Is it Time to Buy Crescent Point Energy Corp. (TSX:CPG)?

Description

Oil's latest sharp pullback, which sees the North American benchmark West Texas Intermediate (WTI) trading at US$47 per barrel, leaving it down by 18% for the year to date, has hit energy stocks hard.

Among the hardest hit is **Crescent Point** (TSX:CPG)(NYSE:CPG), which has seen its market value plunge sharply since the start of October 2018 to be down by 58% for the year to date. This has sparked speculation that the company represents a deep-value opportunity to play higher oil. There is every likelihood that crude will firm in coming months once the latest production cuts agreed to by OPEC and its allies come into force during January 2019.

Embarked on a strategic turnaround

Crescent Point has, in the past, attracted considerable ire from investors, because it was a serial diluter of existing shareholders, using newly issued stock to fund a flurry of acquisitions. While those deals significantly boosted its oil reserves and production, they also weakened Crescent Point's balance sheet and left analysts questioning whether it could ever realize its full potential value.

To adjust to the difficult operating environment now being witnessed and assuage the concerns of investors, Crescent Point embarked on a strategic review of its business. It implemented a strategy aimed at strengthening its balance sheet, improving the efficiency of its operations, reducing costs, and focusing on developing its core assets.

Key to those initiatives is the plan to reduce debt by $1 billion, have a debt-to-cash-flow ratio of 1.3 times or less, boost free cash flow, and create around $50 million in annual cost savings. Crucial to achieving those objectives is Crescent Point's plan to sell non-core assets as well as potentially monetize some of its energy infrastructure and reduce its workforce.

By the end of the third quarter 2018, long-term debt totaled just over $4 billion, which was 2.2 times trailing 12-month cash flow. While this is significantly higher than the 1.3 times or less that Crescent Point is targeting as part of its debt-reduction strategy, it still indicates that the driller's level of debt is manageable, even in the current difficult operating environment.

Latest operational results were disconcerting

A disappointing aspect of Crescent Point's operations that has also contributed to the company's stock being heavily marked down by the market is that third-quarter 2018 crude production declined by 4% year over year. While Crescent Point's average realized sale price per barrel of crude rose by 42% compared to the same period in 2017, the driller's netback only increased by 19%. That can be attributed to a 5% year-over-year increase in operating expenses and a $7.14 per barrel loss triggered by Crescent Point's commodity hedges.

You see, like the majority of Canadian oil companies, Crescent Point established a hedging strategy aimed at mitigating the financial impact of weaker. During the third quarter, the price of WTI unexpectedly soared so high that the driller incurred a significant loss totaling $114 million on those derivative contracts.

Those contracts, however, will now work in Crescent Point's favour because of the sharp decline in the value of crude. A considerable portion of those hedges expire at the end of 2018. This means that if oil recovers as predicted because of the latest round of OPEC production cuts, then Crescent Point will incur a significantly lower loss because of those contracts. That bodes well for higher earnings, which — along with a stronger balance sheet and a focus on expanding production at its core assets — should give Crescent Point's market value a healthy lift.

Why buy Crescent Point?

Crescent Point, while not the most appealing play on higher oil, has seen its value decline so sharply that is attractively valued. The driller's focus on developing its core oil acreage will also bolster production, which will further boost earnings. Once Crescent Point demonstrates to the market that its operations are improving and that debt has been reduced to a more manageable level, its value will rise accordingly.

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