Crescent Point Energy Corp.'s 2016: A Year in Review

Description

It would not be an exaggeration to say 2016 was one of the most important years in **Crescent Point Energy Corp.'s** (TSX:CPG)(NYSE:CPG) 15-year history. The year saw the recovery from a historic oil rout, a landmark agreement between OPEC and non-OPEC producers (the first in nearly two decades) that is set to deliver Crescent Point a strong 2017, and a major shift in Crescent Point's capital-allocation and funding strategy.

Crescent Point is widely seen as having some of the best assets in Canada, and it shows in the company's operating and financial performance for 2016. The company is likely to be free cash flow positive for the year—generating a likely $200 million in free cash flow for the year, despite average oil prices for 2016 expected to come in around the $43 mark.

The company was also able to grow its production in 2016, while many of its peers saw production fall as cash needed to be allocated to debt repayment instead of drilling. Crescent Point will end 2016 with production growth over 2%, and debt that is only 2.3 times cash flow compared to over eight times for its peer group of intermediate producers.

With $1.1 billion of capital spent in 2016, Crescent Point was not only able to grow its production, but it was also able to set itself up for future growth by exploring and developing its highly economic Flat Lake and Uinta locations. Crescent Point added 1,000 drilling locations in 2016, which more than replaced the locations drilled during the year.

As a result of this spending, a strong platform for growth is set up for 2017, and Crescent Point recently announced a 2017 production guidance of 183,000 barrels per day—10% above 2016's expected 167,000 barrels per day. This is a conservative target, and Crescent Point thinks there could be even further upside from these levels.

With assets that are consistently ranked as some of the most economic in North America, a strong balance sheet, an excellent production growth runway, and a strong track record of execution, some may be surprised to see Crescent Point stock actually underperformed many of its peers in 2016.

Crescent Point shares are up a respectable 18% year-to-date, but over the past six months, Crescent

Point is actually the second-worst-performing energy stock in a group of 41 names. Crescent Point significantly underperformed the Energy Index, which returned over 40% year-to-date.

A poor management decision is the cause of the underperformance

Why is one of Canada's best energy stocks underperforming? It can mostly be linked to the fact that Crescent Point pleased shareholders earlier in the year by announcing that the company would focus on living within cash flow, internally funding growth opportunities, and focusing on per-share growth.

This is a massive departure from what Crescent Point used to do. Crescent Point was notorious for funding large acquisitions by issuing shares (which has the effect of diluting current shareholders). The company spent its spare cash on a massive dividend, and since it couldn't fund this dividend entirely, it had a DRIP program, which paid for part of its dividend in Crescent Point stock.

Investors prefer Crescent Point's focus on using its cash flow to grow its production organically rather than spending it on a dividend and funding its growth by buying properties with stock. Earlier in the year, Crescent Point changed its course by eliminating its DRIP program and slashing its dividend by 70%. Crescent Point stuck to this strategy through the year, making some small acquisitions with its own cash.

In September, however, Crescent Point decided to issue $650 million in equity to expand its production growth in 2016 and 2017, which was a reversal of its commitment to fund growth with its own capital. The idea was that Crescent Point would have spare cash on hand to continue drilling, even if oil prices continue to fall; this way, the company would be prepared with wells in place when prices finally rise.

The market has punished Crescent Point ever since. While this may have been an unpopular move, it is also an opportunity. Crescent Point is now undervalued, and as oil prices continue to rise and Crescent Point shows discipline around its strategy, the market should reward Crescent Point with outperformance.

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