OPEC Deal or Not, Crescent Point Energy Corp. Is a Buy

Description

With OPEC set to emerge with the details of their recent production-cut negotiations, the price of oil is being dictated entirely by OPEC headlines. While nobody knows for sure whether OPEC will agree to cut production or not, the results will likely only matter for prices over the next few months (at very best). The longer-term outlook is still bullish as ever.

Even Saudi Arabia—OPEC's largest producer by a long shot—agrees. Recently, Saudi Arabia's energy minister stated that they expect oil demand to recover in 2017, which will lead to prices stabilizing. He said this would happen with or without an agreement from OPEC. While there is no doubt that OPEC cutting its production by 600,000 to 1.1 million bpd immediately would be extremely constructive, the oil market will re-balance anyway, especially since OPEC's current production levels are unsustainable.

While investors should expect something out of OPEC's meeting (OPEC's credibility as an organization will be destroyed if they don't agree to at least a mild cut at this point), a look at both a deal and no-deal situation reveals reason to be bullish. Investors can use the recent price weakness to purchase shares in energy names.

Scenario 1: OPEC comes to an agreement

While it is impossible to guess exactly what OPEC's agreement would be, they had originally stated that they would like to cut production to between 33 million bpd and 32.5 million bpd (from October 2016 levels of 33.6 million bpd). A cut to either of these levels would be a success.

This would obviously be bullish. Even a 600,000 bpd cut would cause the oil market to re-balance extremely quickly, and the IEA states that the market would move from a surplus to a deficit. A 600,000 bpd cut would work out to 108 million barrels over a six-month period. Currently, global inventories are around 300 million barrels above the five-year average, and an OPEC cut would drain a good deal of this surplus over a six-month period. This would certainly be bullish for prices.

Should a deal happen, analysts at **Bank of Nova Scotia** see oil prices moving up to the $60 level in fairly short order.

Scenario 2: A weak or no OPEC deal

There is the possibility that OPEC will simply come out with a statement committing a future meeting or choose to let the market re-balance itself. This would almost definitely lead to some near-term price weakness with many analysts saying a drop to the high US$30/bbl range is likely.

Into 2017, however, oil prices are likely to recover. Firstly, the oil market is already re-balancing—the oil oversupply for the first three quarters of 2015 was 2.1 million bpd. This has fallen to 1.1 million bpd for the first three quarters of 2016, and, in the most recent quarters, the market is actually extremely close to being balanced.

Most importantly, global and U.S. inventories have been falling steadily. Total global crude inventories fell by the most in August to September in the past three years and have been on a steady decline since January 2016 (which is why a drop back to price levels of January/February 2016 is unlikely).

In addition, plenty of OPEC production is set to fall on its own, even if there is no deal. Saudi Arabia, for example, is currently producing at an extreme record high level of 10.6 million barrels per day. This will likely drop 400,000 to 500,000 barrels per day simply due to seasonal factors over the next few months. Other OPEC producers (like Iran and Iraq) simply do not have the money to grow their production much more.

U.S. oil producers need oil prices of at least $55 per barrel to grow production, and all of this points to higher prices. Investors should look to play this by purchasing names that are trading at a discount to their peer group.

Currently, **Crescent Point Energy Corp.** (TSX:CPG)(NYSE:CPG) is trading at the second-cheapest valuation in its peer group, according to Bank of Nova Scotia analysts, despite having best-in-class assets and good production growth. This makes it a solid buy.

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