energy Corp.** (TSX:CPG)(NYSE:CPG) for its recent $650 million share sale which saw total shares outstanding grow by 33.7 million, or 6.6%. While oil prices recently rocketed above US$50 per barrel for the first time since June, Crescent Point shares are currently 22% lower than they were during the last move above US$50 per barrel.

Not only is Crescent Point 22% lower than the last time oil crossed US$50, but Crescent Point shares haven't even managed to climb above where they were at in early September, before the company announced its equity financing. Shares are still 10% below these levels, despite news of an OPEC production freeze markedly improving sentiment in oil markets.

Crescent Point shares are trading at 6.2 times 2017 EV/DACF (using **TD Bank's** US$57 price forecast for 2017), and this compares to over eight for its peer group of junior and intermediate producers. Crescent Point traded at close to seven times before the news of the equity issue.

For investors, this represents an opportunity. Assuming an oil price in the high US$50s per barrel for 2017, Crescent Point is set to see an explosion of free cash flow. When combined with the proceeds of the recent equity issue, Crescent Point will have significant cash to deploy to drill its highly economic and industry-leading inventory of locations. This should lead to production outperformance going forward and should also justify a premium share valuation.

The free cash flow outlook

Crescent Point's capital budget is currently set up to be cash flow neutral in even the most bearish (and extremely improbable without an economic shock) oil-price outlooks for 2017, while at the same time having incredible leverage to a bullish (and more probable) oil price in 2017.

Crescent Point's sustaining capital budget is currently set at $950 million. This budget would be able to support production of 165,000-167,000 bpd, which is where 2016 production is expected to end up. It is important to note that this budget is expected to be cash flow neutral at an oil price of US$35 per barrel. There is no fundamental case for US$35 per barrel oil in 2017, barring some unexpected, massive drop in demand.

At US$45 per barrel, Crescent Point can comfortably fund not only its sustaining capital program, but also its expected cash dividend of $194 million. It is at this point where the true value of Crescent Point's recent move to issue shares comes in.

Valued at $650 million, Crescent Point can use the proceeds of the equity issue to accelerate its drilling program ahead of oil prices, and it plans on doing just this by raising its 2017 capital budget to $1.4 billion, $450 million above sustaining levels. This would in turn support production growth to between 175,000 bpd and 177,000 bpd.

The proceeds would allow Crescent Point to fund the entire program at US$45 per barrel, but, in a more bullish scenario, Crescent Point would be in a position to fund its budget entirely through its own cash flow. At oil prices of US$57 per barrel for 2017, TD Bank sees free cash flow of $414 million (post-dividend).

Crescent Point would still have the proceeds of the equity issue to use as well in this scenario, which would give it the opportunity to even further advance production growth (Crescent Point stated the move to boost production was simply the first phase of an organic-growth program) or to reduce debt. Both actions would work to offset any dilution from the equity issue. They would also support a higher valuation for the stock, especially if the company remains disciplined going forward.

Crescent Point has a large and competitive drilling inventory

It is important to note that Crescent Point will be deploying its capital to drill wells that will be highly economic at oil prices of US$45 per barrel. Crescent Point's plays are all top ranked in North America, but horizontal drilling in its new Uinta play has top quartile industry economics according to **Bank of Nova Scotia**. This includes a breakeven price of US$35.50 per barrel and would be able to pay back its full capital costs after only 13 months at US$60 per barrel.

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