Oil Has Broken $50/bbl: What This Means for Crescent Point Energy Corp.

Description

It would seem that OPEC's much-lauded production cuts are having the opposite of their intended effect. According to media outlets, U.S. commercial crude supplies have been rising for nine straight weeks in response to the oil price rally, culminating in the production of 528.4 million barrels last week.

Moreover, Wednesday's surprise build of an 8.2-million-barrel increase from the week prior signaled that cash-strapped North American producers are not slowing down anytime soon, and oil's supply glut might continue into the near future. This, of course, doesn't bode well for **Crescent Point Energy Corp.** (TSX:CPG)(NYSE:CPG), whose twice-slashed dividend forecast is based on $52/bbl oil.

Preparing for the worst-case scenario: a dividend suspension/cut

Even before the recent sell-off, Canada's most prolific driller was already trading at a discounted valuation (25% to peers according to **Barclays's** estimates) thanks to the company's reputation of being a serial equity issuer. Now that oil is once again below $50/bbl, there is another infraction from Crescent Point's past that might come back to haunt the company: a suspension or a further cut of its dividend.

Let me explain.

When Crescent Point cut its dividend from $.10 per share to $.03 per share in early 2016, its funds flow from operations payout ratio was roughly 62%. Recently, Crescent Point targeted a 100% payout ratio for 2017 based on WTI at $52/bbl. Moreover, according to company filings, Crescent Point's exhibits a +/- $50 million sensitivity to per-dollar changes in the price of oil, meaning that if oil were to once again hit $45/bbl (or lower), Crescent Point's funds flow from operations will come in $350 million lighter, and the dividend could very well be in jeopardy with an already restrictive payout ratio.

Furthermore, the potential of a dividend cut or suspension is all the more reasonable, given that Crescent Point is effectively barred from further equity raises (unless it wishes to further erode investor confidence, following the last bought deal in September 2016), and management has been hesitant to take on further debt.

There are silver linings

Although a dividend suspension would, of course, be the absolute worst-case scenario for shareholders, there are a few factors that make Crescent Point a worthwhile investment, even at sub-$50 oil.

Firstly, Crescent Point has a great liquidity position of some $3.5 billion in net debt for a 1.9 times debt-to-cash flow ratio, which is in line with the rest of the industry.

Secondly, management has made no made no secret that it is exploring asset sales, and while divestitures were only $30 million in 2016, we can expect bigger asset sales if oil prices continue to decline.

Finally, Crescent Point has improved tremendously from a cost-efficiency standpoint with 2016 costs coming in at $11.27/boe (8% better than target) and 40% below FY 2014.

The bottom line

Once again, we have to prepare for oil to be lower for longer; for Crescent Point, this means we have to consider the very real possibility of a dividend suspension. Of course, countering the worst-case scenario is the company's solid balance sheet and strong operational fundamentals. With that being said, if you're looking to take advantage of the oil sell-off (and Crescent Point's discounted valuation), then the shares are looking like a great buy here — just as long as you are prepared for the worst.

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