Canadian Oil Sands: Dividend Champ or Chump?

Description

By Dave Van Geem

Today I'd like to look at Canadian Oil Sands to examine whether or not it is a good long-term dividend investment. You should already be comfortable with the company's chance of being in business 10 (or more!) years from now, the inherent risk of the stock; hopefully you've also bought in at a valuation reasonable to you.

Now it is all about monitoring the investment to ensure a continuing flow of dividends to reinvest or fund your retirement. To that end, let's look at three key things to get a snapshot of our stock:

- Yield (increasing, decreasing or stable)
- Balance sheet (adequate working capital)
- Free cash flow (show me the money!)

Yield
Canadian Oil Sands is currently yielding 6.7% on a dividend of $1.40. The company converted from an income trust to a corporation on Dec. 31, 2010. Over the past two and a half years, the dividend has increased three times — from $0.20 to $0.35 a quarter.

Dividend Payments	FY 2012	FY 2011	FY 2010
Q1	$0.35	$0.30	$0.20
Q2	$0.35	$0.35	$0.30
Q3		$0.35	$0.30
Q4		$0.35	$0.30

Source: Google Finance.

Balance sheet
Increasing dividends are always nice, but not if they come at the expense of strangling the future of the company by shortchanging capital investment and leaving managers unable to meet day-to-day expenses. One way to monitor this is through changes in working capital.

Working Capital	**FY 2012**	**FY 2011**	**FY 2010**
Current Assets	$2,010	$1,246	$594
– Current Liabilities	$1,117	$562	$456
= Working Capital	$893	$684	$138

Source: Canadian Oil Sands annual statements. Figures in millions of Canadian dollars.

In its most recent fiscal year, Canadian Oil Sands' cash increased $835 million along with increases to accounts payable of $225 and long-term debt of $365. Accounts receivable decreased $65 million.

Free cash flow
The balance sheet isn't the only way to look at the health of your company — cash flow gives an idea as to whether the company can actually pay the dividends it promised. Canadian Oil Sands is producing good levels of free cash:

Free Cash Flow	**FY 2012**	**FY 2011**	**FY 2010**
Cash flow from operations	$1,864	$1,958	$1,295
– Capital expenditures	($1,086)	($643)	($582)
= Free cash flow	$778	$1,315	$713

Source: Canadian Oil Sands annual statements. Figures in millions of Canadian dollars.

The verdict: Champ or chump?
With an impressive 6.7% yield at current prices, increasing working capital, and positive free cash flow, I'm tempted to call Canadian Oil Sands an unconditional Champ. Milton Friedman famously said there's no such thing as a free lunch, and that is certainly the case here.

Canadian Oil Sands is in the midst of four expensive capital refurbishment projects. Takeaway capacity is constrained and the company faces higher labour and material costs as other oil sands producers compete for scarce resources required to finish these critical projects.

Finally, oil sands production sells at a discount to market prices. When you add in a payout ratio of 67% ($1.35 dividend divided covered by earnings per share of $2.02), this company's high yield seems justified.

Want more dividend-paying stocks like COS in your portfolio? To help take the guesswork out of dividend investing, The Motley Fool assembled a Special FREE Report, "13 High-Yielding Stocks to Buy Today". Simply click here now to receive a copy at no charge!

Dave Van Geem owns shares of Canadian Oil Sands as part of a diversified portfolio.

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