Penn West Petroleum Ltd. vs. Lightstream Resources Ltd.: Which Monster Dividend Yield Is Sustainable?

Description

Rapidly declining crude prices have hit the energy patch hard, with energy stocks leading the **S&P TSX Composite Index** lower over recent weeks. While the TSX Composite is down 5.5% over the last month, energy stocks have tumbled almost 13% for the same period.

As a result, a number of energy companies are now paying unbelievable dividend yields, with many over 6% and some climbing into double figures. But the big question for investors is: Which monster yields are sustainable given that they are predicated on higher crude prices?

Let's take a closer look at two of the biggest losers over the past few months to find out the answer.

Penn West Petroleum Ltd.

It has been an *annus horibilis* for onetime darling of the energy patch **Penn West Petroleum Ltd.** (TSX: PWT)(NYSE: PWE). The company's share price has plummeted to earth by a whopping 35% over the last year on the back of a raft of bad news. This included the identification of an internal accounting scandal that forced it to restate two years of financial statements. It has also left Penn West exposed to a range of shareholder class actions that have yet to be settled.

It was only in late 2013 when Penn West slashed its dividend by almost half as part of a transformation program aimed at preserving capital and strengthening its balance sheet. But even after slashing the dividend, it has a monster yield of 7.4% thanks to sustained weakness in its share price. Yet there are growing signs this dividend is unsustainable.

For some time, dividend payments have exceeded Penn West's net income, with the company reporting a net loss for six of the last eight consecutive quarters. More concerning is after deducting production sustaining capital expenditures, working capital deficiencies, and debt repayments, there is insufficient cash flow to meet the full dividend payment. As a result, Penn West has been meeting this funding shortfall with the proceeds of asset divestments. But this can't continue indefinitely, with asset sales set to end upon the completion of the transformation program.

Another concern is the company's relatively low operating margin, or netback, which has been consistently under $40 per barrel for the last eight consecutive quarters. This thin margin leaves little room to absorb softer crude prices without significantly impacting cash flow.

As a result, I believe Penn West's dividend is unsustainable and if crude prices soften further, the company will be forced it to cut its dividend yet again.

Lightstream Resources Ltd.

Another former energy patch favourite, **Lightstream Resources Ltd.** (TSX: LTS), also found itself beset by a range of problems at the end of 2013, the most pressing being its weak balance sheet.

As a result, it implemented a transformation program aimed at preserving capital and rebuilding its balance sheet. A key component of this was slashing its dividend by 50% as well as taking a knife to capital expenditures and divesting itself of non-core assets. But even after the dividend cut, it now has a monster yield in excess of 10%, thanks to its share price plunging 36% over the last year.

However, unlike Penn West, I believe Lightstream's dividend is sustainable, so let's take a closer look to see why.

Since implementing the transformation program, Lightstream's dividend payout ratio as a portion of net income is now a sustainable 59%. More importantly, operating cash flow exceeds the funds required to pay the dividend after deducting production sustaining capital expenditures, debt repayments, and any working capital deficiency.

Lightstream's operations are also extremely profitable, with it having one of the best netbacks in the patch, which for the second quarter of 2014 was $54.79 per barrel and over $50 per barrel for four out of the last eight consecutive quarters. This leaves plenty of room for Lightstream to absorb lower oil prices without cash flow being adversely affected.

Even more promising for investors is that its transformation program continues to gain traction, with its degree of leverage now lower and balance sheet stronger. This over the long run will certainly act as a catalyst to drive its share price higher once industry fundamentals improve.

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1. Dividend Stocks
2. Energy Stocks
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