Will Oil Soar Higher?

Description

Oil is on another tear, which sees the North American benchmark West Texas Intermediate (WTI) rallying sharply over the last week to be trading at close to US$70 a barrel. Bullish data from the latest U.S. Energy Information Administration (EIA) report sent crude soaring. There is every sign that WTI could rally to as high as the psychologically important US$80 per barrel mark, which would be a boon for Canada's beaten down energy patch.

This would give one-time investor darling **Crescent Point Energy Corp.** (TSX:CPG)(NYSE:CPG) a solid boost. While WTI has gained almost 20% since the start of the year, the intermediate upstream oil producer has plunged by 19%, as the market remains unconvinced that Crescent Point can unlock value for investors.

Now what?

According to the EIA's Weekly Petroleum Data for the week ending 24 August 2018, U.S. commercial oil stocks fell by 2.6 million barrels compared to a week earlier, while gasoline inventories dropped by 1.6 billion barrels. The latest U.S. rig count for the same period shows that the volume of active rigs fell by 13 to be at its lowest point in almost a month.

Furthermore, there are additional signs that North American oil production won't increase as significantly as some analysts were predicting because of infrastructure bottlenecks in the Permian, logistical constraints and high decline rates for existing shale oil fields. This, along with firmer than expected demand growth sparked by the ongoing global economic upswing bodes well for higher prices.

There are also the threats of further supply outages from OPEC including sanctions being reinstated on Iran's oil exports and escalating conflict in Libya. The near collapse of Venezuela's oil industry has removed roughly one million barrels daily from global oil supplies since the end of 2016.

While it is highly unlikely that crude will reach triple figures, it is increasingly clear that higher oil is here to stay.

This will be a boon for Crescent Point, especially because its production is predominantly weighted to oil and other petroleum liquids with minimal exposure to Canadian heavy crude. The company is well positioned to fully benefit from firmer oil prices, which will give its earnings a solid lift, especially when considered that for the second quarter 2018, Crescent Point reported a notable netback of $35.43 per barrel.

You see, an upstream oil producers' netback is an important measure of operational profitability, and Crescent Point's is one of the highest among its Canadian peers.

A key factor impacting Crescent Point's netback was a second quarter loss of $5.31 per barrel that was incurred because of the hedges established by the company to mitigate the risk of lower oil prices. A large portion of those hedges covering 68,500 barrels of production will unwind at the end of 2018, giving Crescent Point the ability to fully benefit from higher WTI on the majority of its production. This will give the driller's 2019 earnings a solid lift should higher oil remain in play, which is likely for the reasons discussed.

So what?

Crescent Point is an appealing, yet underappreciated play on higher oil, and its earnings will benefit significantly once the commodity price risk management contracts covering a large portion of its production end in December 2018. Management has also implemented a strategy aimed at assuaging many of the concerns held by the market over Crescent Point's ability to unlock value for investors. The focus of this plan is to improve Crescent Point's balance sheet, reduce costs, boost profitability and enhance returns from capital expenditures, which will ultimately boost earnings and the company's market value.

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